Bankruptcy Court Decisions

WEEKLY NEWS & COMMENT

VOLUME 45, ISSUE 20 JANUARY 17, 2006

COVER STORY

Creativity yields bright future for old mill — and creditor recoveries to boot

U.S. Bankruptcy Judge Lamar W. Davis Jr.'s recent approval of the sale of the former Durango Paper Mill, held by the bankruptcy estate of **Durango-Georgia Paper Co.**, for more than $36 million is one of those lemons-to-lemonade stories. And according to **Anthony Schnelling**, trustee for the estate and founding member of **Bridge Associates LLC**, it's also one that could be a model for future bankrupt brownfields around the country.

"This is not just a real estate transaction. The real story here is how a distressed piece of property, with very limited perceived value, ultimately became the subject of a vigorous bidding process, which resulted in a significant recovery to the estate and its creditors," said Schnelling. **Find out how they did it on page 4.**

TOP LEGAL CASES

Avoidance recovery only goes so far

Not all guarantors will fit into the category of an "entity for whose benefit such transfer was made" under Section 550(a)(1). For a trustee to use that prong to recover an avoided transfer, the benefit must come from the initial transfer.

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Attorneys' names are sealed in judge's case

Rule 9018(3) can be used to seal a party's name, the bankruptcy court decided in a case in which the debtor took loans from attorneys while she was a municipal court judge.

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Debtors must be wary of partners' fraud

In determining whether the Section 523(a)(2)(A) fraud exception to discharge applies, the culpability of the debtor partner is irrelevant if a nondebtor partner has committed fraud.

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Cases reported

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Lending issues boil over in 2006

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Debtors say their home was illegally sold by trustee

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Judge Carey makes Delaware his new home

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Judge rules church property subject to bankruptcy settlement

The battle of canon law over bankruptcy law lost a bit more footing last month when **U.S. Bankruptcy Judge Elizabeth Perris** ruled that it's the **Archdiocese of Portland**, not its parishes, that owns the property and real estate controlled by the archdiocese.

"Who owns the property is, quite simply, not a theological or doctrinal matter," Perris wrote. "The religious organization's internal law is not relevant to the dispute."

An appeal, of course, is being considered.

Judge Perris' ruling follows **Judge Patricia Williams**' ruling in the **Diocese of Spokane** (Wash.) case. Judge Williams likewise ruled that the disputed assets were owned by the diocese.

Oil prices fuel Pliant filing

Illinois-based packaging product manufacturer, **Pliant Corp.**, filed Chapter 11 in the **U.S. Bankruptcy Court, District of Delaware**, citing recent surges in crude oil prices as a driving factor.

In motions filed with the court, Pliant reported that its decision to file for Chapter 11 was influenced by the increase in the price of the raw materials such as polyethylene, PVC and polypropylene, which are petrochemical products whose price and availability are linked closely to the market supply of crude oil and natural gas. The cost of resin constituted nearly two-thirds of Pliant's total manufacturing costs in the first half of 2005. Recent events such as Hurricane Katrina and Hurricane Rita triggered increases in the price of resin and tightened availability, a company statement said. Coupled with the tightening of trade terms by certain of Pliant's key suppliers, that increase in price resulted in a steady deterioration of the company's liquidity position.

While the company's operations in Mexico, Germany, and Australia were not included in the Chapter 11 filing, three of the company's Canadian subsidiaries will seek recognition of the Chapter 11 proceedings in a Canadian court as foreign proceedings.

Pliant's principal legal advisors are **Sidley Austin LLP** and **Young Conaway Stargatt & Taylor LLP**. The company's financial advisor is **Jefferies & Company Inc.**

Nursing facility reorganized, emerges intact and healthy

Wayne, N.J.'s **Lakeview Subacute Care Center Inc.** recently bucked the odds and emerged from Chapter 11 without any interruption in service.

"Although we realized that reorganization, instead of a sale, would be more costly and difficult, we devoted our energy and resources to doing it," said the nursing home's owner, **Richard Grosso Jr.**

"Hopefully this result will demonstrate to the industry that a financially troubled nursing facility can be reorganized even in today's environment and that it is certainly worth the try," he said.

Represented by **Fox Rothschild LLP**'s **Hal L. Baume** and **Allison Berger**, Lakeview filed for Chapter 11 burdened by approximately $20 million in debt, numerous creditor collection actions and threatened possible liquidation.

Delighted to see Lakeview succeed, Baume said, "We fixed Lakeview's operating problems, made it profitable while maintaining high quality care of its patients, and confirmed a restructuring plan to allow for its continued operation while paying most of its debt over time. We not only saved the business and the jobs of approximately 200 employees, but eliminated any risk of disruption to the lives of the elderly residents and patients. Everyone is a winner — this is the kind of case that Chapter 11 was designed for."

The 120-bed, skilled nursing facility provides ventilator care for patients on life support, short-term rehabilitation and postsurgical care, in addition to traditional geriatric nursing home care.

Calpine

Filing date: Dec. 20, 2005
Case: 05-60200
Court: Southern District of New York
Judge: Burton R. Lifland
Counsel: Kirkland & Ellis LLP, N.Y.
Restructuring firm: AlixPartners
Assets: $26.6 billion
Liabilities: $22.5 billion
Calpine owns, leases and operates power plants in 21 states and three Canadian provinces.

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'Benefit' under Section 550(a)(1) must come from initial transfer

If a trustee wants to recover an avoided transfer under Section 550(a)(1), she may recover from the initial transferee. And if that is not feasible, the section also allows the trustee to recover from the "entity for whose benefit such transfer was made." But just how far can the trustee stretch this second category to find someone who must come up with the money?

A typical transfer beneficiary from whom a trustee can recover under the second prong of Section 550(a)(1) would be a guarantor. A person who is not the initial transferee but whose indemnification obligations or whose own debts are reduced by the transfer, is an "entity for whose benefit such transfer was made."

However, the second prong is not so elastic as to include the guarantors of a loan to the initial transferee, ruled **Judge A. Benjamin Goldgar**, in an unpublished decision, *Peterson v. Hofmann (In re Delta Phones, Inc.)*, 45 BCD 218 (Bankr. N.D. Ill. 2005).

The avoided transfer from the debtor **Delta Phones** to the initial transferee was payment of a loan made by the initial transferee to the debtor. The monies for the loan were originally provided to the initial transferee by a bank. It was this loan from the bank that the defendants guaranteed. The court declined to find that the defendants were transfer beneficiaries under the second prong of Section 550(a)(1). While the defendants did benefit when the initial transferee later paid the bank, "[t]hose payments," said Judge Goldgar, "were subsequent transfers of the Delta Phones payments, not initial transfers. Section 550(a)(1) extends liability only to an entity who benefits from 'such transfer,' meaning 'the *initial* transfer.'"

Shareholder status doesn't change analysis

OK, let's say that the defendants who guaranteed the loan from the bank were also shareholders of the initial transferee. Could they have benefited from the debtor's payment as shareholders of the initial transferee?

Not according to Judge Goldgar. "That a shareholder holds some ownership interest in a corporation," said the judge, "does not somehow mean that all transfers made to the corporation or by it are automatically made for the 'benefit' of the shareholder under Section 550(a)(1). The 'entity' under Section 550(a)(1) must benefit from the transfer directly, not indirectly."

McCook Metals defines status of transfer beneficiary

Judge Eugene R. Wedoff in *In re McCook Metals, L.L.C.*, 44 BCD 44 (Bankr. N.D. Ill. 2005), found little case law analyzing when a person is an "entity for whose benefit such transfer was made" under Section 550(a)(1).

Judge Wedoff stated further, "As the **7th U.S. Circuit Court of Appeals** noted in *Bonded Financial Services, Inc. v. European Am. Bank*, 17 BCD 299 (7th Cir. 1988), the status [of transfer beneficiary] raises a number of questions whose answers are not apparent from the statutory language, including: 1) whether, for a person to be a transfer beneficiary, the transferor must have intended to confer a benefit on that person; 2) whether, to be a transfer beneficiary, a person must have actually received a benefit; and 3) if so, whether the benefit must be quantifiable. The 7th Circuit did not answer these questions in *Bonded Financial*."

After analyzing *Bonded Financial* and considering other relevant matters, Judge Wedoff found that "transfer beneficiary status depends on three aspects of the 'benefit': 1) it must actually have been received by the beneficiary; 2) it must be quantifiable; 3) it must be accessible to the beneficiary."

On the shareholder issue, Judge Goldgar disagreed with *In re McCook Metals, L.L.C.*, 44 BCD 44 (Bankr. N.D. Ill. 2005) (*see sidebar for* McCook*'s definition of transfer beneficiary status*).

Judge Goldgar said that in discussing whether the benefit is accessible to the beneficiary, *McCook* "suggests that a person's 'control' of a corporate transferee is enough to make the benefit from the transfer accessible to him and so turn that person into an entity 'for whose benefit such transfer is made.'

"In making this suggestion, however, *McCook* does not define 'control,' and so the decision appears not to limit 'control' to alter ego situations. If that is what *McCook* means, the test renders every majority shareholder of a closely held corporation (to take one example) liable for transfers to the corporation, although ... all corporate formalities have been carefully observed."

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COVER STORY

Trustee's vision transforms eyesore into resort

The 750-acre site of the idle Durango Paper Mill in St. Marys, Ga., was a depressing place and an eyesore. The most the community could hope for was that the mill would start belching foul-smelling smoke again and provide jobs to the community. The most **Durango-Georgia Paper Co.**'s creditors could hope for was about $7 million against their $40 million to $80 million in unsecured claims.

"This was a piece of property that was perceived as having no value," said **Anthony Schnelling**, whose firm, **Bridge Associates**, was appointed as trustee in the case under the terms of a Plan of Liquidation. "But through some hard work and creativity, we were able to create a win-win situation."

Create a win-win situation they did. At a hearing on Dec. 15, 2005, **U.S. Bankruptcy Judge Lamar W. Davis Jr.** approved the sale of the former mill for $36.45 million to residential developer **LandMar Group LLC**. The judge also approved separate sales of the paper mill equipment and other properties. The auction produced a total of $42 million and paves the way for the transformation of the paper mill and land into a multiuse residential community.

It was the first time a paper mill has been sold for real estate development, and according to Schnelling, what was accomplished at the Durango property can be replicated at other abandoned paper mill sites around the country.

"When we started this process, the value of the offers that we received for the bankruptcy estate was virtually zero," noted **Ward Stone Jr.** of **Stone and Baxter LLP**, attorneys for the estate. "To be able to provide in excess of $42 million to the estate is simply a phenomenal outcome that would not have happened if the property were marketed as a paper mill. The proof is that we received no bid from a mill restarter."

Exhaustion prompts new outlook

In the beginning, a favorable outcome seemed unlikely. An involuntary Chapter 7 petition was filed against Durango on Oct. 29, 2002. The debtor converted its case to a voluntary Chapter 11 in November of that year. An explosion left the mill idle, and employment numbers fell from 900 to just three. Despite the debtor's efforts to sell the mill in hopes of paying creditors in full, Durango received no credible offers. Meanwhile, as years passed, creditors were fatigued and almost ready to bite at the debtor's disappointing offers.

The traditional way of dealing with the situation — selling off the machinery and land — would have brought in around $7 million, Schnelling estimates. So it's no surprise that everyone was in search of an alternative.

When Bridge Associates principal **Michael L. Newsom** advised Schnelling to meet him at the site, he got a firsthand look at what those alternatives might be.

Schnelling found Saint Marys to be a very pleasant town on the South Georgia coast, with a quaint downtown, a simple port and ocean access. On its south side was ritzy vacation destination Amelia Island, and on the north side, Jekyll Island.

Schnelling and Newsom were overlooking St. Mary's from a second floor restaurant dining on fried shrimp when it sunk in that they weren't dealing with a typical mill town. "It was easy to picture marinas, sailboats, and people doing water sports. The climate is perfect, and the land is beautiful."

The mill property suddenly started looking less like a 750-acre eyesore, and more like 750 acres of waterfront real estate in a highly desirable area. That is, except for the environmental issues.

Prior to becoming a partner at Bridge Associates, Newsom had extensive experience with environmental issues. Paper mills, he assured Schnelling, are not the stuff of Superfund sites.

That assurance ultimately led the team to take two tracks, one that contemplated selling the property to a paper company, and the other, which contemplated selling to a real estate developer. The team turned to distressed real estate firm **Hilco Real Estate** for help.

Getting support

The team met with city leaders to find out which track they preferred. There were a number of people in the town who were interested in restarting the mill — with a fond memory of the 900 jobs the mill provided up until the late 1990s. What they didn't understand was that there were never going to be 900 jobs again, and that the mill was only going to support a maximum of 100 or so employees.

Ultimately, city leaders made it clear that they would not be opposed if the plant was developed into something else. Getting that nod from the town was important, because it also implied a willingness to help rezone and help with tax breaks.

One year ago, the team started inviting bids from paper manufacturers as well as redevelopers. Eventually, the group selected LandMar as the stalking horse and also accepted a cash bid rather than a joint venture bid because of the certainty of being paid, Schnelling said.

"At the end of the day, could we have gotten a few dollars more a different way? I don't know. My sense is we didn't leave a lot on the table if we left anything."

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TRENDS

Brace yourself for a contentious year

To kick off the New Year, we asked bankruptcy professionals around the country to tell us their visions for 2006 (*see Jan. 10, 2006 issue, p. 4*). The response was too good to pack into just one issue. This week, turnaround manager **Craig S. Dean**, principal of restructuring advisory firm **AEG Partners**, shares his vision, and **George H. Singer** reveals which **BAPCPA** provisions he thinks will cause the most chaos in 2006.

Lending issues boil over in 2006

Craig S. Dean, Principal, AEG Partners

For the bulk of 2006, we expect the majority of controversies to be centered around issues stemming from the dramatic changes in the makeup of the lending community.

With the accelerating prevalence of hedge funds, distressed investors, and second lien financing providers in leveraged transactions, the mix of lenders is far different than just a few years ago. While traditional cash flow and asset-based lenders have established some standard protocols for working through bankruptcies, the more recent entrants have wide-ranging agendas. Some lobby for a rapid Section 363 sale or windup of a case to make for a successful "trade," while others work to control the agenda as a means to become the owner of the debtor. In the latter case, we definitely expect to see more onerous DIP financing structures, designed to put the lender in a position to better control the process. As a result, there will be some healthy controversies over the terms and conditions of DIP financing in the months ahead.

While many of the new **BAPCPA** provisions will eventually end up in some form of litigation, one of the sections likely to be tested early is information sharing among unsecured creditors. Further, with the new law potentially encouraging more concentration of committee membership among bondholders, you can expect some dissatisfied unsecureds to test the adequacy of the information and solicitation in court soon.

From the turnaround manager perspective, we do expect an increase in the pace of cases calling for restructuring professionals in the coming year. While certain industries such as auto parts, airlines and mid-tier retailers will remain under severe pressure, we expect much of the upturn to be driven by the aggressive leverage practices of the last two or three years. We have seen the market shift, however, toward professionals who can deliver operational as well as financial restructuring skills to the debtor. As a result, the professionals we added to the **AEG** team in 2005 have very extensive operating management experience, and we will continue that focus in 2006.

BAPCPA hornets' nests

We asked **George H. Singer**, a partner at **Lindquist & Vennum PLLP**, in Minneapolis, and former attorney on staff with the **National Bankruptcy Review Commission**, to predict what **BAPCPA** provisions will shake up the New Year the most.

KERPS: Singer predicts that Chapter 11 attorneys are going to have to test the waters surrounding the impact of the BAPCPA on Key Employee Retention Plans and other incentive programs, changes which, he says, could negatively impact reorganizations. "Attorneys will need to be creative in finding palatable work-arounds to the new stringent requirements. It remains to be seen whether the creativity of counsel and other professionals can defeat the will of **Congress**."

Small businesses: When it comes to contentious litigation resulting from the BAPCPA, Singer points his finger at the new rules for small business reorganizations. Singer says that these changes will result in earlier and more frequent conversion of these cases to Chapter 7. "The fact that many of the requirements in small business cases are new will inevitably spur litigation in 2006. However, most of the litigation will undoubtedly be between the debtor and the U.S. Trustee."

Leases: Circuit splits are most likely to revolve around the changes relating to nonresidential real estate leases, Singer predicts, in particular, the new limitations placed on administrative claims under 11 USC 503(b)(7) and the amendments related to assumption and assignment under Section 365(b)(1) and Section 365(f).

Committees: When asked which BAPCPA provision will cause the most headaches at his firm, Singer said that the uncertainty created by the changes that provide the court with the authority to change the composition of committees of creditors and equity holders, impose new reporting and information sharing obligations on committees and their counsel, and confer new rights upon creditors and equity holders that are not members of committees, will present among the most significant challenges. "Congress imposed new requirements on committees and their counsel, yet failed to articulate standards for dealing with confidentiality and myriad of other issues."

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Rule gives alternate reason for sealing attorneys' names

"Inquiring minds want to know. But are they entitled to know?" wondered **Judge Jerry W. Venters** in *In re Neal*, 45 BCD 219 (Bankr. W.D. Mo. 2005). It is a decision in which the court sealed a list of attorneys, some of whom may have unethically loaned money to the debtor — a municipal court judge.

Sensitive to public perception of a court decision that prevents disclosure of the names of misbehaving lawyers, Judge Venters took great pains to explain why it was appropriate to seal the list under Section 107(b)(2).

But so thorough was the judge that he saw fit to find an alternate basis for his ruling — Rule 9018(3). What is interesting about that rule is that while Rule 9018(1) and (2) mirror Section 107(b)(1) (protect trade secrets, confidential research, development, or commercial information) and Section 107(b)(2) (protect against scandalous or defamatory court filings), Rule 9018(3) provides a power not found in the Code. Rule 9018(3) allows a court "to protect governmental matters that are made confidential by statute or regulation."

Judge Venters stated that "[i]nvestigations conducted by [the state's **Office of Chief Disciplinary Counsel**] are clearly governmental matters. The **Supreme Court of Missouri** is the head of the judicial branch of the Missouri government, and the Missouri Supreme Court created the OCDC to investigate matters of alleged misconduct by members of the Missouri Bar. Missouri Supreme Court Rules ... require that those matters be kept confidential." Therefore, the court held that it had authority to issue an order sealing the list of unnamed creditors (the attorneys) to protect the confidentiality of the ongoing disciplinary investigations.

The judge did not interpret Rule 9018(3) as giving the court a "roving mission" to protect the confidentiality of bar disciplinary investigations. "However, Rule 9018's specific authorization of *sua sponte* orders does suggest that the court has a duty to protect the confidentiality of governmental matters once information potentially violating that confidentiality is brought to the attention of the court. And that is exactly what has happened here," he said.

"In short," said the court, "disciplinary proceedings for many professions are confidential for a reason — to protect the reputations of innocent people."

The full text of *Neal* appears on page 16.

Enron exec starts New Year with a plea deal

Enron's former chief accounting officer pleaded guilty to a charge of securities fraud, perhaps giving prosecutors the trump card they'll need at the end of the month when former Enron CEOs **Kenneth Lay** and **Jeffrey Skilling** go to trial.

Richard A. Causey's plea deal calls for a sentence of seven years in prison, which will be reduced by up to two years if he cooperates with authorities. Trial for Causey's codefendants, Lay and Skilling, is scheduled to begin on Jan. 30, 2006 — two weeks after the trial's original date — in order to give prosecutors time to make the best use of any information Causey may provide. As part of the agreement, Causey also agreed to forfeit $1.25 million to the government and give up claim to any deferred compensation claims from Enron.

Causey admitted to conspiring with members of Enron's senior management to make false and misleading statements in filings with the **Securities and Exchange Commission** and in analyst calls about the financial condition of the company. Causey also admitted to participating in efforts to use Enron's public filings and public statements to mislead the investing public.

The Woodlands, Texas, resident entered his plea in Houston before **Judge Sim Lake** of **U.S. District Court, Southern District of Texas**. Causey's plea deal is the 16th one the government has obtained in the case. Causey faced more than 30 counts of conspiracy, fraud, insider trading, lying to auditors and money laundering, in indictments he largely shared with Skilling.

Enron filed for bankruptcy on Dec. 2, 2001.

The investigation into Enron's collapse is being conducted by the Enron Task Force, a team of federal prosecutors supervised by the **Justice Department**'s Criminal Division and agents from the **FBI** and **IRS** Criminal Investigation. The Task Force also has coordinated with and received assistance from the SEC.

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HOMESTEAD

Debtors say their home was illegally sold by trustee

A California couple says a bankruptcy court ignored their homestead exemption and allowed their home to be sold by a trustee free and clear of their exempt interest in the property. To make matters worse, they say, their appeals were denied because of the bankruptcy mootness rule.

The couple, **Roger** and **Christine Fearing**, have asked the **U.S. Supreme Court** to decide if courts applying the mootness rule are correctly interpreting Section 363(m), which allows a trustee's sale of a debtor's property to stand even if the order allowing the sale is overturned on appeal if the property was sold to a good-faith purchaser and there was no stay pending appeal.

The Fearings filed for Chapter 11 relief and claimed their home as exempt without objection. More than two years later, their case was converted to Chapter 7, and **David Seror** was appointed as the trustee.

According to the Fearings, Seror listed their home for sale at a price less than the amount necessary to satisfy all liens and their exemption. Within six hours of the debtors filing a motion to force the trustee to abandon the estate's interest in their home, the trustee's broker notified the debtors that their home had been sold. The trustee then filed a motion to sell the debtors' home free and clear of all liens. The motion was allowed over the debtors' objection.

The Fearings' writ of certiori alleges that the trustee "presented an order to the judge which contained language that had not been included in the trustee's motion." That language provided that the debtors' home would be sold free and clear of their homestead exemption. The bankruptcy court signed orders approving the sale and evicting the debtors from their home.

"They simply ignored our homestead exemption," said Roger Fearing. "So we began to fight back in the appellate courts. But those courts devised a 'rule' that we cannot appeal because our homestead had already been sold, even if illegally."

The debtors say they asked for an emergency stay of the sale pending appeal six days before the sale closed, but that it was not presented to the judge until three days after the sale closed. By that time, it was too late to stop the sale. The court then ruled that the debtors' appeal was moot because the property had been sold.

In an unpublished decision, the **9th U.S. Circuit Court of Appeals** affirmed the dismissal of the debtors' appeal. (*In re Fearing*, Nos. 03-56549, 04-55298 (9th Cir. 07/18/2005).) "This court has fashioned a mootness rule with respect to the appeal of a sale of assets in bankruptcy. When, in the absence of a stay of the order of sale, a sale to a 'good-faith purchaser' has been concluded, an appellate court cannot undo the sale. Because the court cannot provide meaningful relief to the appellant under those circumstances, any appeal of the order of sale thereby becomes moot," the 9th Circuit said.

The Fearings are asking the Supreme Court to rule that mistakes depriving debtors of their property can and should be reviewed.

"Worse that allowing a trustee to sell our exempt homestead, a wrong interpretation of Section 363(m) allows appellate courts to brush aside all debtors' rights to appeal any trustee's sales, even if those sales are illegal," Fearing said.

CONFERENCE CALENDAR

FEBRUARY

Feb. 7-8
The 2006 U.S. Turnaround Management & Distressed Investing Forum
New York
Presented by: Institutional Investor
Information: *www.iievents.com*

Feb. 9
Corporate Restructuring & Distressed Investing in Latin America Forum
New York
Presented by: Institutional Investor
Information: *www.iievents.com*

Feb. 9-10
Second Caribbean Insolvency Symposium
Miami
Presented by: American Bankruptcy Institute
Information: *www.abiworld.org*

MARCH

March 4-7
Norton Bankruptcy Law Institute
Park City, Utah
Presented by: Norton Institutes of Bankruptcy Law Inc.
Information: *www2.nortoninstitutes.org/norton*

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Judges receive 1.9 percent raise

As of Jan. 1, our nation's overworked bankruptcy judges now make $151,984, up from $149,132.

The Employment Cost Index adjustment of 1.9 percent in the pay of judges was included in the **Federal Judiciary**'s FY 2006 appropriation bill.

In his *2005 Year-End Report on the Federal Judiciary*, **Chief Justice John G. Roberts Jr.** wrote, "If **Congress** gave judges a raise of 30 percent tomorrow, judges would — adjusting for inflation — be making about what judges made in 1969. This is not fair to our nation's federal judges and should not be allowed to continue."

Real pay declining

According to the **Administrative Office**, the real pay of federal judges has declined since 1969 by almost 24 percent, while the real pay of the average American worker during that time has increased by more than 15 percent.

Justice Roberts went on to express his concerns over the increase in federal judges leaving the bench and his fear that if the difference between pay rates for lawyers and judges remains too large, "the judiciary will over time cease to be made up of a diverse group of the nation's very best lawyers. Instead, it will come to be staffed by a combination of the independently wealthy and those following a career path before becoming a judge different from the practicing bar at large."

Judges' checks creep upward

Year	Pay
2003	$142,300
2004	$145,500
2005	$149,132
2006	$151,984

Source: Administrative Office of the U.S. Courts.

Judiciary may hire back lost jobs

The **Administrative Office of the U.S. Courts** reports that the **Federal Judiciary** received a 6.1 percent increase for FY 2006 over the FY 2005 appropriations level, and the courts' Salaries and Expenses Account received a 5.4 percent increase. The AO warns, however, that good news may be later tempered by **Congress**' consideration of reductions to spending bills, although those across the board cuts would have to be significant in order to damper the judiciary's hopes of rehiring lost positions.

"Not only should the courts be in a position to restore some of the staffing losses that took place over the last two years, but funding for court operating expenses also will improve," said AO Director **Leonidas Ralph Mecham** in a statement.

Your CARE needed even more

By Chief Judge John C. Ninfo II, U.S. Bankruptcy Court, Western District of New York

In April 2004, *BCD* was the first bankruptcy publication to report on the **Credit Abuse Resistance Education Program**. Going into 2006, thanks to so many interested and caring bankruptcy judges, Assistant U.S. Trustees, panel trustees and attorneys, this grassroots financial literacy education program of the bankruptcy community is now being developed and presented in 28 states and in major cities too numerous to list, but they even include Anchorage, Alaska.

Get involved!

Check out the CARE program Web site, *www.careprogram.us,* to download materials for free and for more information. Consider becoming a part of CARE in 2006.

With bankruptcies, interest rates and minimum payments on credit cards rising, and the provisions of the bankruptcy reform legislation now in effect, the need is greater than ever for high school and college students to improve their financial I.Q. by learning more about: 1) the necessity to have both a budget, developed with an understanding of "needs" versus "wants," and savings for life's anticipated expenses and emergencies; 2) the true cost of consumer credit at high interest rates; 3) the need in these times of deregulation to carefully read and analyze all of their financial contracts; and 4) the many consequences of credit abuse for young people, such as losing out on jobs and student loans.

Presenters in the CARE Program continue to rave about being able to make a difference in the lives of so many young people, and the students who have been exposed to the program continue to confirm its importance to their futures. One high school senior recently remarked in a newspaper article that "they should bring the CARE Program to the world."

The program continues to collaborate with many other financial education initiatives nationally, and it always welcomes new presenters to become a part of existing local programs or to start new ones, especially in the 22 states where CARE is not yet being offered. The program has even begun to receive unclaimed funds from consumer credit-related class actions, like the $100,000 recently received by the San Diego CARE Program (something CARE hopes all class action attorneys will seriously consider.)

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Judge Carey makes Delaware his new home

The **3d U.S. Circuit Court of Appeals** recently appointed **Judge Kevin J. Carey** to the bench in the **U.S. Bankruptcy Court, District of Delaware** to fill one of the new judgeships in the court. Judge Carey is no stranger to the court, of course. Previously he served as a bankruptcy judge in the **Eastern District of Pennsylvania** and served the Wilmington court as a visiting judge.

The 3d Circuit is considering **Kevin Gross** of **Rosenthal Monhait Gross & Goddess**, **Brendan L. Shannon** of **Young Conaway Stargatt & Taylor** and **Christopher Sontchi** of **Ashby & Geddes** for other vacancies on the Delaware bench.

Meanwhile, on the other coast, **U.S. Bankruptcy Judge Patricia C. Williams** was recently elevated to chief judge in the **U.S. Bankruptcy Court, Eastern District of Washington**, succeeding **U.S. Bankruptcy Judge John A. Rossmeissl**, who retired.

Brown Rudnick readies for business bankruptcies abroad

Brown Rudnick recently announced its appointment of **Peter J.M. Declercq** as a partner to its bankruptcy and finance department in the London office, and its plan to establish a resident London team focused on corporate reorganizations in Europe.

"We have assisted in reshaping the dynamics of insolvency in the United States, and we plan to translate that legacy to the European market," said **Ed Weisfelner**, chair of Brown Rudnick's bankruptcy and corporate restructuring group.

Formerly counsel at **Akin Gump Strauss Hauer & Feld LLP**, Declercq is a member of the Amsterdam and New York Bars, and is a registered European lawyer entitled to practice in the United Kingdom.

"The firm is on an aggressive growth path and is gaining significant momentum in the European market. My objective is to parlay the U.S. expertise of the bankruptcy and corporate restructuring group into a successful Pan-European practice," Declercq said.

Share your news

BCD wants to hear from you — about your latest success story, new members joining your firm, recent appointments, awards, and any other significant happenings in your practice.

E-mail your news to *News and Comment* Editor, Kate Colangelo at *kcolangelo@lrp.com*, or call (561) 622-6520, Ext. 8301.

GCD opens New York office focused on restructuring

Gardner Carton & Douglas LLP has expanded its New York presence with a new midtown Manhattan office that initially will concentrate on serving the firm's growing corporate trust and restructuring client base in the city.

Serving as managing partner of the new office will be **Stephanie Wickouski**, cochair of the firm's corporate restructuring and financial institutions practice group. Wickouski has been a partner with the firm since 2002 and managing partner of its Washington office for the past year. She will be joined by partner **Janice Grubin**, former chair of the bankruptcy practice of **Wormser, Kiely, Galef & Jacobs LLP** in New York. The firm plans to add several other lawyers in corporate restructuring and other practice areas over the next several months. With the opening of the New York City office, GCD will have nine attorneys based in New York, with 19 attorneys firm-wide licensed to practice in New York.

"Stephanie and Janice bring remarkable expertise and highly sought after experience in corporate restructuring and bankruptcy to clients that could benefit from and wanted us to have a presence in such an important financial center," says **Harold Kaplan**, GCD chairman. "We already are a major participant in major cases filed increasingly in New York City."

Cadwalader elects insolvency lawyers to partnership

Cadwalader, Wickersham & Taft LLP recently elected two insolvency professionals, **Ingrid Bagby** and **Peter M. Dodson**, to its partnership, effective Jan. 1.

Bagby is an attorney in the New York financial restructuring department and focuses her practice in the areas of bankruptcy, corporate reorganization and commercial litigation, as well as international and cross-border insolvency proceedings.

Dodson, an attorney in the Washington financial restructuring department, focuses his practice on bankruptcy-remote structures in connection with commercial real estate transactions and the representation of various parties in Chapter 11 cases. He also provides advice in relation to capital markets transaction structures and opinions. In addition, Dodson has substantial experience representing debtors and creditors in bankruptcy cases, and debtors in insurance insolvency cases.

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U.S. SUPREME COURT DOCKET

Docket No.	Case / Issue	Status
04-885	*Central Virginia Community College v. Katz,* 106 Fed. Appx. 341 (6th Cir.) ...... ISSUE: Sovereign immunity — Article I, Bankruptcy Clause.	Cert. filed 12/28/04 Review granted 04/04/05 Argued 10/31/05
04-1544	*Vickie Lynn Marshall v. E. Pierce Marshall*, 44 BCD 14 (9th Cir.) .... ISSUE: Probate exception to federal jurisdiction.	Cert. filed 05/17/05 Review granted 09/27/05
05-08	*Snavely v. Miller*, 124 Fed. Appx. 495 (9th Cir.) .... ISSUE: Probate exception to federal jurisdiction.	Cert. filed 06/27/05
05-75	*White v. Univision of Virginia Inc.*, et al. 44 BCD 111 (4th Cir.) .... ISSUE: Shareholder was not "person aggrieved" and lacked appellate standing.	Cert. filed 07/07/05 Review denied 10/03/05
05-109	*Ivey v. Great-West Life & Annuity Insurance Co.*, 73 U.S.L.W. 1688 (4th Cir.) .... ISSUE: Priorities — employee benefit plan.	Cert. filed 07/18/05 Review denied 10/03/05
05-128	*Howard Delivery Service Inc. et al. v. Zurich American Insurance Co.*, 44 BCD 122 (4th Cir.) .... ISSUE: Unpaid workers' compensation insurance premium has priority status.	Cert. filed 07/22/05 Review granted 11/07/05
05-144	*Bank of Louisiana v. Craig's Stores of Texas Inc.*, 44 BCD 102 (5th Cir.) .... ISSUE: Entitlement to monies deposited in bankruptcy court's registry.	Cert. filed 07/27/05 Review denied 10/03/05
05-149	*Prater v. Ormiston*, unpublished (9th Cir.) .... ISSUE: Automatic stay — discharge — easement on debtor's land.	Cert. filed 07/23/05 Review denied 10/17/05
05-183	*Official Committee of Unsecured Creditors of UAL Corp., et al. v. U.S. Bank NA*, 44 BCD 191 (7th Cir.) .... ISSUE: Whether antitrust laws forbid creditors from coordinating positions.	Cert. filed 08/04/05 Petition dismissed 10/18/05
05-225	*General Datacomm Industries Inc. v. Arcara*, 44 BCD 199 (3d Cir.) .... ISSUE: Debtor's Section 365 rejection rights — employees' Section 1114 rights.	Cert. filed 08/12/05 Review denied 11/28/05
05-297	*Snyder v. Cosby*, unpublished (4th Cir.) .... ISSUE: Debtors denied dischargeability hearing — postpetition interest.	Cert. filed 07/15/05 Review denied 11/05/07
05-508	*Heavrin v. Schilling*, 130 Fed. Appx. 766 (6th Cir.) .... ISSUE: Debtor's attorney — disgorgement of fees.	Cert. filed 10/07/05
05-518	*Ring v. Rameker*, unpublished (7th Cir.) .... ISSUE: Probate exception to federal jurisdiction.	Cert. filed 10/17/05
05-556	*Massey v. Stosberg*, unpublished (6th Cir.) .... ISSUE: Judicial immunity — civil rights action against bankruptcy judge.	Cert. filed 09/02/2005 Review denied 12/05/05
05-563	*Stewart Tile Guaranty Co. v. Logan*, 44 BCD 255 (4th Cir.) .... ISSUE: Trustee, as assignee of lenders, has standing to sue debtor's coconspirators.	Cert. filed 10/31/05
05-619	*George v. Morro Bay, Calif.*, unpublished (9th Cir.) .... ISSUE: Surrender of lease — claim preclusion.	Cert. filed 11/08/05
05-629	*Muegler v. Bening*, 413 F.3d 980 (9th Cir.) .... ISSUE: Discharge of debt incurred by fraud.	Cert. filed 11/15/05
05-729	*Barcus v. Schneider*, unpublished (9th Cir.) .... ISSUE: Jurisdiction — sanctions — timeliness.	Cert. filed 10/21/05

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COURTS OF APPEALS

Derivative standing, if permitted, follows strict conditions

Case name: *Baltimore Emergency Services II, Corp., In re (Scott v. National Century Financial Enterprises, Inc.)*, 45 BCD 210 (4th Cir. 2005).

Ruling: The **4th U.S. Circuit Court of Appeals**, declining to decide if creditor derivative suits are permissible, reversed the lower courts and remanded with instructions that the injunction and contempt order against the defendant insider be vacated.

What it means: To have a chance at derivative standing, a creditors' committee must show that it has the debtors' consent and that the suit is beneficial to the bankruptcy estate and necessary for fair resolution.

Summary: After the debtors filed for Chapter 11 relief, their principal resigned and began negotiations to obtain work from an entity that had a contract with the debtors and was a major source of revenue for the debtors. A secured creditor and the unsecured creditors' committee filed a complaint against the principal alleging that he had undermined the debtors' business relationships and reduced the value of the estate. The bankruptcy court held that the plaintiffs had standing and entered a preliminary injunction and contempt order in their favor. The District Court affirmed the standing determination. The 4th U.S. Circuit Court of Appeals reversed and remanded on the issue of derivative standing. The 4th Circuit noted that the "[p]laintiffs presented no evidence to the bankruptcy court that they actually had the debtors' consent, nor did the bankruptcy court determine that allowing the suit would be beneficial to the estate and necessary to a fair and efficient resolution of the bankruptcy proceedings. Without these procedural safeguards, there is no clear way to prevent creditors from commandeering bankruptcy proceedings to pursue their own interests to the detriment of the estate and other creditors."

The 4th Circuit noted that it has yet to decide whether creditor derivative suits are permitted in bankruptcy courts but stated that "[i]t would be ill-advised to decide this important and difficult issue here." Those circuits that permit derivative standing do so only under strict conditions. The leading case on consent-based derivative suits is *In re Commodore Int'l Ltd.*, 38 BCD 72 (2d Cir. 2001). Here, the plaintiffs argued that they had the consent of the debtors' chief restructuring officer to file the suit. But they failed to satisfy any prong of the *Commodore* test.

The *Commodore* test states that "[a] creditors' committee may acquire standing to pursue the debtor's claims if: 1) the committee has the consent of the debtor-in-possession or trustee; and 2) the court finds that the suit by the committee is — a) in the best interest of the bankruptcy estate; and b) is necessary and beneficial to the fair and efficient resolution of the bankruptcy proceedings."

If partner committed fraud, debtor's debt is nondischargeable

Case name: *Quinlivan, Robert G. and Kimberly A., In re (Tummel & Carroll v. Quinlivan)*, 45 BCD 211 (5th Cir. 2005).

Ruling: The **5th U.S. Circuit Court of Appeals**, on the creditor's appeal in this Section 523(a)(2)(A) nondischargeability case, remanded to the bankruptcy court for findings regarding state agency law and whether under that law, the debtor's business associate acted as the debtor's agent in securing the services of the creditor.

What it means: Holding debtors accountable for their partners' fraud effectuates important state law policies regarding imputed liability. These policies create incentives for debtors to monitor the conduct of their partners. As a result, when determining whether the Section 523(a)(2)(A) fraud exception to discharge applies, the culpability of the debtor partner is irrelevant.

Summary: The debtor Robert Quinlivan, and nondebtor Donald Totten, were principals of related corporations. Totten contacted a law firm to request representation for the two corporations. He asserted that a bank wrongfully terminated their Visa/Mastercard merchant account. Totten made representations to induce the firm into a contingent-fee contract. Totten and Quinlivan signed the retainer agreement. The firm sued the bank. The state court denied the plaintiffs a TRO, finding that Totten and Quinlivan had unclean hands. The two dropped the suit. The firm billed them for hours expended and sued on its invoice. It obtained summary judgment against Quinlivan. The judgment contained no findings that Quinlivan incurred the debt under false pretenses. The firm's fraud case against Totten settled. In Quinlivan's Chapter 7 case, the firm filed a nondischargeability action under Section 523(a)(2)(A). The bankruptcy court ruled for Quinlivan. The District Court affirmed. The 5th U.S. Circuit Court of Appeals remanded. The bankruptcy court ruled that because Quinlivan did not engage in

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fraudulent behavior, his debt was nondischargeable. But the 5th Circuit stated that "if Totten acted as Quinlivan's partner or agent, and Totten committed fraud in incurring debt to [the firm], then Quinlivan's debt is not dischargeable."

Because the plain language of Section 523(a)(2)(A) is designed to protect victims of fraud, *In re M.M. Winkler*, 37 BCD 95 (5th Cir. 2001), construed that section to except debt incurred as a result of a business partner's fraud. Fraud is imputed to a debtor only if the fraudulent representations were made by a formal partner or agent.

Here, the precise nature of the relationship between Totten and Quinlivan was difficult to discern. The bankruptcy court made no substantive findings regarding their formal relationship. The bankruptcy court erred in conflating the inquiry regarding whether Quinlivan knew about Totten's representations and whether Totten was acting as Quinlivan's agent. Under *Winkler*, debt incurred as a result of fraud cannot be discharged even if the debtor did not know or had no reason to know that his agent was acting fraudulently.

Alleged debtor must timely assert exempt status as affirmative defense

Case name: *Marlar, John Samuel, In re*, 45 BCD 212 (8th Cir. 2005).

Ruling: The **8th U.S. Circuit Court of Appeals** affirmed the **U.S. District Court, Western District of Arkansas**, which affirmed the bankruptcy court's rejection of the debtor's jurisdictional challenge under Section 303(a) to the involuntary bankruptcy case.

What it means: An individual's status as a farmer does not go to the jurisdiction of the bankruptcy court over an involuntary bankruptcy petition, but instead is an affirmative defense that may be waived.

Summary: The alleged debtor contested the involuntary bankruptcy petition filed against him. At the hearing, the debtor did not raise the issue of his status as a farmer. The court adjudicated him to be a debtor. Five years later, the debtor moved to dismiss the case, asserting that Section 303(a) strips bankruptcy courts of subject matter jurisdiction over involuntary petitions brought against farmers. The debtor contended that he was a farmer when the involuntary petition was filed. Section 303(a) provides that an involuntary case may be commenced only "against a person, except a farmer." The bankruptcy court concluded that the debtor's status as a farmer was an affirmative defense that he waived by failing to raise it in a timely manner. The District Court affirmed. The 8th U.S. Circuit Court of Appeals affirmed, stating that, "[the debtor] argues that his five-year delay in asserting his status as a farmer is irrelevant, as challenges to subject matter jurisdiction may be raised at any point in a bankruptcy proceeding. We conclude, however, that [the debtor's] interpretation of Section 303(a) cannot be reconciled with Section 303(h) or the general grant of subject matter jurisdiction in 28 USC Sections 157 and 1334."

Section 303(h) provides that "[i]f the petition is not timely controverted, the court shall order relief against the debtor in an involuntary case under the chapter under which the petition was filed. Otherwise, after trial, the court shall order relief against the debtor in an involuntary case under the chapter under which the petition was filed."

The 8th Circuit read Section 303(h) to mean that a farmer against whom an involuntary petition is filed must timely controvert the petition by raising his status as a farmer in order to preclude commencement of an involuntary case. Thus, rather than stripping the court of subject matter jurisdiction over all cases involving farmers, the exception simply provides a means for farmers to escape the commencement of an involuntary case against them. If the alleged debtor fails to timely raise the issue, it is waived.

Finally, the District Court properly concluded that the debtor's five-year delay in asserting his status as a farmer was untimely.

Debtor has no claim against execs who start up competitor

Case name: *Professional Home Health Care, Inc., In re (Professional Home Health Care, Inc. v. Complete Home Health Care, Inc, et al.)*, 45 BCD 213 (10th Cir. 2005).

Ruling: The **10th U.S. Circuit Court of Appeals** affirmed the **U.S. District Court, District of Colorado**, which affirmed the bankruptcy court's judgment in favor of the defendants after a 12-day trial in the adversary proceeding commenced by the Chapter 11 debtor. The bankruptcy court did not err as a matter of law in rejecting the debtor's claims against its former employees.

What it means: Employees enjoy a privilege that enables them to prepare or make arrangements to compete with their employer prior to leaving its employ. Where the employer files bankruptcy and sues its former employees for conspiring to destroy its business, state law determines whether the debtor can establish a cause of action.

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Summary: The debtor was a home health-care provider. After filing for Chapter 11 relief, the debtor filed a complaint against four individuals and the corporation they formed. The individuals were former managers of the debtor. The defendant corporation was a home health-care provider. The debtor's complaint alleged that the individual defendants breached their duty of loyalty and violated an employee work agreement when they resigned from the debtor's employ and established the competing company. The bankruptcy court rejected the debtor's claims. The District Court affirmed. The 10th U.S. Circuit Court of Appeals, in an unpublished opinion, affirmed. The debtor argued that the bankruptcy court did not understand that it claimed that the individual defendants solicited each other improperly. That was not correct. The bankruptcy court found that the individual defendants did not improperly solicit each other because they were protected by the legal privilege entitling them to make career preparations. The court found no evidence that other employees were offered inducements. Further, contrary to the debtor's assertions, the bankruptcy court directly addressed the en masse nature of the resignations and found that the defendants were at-will employees who were not motivated by ill-will.

Under Colorado law, an employee breaches her duty of loyalty if she solicits other employees to terminate their employment. Colorado case law applies the Restatement (Second) of Agency's test for determining when a breach of loyalty arises. To determine whether an employee's actions rise to the level of a breach of loyalty, courts should focus on: 1) the nature of the employment relationship; 2) the impact of the employees' actions on the employer; and 3) the extent of any inducements made to coworkers to obtain their services in the competing business. No single factor is determinative and courts should take a flexible approach.

As for the alleged violation of the work agreement, the fact that the debtor was unable to come forward with any direct evidence contradicting the individual defendants' testimony that they did not solicit the debtor's patients fully supported the bankruptcy court's finding that the debtor failed to prove any recruitment — direct or indirect.

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BANKRUPTCY APPELLATE PANELS

Bank may or may not be insider of debtor 'director emeritus'

Case name: *Kunz, Ronald Kent, In re (Rupp v. United Security Bank)*, 45 BCD 214 (Bankr. 10th Cir. 2005).

Ruling: The **10th U.S. Circuit Bankruptcy Appellate Panel** affirmed the denial of the defendant bank's motion for partial summary judgment on the issue whether the bank was an insider, but reversed the granting of partial summary judgment to the trustee on the same issue. Resolution of the issue required a weighing of the facts, which was not permissible on summary judgment.

What it means: Adjectives can provide important legal distinctions. A "director emeritus" is not necessarily a "director" for purposes of Section 547(b)(4)(B) and Section 101(31)(A)(iv). The ordinary, common meaning of "director" includes an element of control of the corporation. It is error to ignore the adjective "emeritus" and assume that a "director emeritus" is a "director" for the purpose of applying the extended one-year preference period.

Summary: The debtor resigned from the bank's board of directors in 1990. Thereafter, he held the title of "director emeritus." He had no decision-making power, no office and no staff. He was not entitled to attend any meeting on bank business, did not make decisions on the extension of credit, and did not have signatory authority. The bank's six directors emeritus received a fixed monthly honorarium of $400 and were listed in the bank's annual reports. The debtor filed for Chapter 7 relief in 2002. More than 90 days prior to the filing, but within one year of the filing, the debtor made transfers to the bank in payment of a debt. The trustee filed a preference action against the bank. The trustee and the bank moved for partial summary judgment on the issue whether the bank was an insider of the debtor. The court denied the bank's motion and granted the trustee's motion. The 10th U.S. Circuit Bankruptcy Appellate Panel affirmed denial of the bank's motion but reversed the grant of partial summary judgment to the trustee, holding that "reasonable minds can differ" on whether the debtor exercised control over the bank to the extent it should be considered an insider.

The extended one-year preference period in Section 547(b)(4)(B) applies to insider transfers. Where the debtor is an individual, Section 101(31)(A)(iv) includes as an insider a corporation of which the debtor is a director. The bankruptcy court held as a

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matter of law that the adjective "emeritus" could be disregarded, and as a "director emeritus," the debtor was a director for purposes of Section 547(b)(4)(B) and Section 101(31)(A)(iv).

The BAP disagreed. It was not clear here whether the debtor, in his position as director emeritus, had the degree of control that a director would have. Whether the debtor exercised control over the bank to the extent that the bank should be considered an insider was a mixed question of law and fact that could not be resolved on summary judgment. Some facts in the record supported the conclusion that the bank was an insider, but other facts lent credence to the conclusion that the debtor was merely a "show dog" along with other directors emeritus listed in the bank's annual reports. The debtor had not attended a board of directors' meeting since 1990.

BANKRUPTCY COURTS

Court cannot extend redemption period pursuant to 105(a)

Case name: *210 Roebling, LLC, In re*, 45 BCD 215 (Bankr. E.D.N.Y. 2005).

Ruling: The **U.S. Bankruptcy Court, Eastern District of New York** denied the single asset debtor's motion for an order further extending the time to redeem its property for an additional 120 days under Sections 108(b) and 105(a).

What it means: Absent extraordinary circumstances, bankruptcy courts cannot extend statutory redemption periods beyond any extension granted by Section 108(b). The right to redeem is a property right, and to extend the time to exercise that right under Section 105(a), absent exceptional circumstances, would enlarge a debtor's property rights beyond those specifically set forth by state law and by **Congress** under Section 108(b).

Summary: The city obtained a foreclosure judgment against the debtor's property. The four-month redemption period ended on Oct. 14, 2005. The debtor filed for Chapter 11 relief on Oct. 12, 2005. Because of the holding in *In re Canney*, 39 BCD 57 (2d Cir. 2002), that Section 108(b) governs the tolling of a redemption period, Section 108(b) gave the debtor a 60-day extension from the date of the order for relief. But the debtor moved for an additional 120 days, arguing that Section 105(a) permitted the court to extend the statutory redemption period beyond the extension granted by Section 108(b). The court denied the debtor's motion, adopting the majority position, which holds that bankruptcy courts cannot utilize their equitable powers under Section 105(a) to extend the redemption period, at least in the absence of extraordinary circumstances. The court also stated "with all due respect to the court in *In re 652 West 160th*, [45 BCD 114 (Bankr. S.D.N.Y. 2005)], we reject a reading of *Canney* that the 2d Circuit adopted *Bevan*'s [*Bank of the Commonwealth v. Bevan*, 7 BCD 557 (E.D. Mich. 1981)] views on the empowering of bankruptcy courts by way of Section 105(a) to extend the redemption period beyond that provided by Section 108(b)."

The minority view, embodied by *Bevan*, holds that a bankruptcy court can toll a redemption period beyond that provided by Section 108(b) as a permissible exercise of authority under Section 105(a).

Here, the debtor asserted that *Bevan* bound the court because it was adopted by the 2d U.S. Circuit Court of Appeals in *Canney*. The debtor cited *652 West 160th* to support that proposition. The court in *652 West 160th* stated *in dicta* that *Canney* adopted *Bevan*'s position on the usage of Section 105(a) to extend a statutory redemption period.

Canney did cite *Bevan* with approval, but only in the context of addressing whether Section 108(b) or Section 362 tolls a statutory redemption period. Nowhere in the *Canney* decision was there any discussion of extending the redemption period beyond that provided by Section 108(b), or even a general discussion of a bankruptcy court's equitable powers under Section 105(a).

Finally, that court found that no exceptional circumstances existed in the context of a motion for an extension of time to redeem property under Section 108(b).

Debtor files Chapter 11 to frustrate enforcement of judgments

Case name: *698 Flushing Realty Corp., In re*, 45 BCD 216 (Bankr. E.D.N.Y. 2005).

Ruling: The **U.S. Bankruptcy Court, Eastern District of New York** dismissed the Chapter 11 case for cause pursuant to Section 1112(b). The court retained jurisdiction to consider motions for sanctions against the debtor's counsel.

What it means: A Chapter 11 case is clearly a bad-faith filing when it is filed in an effort to obtain a perceived advantage in litigation and to obtain an alternative judicial forum for that litigation, and where the facts revealed by the petition conclusively demonstrate that there is no possibility of reorganization.

Summary: The debtor was incorporated nine days before an apartment building was transferred to it by an entity controlled by an insider of the debtor. The

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building was the debtor's sole asset. At the time of the transfer, two state court actions against the transferor entity were pending. The state court plaintiffs subsequently obtained monetary judgments, and they sought to enforce their judgments against the property. The debtor filed a state court action seeking an injunction preventing a sheriff's sale on the basis that the apartment building belonged to the debtor. The state court issued a TRO but later vacated the stay of sale based upon its finding that the transfer to the debtor was a no-consideration fraudulent conveyance to defeat the impending judgments. The debtor filed for Chapter 11 relief. The bankruptcy court granted the state court plaintiffs' motion to dismiss the case, holding that the case "was obviously filed in bad faith. This case is a two-party dispute between the debtor on the one hand, and the movants on the other."

The conclusion that the debtor could not reorganize if the state court plaintiffs were creditors followed from the requirement of Section 1129(a)(10) that a plan may not be confirmed unless at least one impaired class of non-insider creditors votes in favor of it. One of the state court plaintiffs held a claim that dwarfed all other claims in the case, so that she dominated the class of unsecured claims. The debtor asserted that it could solve the problem of its inability to confirm a plan without that creditor's affirmative vote, in the event that it was determined that that person was indeed a creditor, by paying the appraised value of the property. But that proposal was premised upon the incorrect assumption that by paying creditors the value of the property, a debtor can avoid the operation of Section 1129(a)(10). Paying the value of the debtor's assets to a class of claims would not render that class unimpaired unless the claims would be paid in full, which would not happen here.

Moreover, if the debtor were successful in having the state court plaintiffs' claims disallowed, there would be no need for a reorganization. The remaining, minimal claims could easily be paid from the property's cash flow.

Court lacks concurrent jurisdiction over trustee's complaint

Case name: *PRS Insurance Group, Inc., et al., In re (Logan v. Credit General Insurance Co.),* 45 BCD 217 (Bankr. D. Del. 2005).

Ruling: The **U.S. Bankruptcy Court, District of Delaware** denied the defendant's motion for reconsideration of its order denying the defendant's motion to dismiss or stay the trustee's adversary action. The court rejected all of the defendant's arguments, including the jurisdictional arguments under Section 502(d) and 28 USC § 1334.

What it means: 28 USC Section 1334(b) is primarily an expansion of bankruptcy courts' jurisdiction rather than an avenue for state courts to address issues traditionally within the realm of the bankruptcy courts. State courts do not have concurrent liquidation with bankruptcy courts over a trustee's adversary complaint asserting avoidance causes of action as a defense under Section 502(d) to a proof of claim.

Summary: The Chapter 11 trustee filed a preferential and fraudulent transfer action against the debtor's subsidiary with respect to a transfer of $20 million from the debtor to the subsidiary. The subsidiary was an Ohio insurance company placed in liquidation by the Ohio Department of Insurance. The bankruptcy court dismissed the complaint because the claims for affirmative recovery were reverse preempted under the McCarran-Ferguson Act. The trustee then filed this complaint, asserting the same causes of action merely as a defense under Section 502(d) to allowance of the subsidiary's proof of claim. The court, at 45 BCD 94, denied the subsidiary's motion to dismiss the second complaint. The purpose of Section 502(d) is to ensure compliance with judicial orders by totally disallowing any claim filed by a creditor liable for a preferential or fraudulent transfer — unless the creditor first pays the amount due to the estate. That is not the same as seeking affirmative recovery. The subsidiary moved for reconsideration. The court denied the motion, rejecting the subsidiary's argument that the Ohio state court had concurrent jurisdiction over the second adversary proceeding pursuant to 28 USC Section 1334(b).

"There is ample authority," the court said, "for the court's conclusion that it had exclusive jurisdiction over the trustee's adversary proceeding, which seeks to avoid allegedly fraudulent and preferential transfers as a predicate for disallowance of [the subsidiary's] claim."

Sections 1334(a) and (e) are statutory directives by Congress that deprive state courts of jurisdiction over bankruptcy cases and property of the estate. The subsidiary argued, however, that the absence of exclusive jurisdiction in the bankruptcy courts in Section 1334(b) over matters arising in and related to bankruptcy cases evidences the intent of Congress to allow concurrent jurisdiction over those matters.

The court disagreed. Even assuming that a state court could have concurrent jurisdiction over pro-

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ceedings that arise under or in a bankruptcy case, some proceedings exist that are so intimately tied to the bankruptcy case itself as to prohibit any exercise of concurrent jurisdiction by a state court.

Defendants move too quickly for summary judgment

Case name: *Delta Phones, Inc., In re (Peterson v. Hofmann, et al.)*, 45 BCD 218 (Bankr. N.D. Ill. 2005).

Ruling: The **U.S. Bankruptcy Court, Northern District of Illinois**, on motion for summary judgment filed by the two individual defendants in the trustee's fraudulent transfer action, continued the motion to permit the trustee to amend his complaint to allege his new theory of recovery and to conduct discovery. If the trustee should fail to amend, summary judgment would be entered in favor of the defendants.

What it means: Although Fed. R. Civ. P. 56(b) permits a defendant to move for summary judgment "at any time," discovery before summary judgment is strongly favored. A defendant who strikes too quickly under Rule 56(b) takes the chance that his opponent will invoke Rule 56(f) to obtain more time for discovery. If that happens, the defendant who moved for summary judgment is not in a position to complain.

Summary: The trustee alleged that persons controlling M&T LLC orchestrated a fraudulent scheme that entailed acquiring control of phone companies, one of which was the debtor, Delta Phones. M&T obtained a $1.6 million loan from Hofcom LLC, operated by Lee Hofmann and Steven Wicker. Hofcom obtained the funds from First Capital Bank. After the acquisition, M&T (through Delta Phones) repaid Hofcom, and Hofcom transferred most of the payments to First Capital. The trustee filed a fraudulent transfer action against Hofcom, Hofmann and Wicker to recover the payments to Hofcom. Wicker and Hofmann moved for summary judgment. The court, in an unpublished opinion, found that on the complaint as it stood, Hofmann and Wicker were entitled to summary judgment as neither was liable to the trustee. The court granted the trustee's alternative request under Fed. R. Civ. P. 56(f) for time for additional discovery on a new theory offered for the first time on the summary judgment motion. The trustee's new theory was that Hofcom was merely the alter ego of Hofmann and Wicker. Under that theory, they could be liable under Section 550(a)(1) as "initial transferees." The court granted the trustee leave to amend his complaint.

The court stated that the trustee "has invoked Rule 56(f), which protects a party opposing summary judgment who for valid reasons cannot present 'facts essential to justify opposition' to the motion. [The trustee] has submitted the required supporting affidavit in which he requests an opportunity to take discovery on his alter ego claim, an opportunity he says he has not yet had."

Wicker and Hofmann argued that the trustee was too slow in pursuing discovery. The court disagreed. The six-week gap between the defendants' answer and their motion for summary judgment allowed virtually no time for the trustee to take discovery. When the defendants moved for summary judgment, no discovery cutoff had even been set.

Finally, Wicker and Hofmann contended that the complaint alleged no alter ego claim, and therefore there was nothing to which additional discovery on the subject could possibly be relevant. That defect, however, was not fatal because it was appropriate to allow the trustee to amend his complaint under Fed. R. Civ. P. 15(a).

Disclosure of attorney-creditor names would be scandalous

Case name: *Neal, Deborah Alice, In re*, 45 BCD 219 (Bankr. W.D. Mo. 2005).

Ruling: The **U.S. Bankruptcy Court, Western District of Missouri** entered a final order, pursuant to Section 107(b)(2) and Rule 9018, sealing a list of certain unnamed attorney-creditors.

What it means: For purposes of Section 107(b)(2), scandalous materials are statements in a court filing that could cause a reasonable person to negatively alter his opinion of the subject's moral character, taking those statements in the context in which they appear. Here, a linkage of the very identity of the debtor (judge) and the unnamed creditors (attorneys) would render disclosure of the debtor-creditor relationship scandalous.

Summary: The debtor, a municipal court judge, admitted that she had a gambling addiction and that she received loans from local attorneys. She pleaded guilty to mail fraud for not disclosing the loans to the state. The debtor acknowledged that she used her official position to obtain the loans but denied that she gave favorable rulings in exchange. When the debtor filed bankruptcy, she petitioned the court to seal that portion of the list of her creditors containing the names of the attorneys who lent her money. Section 107(b)(2) requires a court to protect an individual with respect to scandalous information contained in a paper filed with the court. Because the list of

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unnamed creditors did not differentiate between those attorneys who did and did not appear in front of the judge, the court agreed that placing the list in the public record would jeopardize the reputations of those attorneys who did not engage in unethical behavior. The court allowed the debtor to file the list of unnamed creditors under seal. A newspaper moved to vacate the order. The court denied the motion, concluding that "publishing the names of the attorney-creditors at this point would be scandalous."

Crucial to the analysis was the context in which the information appeared, namely, a context that was intrinsically colored by the ethical obligations of judges and attorneys and the idiosyncratic nature of their relationship. Until the entity that disciplines attorneys determined which of the unnamed creditors acted unethically, there was no way to distinguish between ethical and unethical unnamed creditors. There was no way to publicize the undifferentiated list without a real risk that reasonable people would draw unfavorable conclusions about the ethical or moral character of all of the unnamed creditors.

The court noted that any potential ethical or criminal violations by attorneys would be duly investigated by the appropriate authorities. Any disciplinary action taken as a result of those investigations would be made public. Therefore, in the end, the public interest in knowing which attorneys in the community engaged in unethical behavior would be served.

Finally, the magnitude of the harm that might befall the innocent unnamed creditors if their names were made public weighed in favor of restricting public access to the information.

Single petitioning creditor has burden of establishing number of creditors

Case name: *E.S. Professional Services, Inc., In re*, 45 BCD 220 (Bankr. S.D. Fla. 2005).

Ruling: The **U.S. Bankruptcy Court, Southern District of Florida** dismissed the involuntary Chapter 7 petition filed by the single petitioning creditor because the creditor could not establish that the debtor had fewer than 12 creditors, as required by Section 303(b)(2). The court ordered that the alleged debtor could submit a request for costs and fees in accordance with Section 303(i).

What it means: A single petitioning creditor in an involuntary bankruptcy will not prevail on the issue whether the debtor has fewer than 12 creditors if there is a small dispute on that threshold issue. That is because it is the petitioning creditor's burden to demonstrate that it is entitled to seek the entry of an order for relief.

Summary: A single petitioning creditor, which claimed that the alleged debtor owed it $400,000, filed an involuntary Chapter 7 petition. The debtor contested the petition, asserting that it had more than 12 creditors, that it was generally paying its debts as they came due, and that the petitioning creditor filed the case in bad faith. The debtor acknowledged that it owed a significant portion of the amount claimed by the petitioning creditor, but argued that the creditor was attempting to put it out of business. The debtor was a former customer of the petitioning creditor and had become a competitor. The court dismissed the petition. "[T]he debtor appears to have more than 12 creditors and appears to be paying those creditors' claims in a satisfactory manner," the court said. The fact that there was still a relatively small dispute as to whether the debtor had more than 12 creditors was not dispositive.

The court also considered whether the petitioning creditor was proceeding in bad faith. While the court was reluctant to presume bad faith, it appeared that there was very little advantage to the creditor filing the petition other than the reason suggested by the debtor — to gain competitive advantage and shut down the debtor's business. The debtor had no saleable hard assets, and its intangible assets could not be converted to actual cash. The other creditors believed the only way they would be repaid was if the debtor stayed operational. The goal of an involuntary bankruptcy should be the equal distribution of assets among creditors.

The petitioning creditor indicated that it filed the involuntary petition because it heard that the debtor's principal was in the midst of a divorce, and because it was concerned about the possibility of certain unspecified transfers of property, which might have been preferential. But it is questionable whether the involuntary bankruptcy statute was intended to be invoked chiefly to utilize the Code's avoidance powers.

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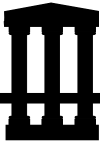

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