

AMERICAN BANKRUPTCY INSTITUTE JOURNAL

February 2025 • Vol. XLIV, No. 2

The Essential Resource for Today's Busy Insolvency Professional

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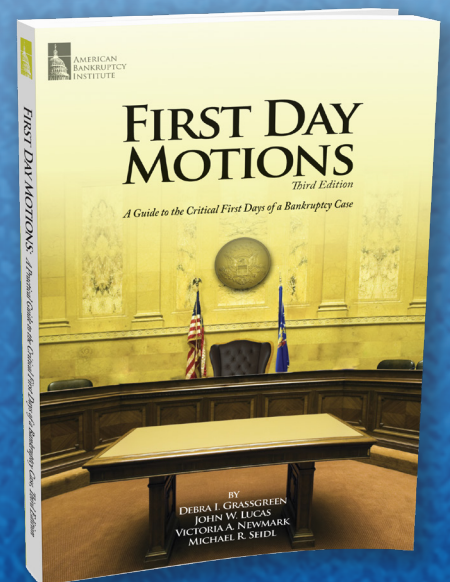
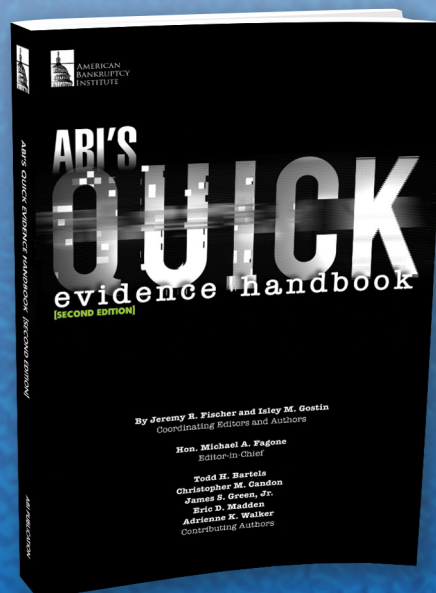
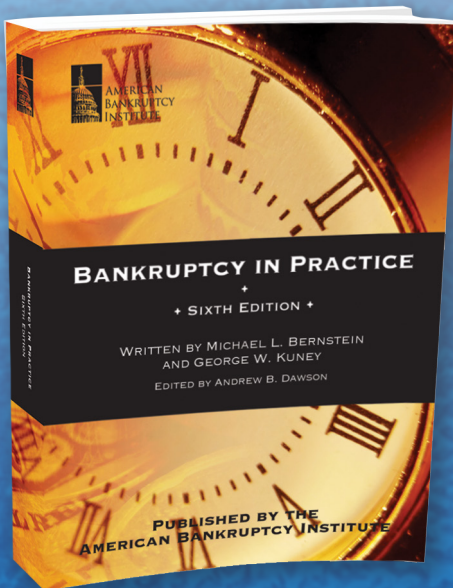
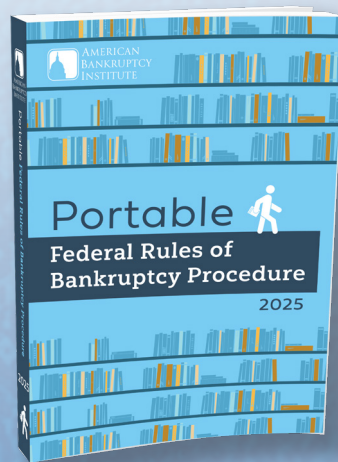
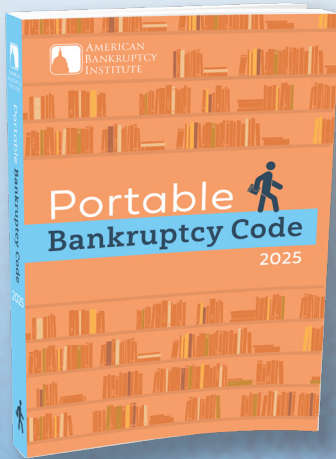
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The ABI Journal (ISSN: 1931-7522) is published 12 times per year for the price of membership by the American Bankruptcy Institute, 99 Canal Center Plaza, Suite 200, Alexandria, VA 22314-5511, (703) 739-0800, Fax (703) 739-1060, info@abiworld.org, abi.org. Periodical postage paid at Alexandria, VA, and additional mailing offices. POSTMASTER: Send address changes to ABI, 99 Canal Center Plaza, Suite 200, Alexandria, VA 22314-5511.

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Benchnotes

BY AARON M. KAUFMAN, BRADLEY D. PACK AND CHRISTINA SANFELIPPO¹

Insurance Policy Buybacks and Settlements Approved in Rockville Centre Diocese Case



Coordinating Editor
Aaron M. Kaufman
Gray Reed; Dallas



Coordinating Editor
Bradley D. Pack
Engelman Berger, PC
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Coordinating Editor
Christina Sanfelippo
Cozen O'Connor
Chicago

Aaron Kaufman is a partner with Gray Reed in Dallas. Bradley Pack is a shareholder with Engelman Berger, PC in Phoenix. Christina Sanfelippo is an associate with Cozen O'Connor in Chicago.

In mass tort cases like many of the diocese sexual abuse bankruptcies, insurance can present a valuable source of recovery for victims — indeed, sometimes the *only* real source of recovery — but coverage disputes can often delay or derail those recoveries for years. In *In re Roman Catholic Diocese of Rockville Centre*,² the debtor had insurance coverage from many different groups of insurers, spanning decades.

From its inception until 1976, the debtor obtained coverage from insurance companies whose successors were now undergoing liquidation proceedings in New York. Between 1976-86, the debtor obtained coverage from a syndicate of insurers under the so-called “London policies,” which included Interstate, Evanston and Lexington. Since 1986, the debtor had been obtaining coverage from a wholly owned insurance company called Ecclesia Assurance Co.

Coverage under several of the debtor’s policies was in dispute, particularly during the years covered by the London policies. Several insurers commenced declaratory judgment actions to limit their exposure and determine that certain claims were barred. The debtor engaged in mediation with several of these insurers, and the parties reached agreements to buy back the policies under several agreements to be approved through a bankruptcy sale and settlement motion. Under the proposed sale and settlement, certain “settling insurers” would buy back policies in exchange for a combined total of approximately \$88.5 million. To maximize the sale proceeds, the debtor sought “channeling injunctions” (channeling victims’ claims to the liquidating trust) and “gatekeeper injunctions.” The debtor filed a motion to approve the sale and settlement.

The U.S. Trustee objected on a number of grounds, but primarily based on the contention that the settlement was a *sub rosa* plan. To be clear, the debtor was not seeking approval of the plan through the sale and settlement motion. The plan was on its own confirmation trajectory.

However, the sales and settlements were conditioned on the plan eventually being confirmed and becoming effective. The sales and settlements with the settling insurers comprised \$88.5 million of the

total \$320 million proposed to be funded into the liquidating trust under the plan.

The U.S. Trustee argued, among other things, that the motion sought to do through a sale what the U.S. Supreme Court held in *Purdue* could not be done through a plan (*i.e.*, release third-party insurers from potential liability to third-party victims without their consent). The U.S. Trustee also argued that the sale and settlement should not be done outside of a plan, and the channeling and gatekeeping injunctions should not be entered outside of an adversary proceeding.

Hon. **Martin Glenn** of the U.S. Bankruptcy Court for the Southern District of New York rejected the U.S. Trustee’s *sub rosa* argument, noting that none of the factors were present to declare the settlement a *sub rosa* plan.³ Key to Chief Judge Glenn’s rejection of this argument was that the \$85.5 million purchase price comprised only about 25 percent of the total \$320 million to be funded through the proposed plan. Nothing in the settlement dictated creditor treatment or voting. Moreover, the settlement did not dictate plan treatment; it was merely conditioned on plan confirmation, which itself required affirmative creditor votes in favor of the plan.

Finally, no one was being asked to waive claims against the debtor. Thus, the court rejected the U.S. Trustee’s argument that the settlement was somehow a *sub rosa* plan. While the court did not directly address the U.S. Trustee’s nonconsensual third-party release arguments, it was implied that such issues were to be taken up at confirmation, not through the settlement.

Having addressed and rejected the *sub rosa* argument, the court’s approval of the sale and settlement was straightforward, applying business-judgment standards to the sale and the *Iridium* factors to the settlement.⁴ The sale of policies was an exercise of sound business judgment, resulting in substantial cash to pay creditors, and any parties objecting to “free and clear” relief were the subject of *bona fide* disputes that could be satisfied with money judgments. The court was satisfied that the debtor sufficiently amended the settlement and sale order to ensure that only estate property was being sold and settled. The court also found that the settling insurers were good-faith purchasers within the meaning of § 363(m).

¹ Mr. Kaufman is special projects leader of ABI’s Commercial Fraud Committee. Ms. Sanfelippo is co-chair of ABI’s Young and New Members Committee and a 2024 ABI “40 Under 40” honoree.

² --- B.R. ---, 2024 WL 4816645 (Bankr. S.D.N.Y. Nov. 18, 2024).

³ See *In re Genesis Glob. Holdco LLC*, 660 B.R. 439, 486 (Bankr. S.D.N.Y. 2024) (internal citations omitted) (“(1) the agreement has the practical effect of dictating the debtor’s reorganization; (2) the agreement infringes creditor voting rights on the debtor’s reorganization; (3) the agreement disposes of large assets belonging to the debtor; and (4) the agreement forced creditors to waive their claims against the debtor.”).

⁴ See *Motorola Inc. v. Off. Comm. of Unsecured Creditors (In re Iridium Operating LLC)*, 478 F.3d 452, 462 (2d Cir. 2007).

Moreover, the settlement factors favored approval. The settlement fairly balanced the coverage litigation's possibility of success with the future benefits attained through settlement. In addition, the court found that the settlement resolved complex and protracted coverage disputes. Perhaps most critically, the settlement was overwhelmingly supported by creditors, including the official committee and its constituents. Finally, the court found that the settlement was the product of extensive arms'-length negotiations, and that the parties were all represented by competent professionals.

Based on these factors and the record presented, the court overruled the U.S. Trustee's objections, and approved the "free and clear" sale of policies to the settling insurers under §§ 105(a) and 363(b) and (f), and Rule 9019(a) of the Federal Rules of Bankruptcy Procedure.

Miscellaneous

• *In re Powell*, --- F.4th ---, 2024 WL 4352615 (9th Cir. Oct. 1, 2024) (Ninth Circuit held that court need not definitively determine whether debtor meets eligibility requirements for chapter 13 relief under § 109(e) before allowing debtor to exercise its "absolute right" to dismiss chapter 13 case under § 1307(b); Ninth Circuit explained that debtor's certification on petition that they meet chapter-specific eligibility requirements presumptively establishes that filing entity "may be a debtor" under designated chapter; § 301(a) neither precludes bankruptcy court from relying on presumption of eligibility established by debtor's certification, nor does it require that filing party "actually" be a debtor or "bona fide" debtor or that court must verify debtor's eligibility; rather, § 301(a) simply states that case is commenced by filing of petition; accordingly, debtor that files petition under chapter 13 and certifies that they meet chapter-specific eligibility requirements is presumptively debtor under chapter 13; under Ninth Circuit's precedent in *Nichols v. Marana Stockyard and Livestock Mkt. Inc.* (*In re Nichols*), 10 F.4th 956 (9th Cir. 2021), once chapter 13 case has been commenced under § 301(a), debtor has absolute right to voluntarily dismiss that case under § 1307(b); Ninth Circuit found support for its holding in Bankruptcy Code's repeated reference to cases as commencing with filing of a petition — not with eligibility determination; for these reasons, bankruptcy court correctly concluded that under § 1307(b), it was required to dismiss debtor's chapter 13 case without further inquiry);

• *FTIGP I LLC on Behalf of Falcata Tech Inv. Fund I LP v. Point Invs. Ltd.* (*In re Point Invs. Ltd.*), 2024 WL 4262832 (D. Del. Sept. 23, 2024) (district court affirmed bankruptcy court's holding that "home court" rule — judicially created exception to automatic stay that permits filing of adversary proceeding against debtor — does not apply in chapter 15 cases; rationale underlying home court rule is that filing of adversary proceeding against debtor in home bankruptcy court is equivalent to filing of proof of claim in debtor's bankruptcy case and, therefore, does not violate automatic stay; however, court explained that underlying rationale does not apply in chapter 15 cases because there is no claims-adjudication process for U.S. bankruptcy court to oversee; "home court" of foreign debtor is foreign main proceeding, and automatic stay in chapter 15 case serves to channel claims

against debtor to debtor's foreign main proceeding; therefore, creditor violated automatic stay by initiating adversary proceeding against debtor in chapter 15 case);

• *Feldman v. John B. Lynch, Jr. (In re Fitzpatrick Container Co.)*, --- B.R. ---, 2024 WL 4511806 (Bankr. E.D. Pa. Oct. 16, 2024) (bankruptcy court held that trustee's fraudulent-transfer claims under § 548 were timely because equitable tolling applied to statute of limitations under § 546; noting that § 546 is not jurisdictional in nature, court explained that equitable tolling may be applied to statute of limitations when trustee can establish diligence in pursuing relevant causes of action and presence of extraordinary circumstances; to avoid incentivizing lack of cooperation with trustee, diligence of trustee must be measured against several competing interests, including limited resources of estate, overall benefit to creditors and ongoing efforts in related proceedings; court rejected defendant's argument that equitable tolling was inapplicable because obstructions in question were caused by involuntary debtor and its principal and not defendant, explaining that equitable tolling can apply based solely on actions of debtor and its principal because bankruptcy cases present "different

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Legislative Update

BY HEIDI J. SORVINO, ANDREW E. ARTHUR AND MICHAEL INGRASSIA

The \$7.5 Million Subchapter V Debt Limit Should Be Reinstated



Coordinating Editor
Heidi J. Sorvino
White and Williams
LLP, New York



Andrew E. Arthur
White and Williams
LLP, New York



Michael Ingrassia
White and Williams
LLP, Wilmington, Del.

Heidi Sorvino has been managing partner in White and Williams LLP's New York office since 2021. Andrew Arthur is an associate in the same office. Michael Ingrassia is an associate in the firm's Wilmington, Del., office.

In 2019, Congress introduced the Small Business Reorganization Act (SBRA)¹ to the Bankruptcy Code. The SBRA, codified as subchapter V of chapter 11, became effective on Feb. 19, 2020. Since its enactment, subchapter V has served as a streamlined, cost-effective and efficient bankruptcy option for small businesses and a new opportunity for practitioners. Instantly popular, the newly enacted subchapter V aimed to provide eligible business debtors (*i.e.*, those under the statutory debt limit) with a quicker and cheaper way to reorganize, which was an appealing alternative to the vastly more expensive traditional chapter 11 filing.

Subchapter V's debt limit was initially set to \$2,725,625, but due to the financial stress of the COVID-19 pandemic,² Congress raised it to \$7.5 million. The increased debt limit showed subchapter V's full potential, with filings reaching record levels in 2023 and accounting for 44 percent of all chapter 11 cases in 2023,³ more than 25 percent of all cases filed since February 2020,⁴ and a 79 percent increase in filings from November 2022 to November 2023.⁵ Despite its rapid and proven success, Congress allowed the subchapter V debt limit to sunset on June 21, 2024, resulting in its reversion from \$7.5 million to an adjusted \$3,024,725.⁶

Subchapter V has become a bankruptcy success story for debtors and the insolvency industry. Small businesses have found a viable alternative to a traditional chapter 11 filing that adequately addresses the unique needs of small business debtors. Thus, subchapter V's proven utility for small businesses should not be ignored when the alternative of a traditional chapter 11 filing requires high costs and a slower process.

Restructuring professionals and ABI have urged and recommended that Congress reinstate and make permanent the heightened debt limit. Subchapter V

is a tool that needs a debt limit expansion to maximize its purpose and bring back the previous volume of filings for the benefit of debtors and practitioners. For several reasons, the \$7.5 million debt limit should be reinstated.

Negative Impact of the Decreased Debt Limit

The repercussions of reverting back to the previous debt limit are well-documented. Since the sunset of the \$7.5 million debt limit, subchapter V filings have dropped significantly.⁷ To illustrate the immediate effects, in the month immediately preceding the debt limit's expiration there were 321 subchapter V filings, but the number of monthly filings fell *by almost half* after the expiration to 175 subchapter V filings.⁸ This sudden decrease after the expiration demonstrates that fewer businesses see subchapter V as an available option.

Further, subchapter V is presently needed in our economic climate as small business bankruptcies continue to grow. In September 2024, subchapter V small business elections increased 9 percent to 167, compared to 153 from September 2023.⁹

While there is still more data to be documented from this debt limit sunset, the aforementioned numbers are trending in the same direction (*i.e.*, lower subchapter V filings, higher filings holistically¹⁰). As has been consistently shown, subchapter V is a desired reorganization option for small businesses. Economic headwinds and market cycles create an absolute need for a small business reorganization path. Having to satisfy a lower debt limit is an unnecessary hurdle to small businesses across the U.S. that are already enduring economic strife.

A Heightened Subchapter V Debt Limit Increases the Probability of Successful Reorganization

In addition to increasing the pool of eligible debtors, a higher subchapter V debt limit also

1 P.L. No. 116-54 (2019).

2 P.L. No. 116-136 (2020), as amended by Pub. L. No. 117-5 (2021), as further amended by Pub. L. No. 115-151 (2022) (extending debt limit).

3 See Final Report and Recommendations of the ABI Subchapter V Task Force (2024), subtaskforce.abi.org. ABI is also continuing its study of subchapter V by collecting experiences from those involved, which can be shared at abi.org/substories. Unless otherwise specified, all links in this article were last visited on Dec. 27, 2024.

4 *Id.*

5 See "November Commercial Chapter 11 Filings Increase 141 Percent over 2022," Epiq Global (Dec. 4, 2023), epiqglobal.com/en-us/resource-center/news/november-commercial-chapter-11-filings-increase-141-percent-over-2022-propelled-by-wework-bankruptcy. See also Joy Kleisinger, "The Expiration of the Increased Subchapter V Debt Limit and Its Impact on Small Business Debtors," *XLIII ABI Journal* 3, 8, 48, March 2024, abi.org/abi-journal/the-expiration-of-the-increased-subchapter-v-debt-limit-and-its-impact-on-small-business.

6 11 U.S.C. § 104, as adjusted for inflation.

7 See Alexander Lugo, "Subchapter V Bankruptcy Filings Plummeted After Congress Let Its Qualification Threshold Sunset," *ALM Global* (Oct. 18, 2024), law.com/dailybusinessreview/2024/10/18/subchapter-v-bankruptcy-filings-plummeted-after-congress-let-its-qualification-threshold-sunset/?slreturn=20241206164715 (subscription required to view article).

8 *Id.* (providing number of filings in June 2024 and July 2024, respectively).

9 See "Bankruptcy Statistics," ABI, abi.org/newsroom/bankruptcy-statistics.

10 *Id.*

resulted in an increase of post-confirmation business viability. The survival rate for organizations with confirmed subchapter V plans in December 2023 is 86 percent higher than the 70 percent survival rate of nonsubchapter V cases.¹¹ As such, businesses reaching plan confirmation in subchapter V maintain strong chances of continued viability upon emergence from bankruptcy.

Even more importantly, subchapter V *more than doubles* the probability of successful reorganization for organizations “near the \$7.5 million threshold.”¹² This documented correlation between businesses near the \$7.5 million debt limit and successful subchapter V reorganizations suggests that those same businesses would not survive post-confirmation if limited to a traditional chapter 11 process.

The Simplified Procedures Provide Broader Access to Reorganization for Small-Business Debtors

Returning to pre-pandemic debt adjustments has been disruptive to an already successful tool. The SBRA was a product of diligent research and studies of small business reorganizations, and the simplified procedures are meant to match the needs of small business debtors. Subchapter V is aimed at, among other things, addressing the costly nature

of a traditional chapter 11 filing for a small business debtor. Subchapter V removes the (1) disclosure statement requirement, (2) appointment of a creditors’ committee(s), and (3) need for U.S. Trustee quarterly fees, which are usually paid by traditional chapter 11 debtors.

Further, subchapter V allows small business equityholders to retain their interests in the debtor entity by eliminating the so-called absolute-priority rule, which expands avenues for plan confirmations.¹³ Such procedures have removed barriers to create greater access for small business debtors and remove the costly aspects of chapter 11 (including related litigation). Increasing the debt limit would similarly expand access to those debtors who are above the current threshold, but who could successfully reorganize under subchapter V.

Proven Successful

Subchapter V’s success is generally withheld in the entities that have filed and confirmed their plans. Such reorganized entities were able to reap the benefits of a bankruptcy process that works and was created for their needs. From 2020 through June 30, 2024, there were 8,498 subchapter V cases filed,¹⁴ a quarter of all chapter 11 cases filed. As com-

11 Edith Hotchkiss, Benjamin Iverson & Xiang Zheng, “Can Small Business Survive Chapter 11?,” March 12, 2024, papers.ssrn.com/sol3/papers.cfm?abstract_id=4726391.
12 *Id.*

13 11 U.S.C. § 1181(a).

14 See “Chapter 11 Subchapter V Statistical Summary Through November 30, 2024,” U.S. Trustee Program, justice.gov/ust/page/file/1499276/dl?inline.

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Legislative Highlights

119th Congress Convened: Listing of Key Committee Leadership

The 119th Congress convened on Jan. 3 at noon, with both the Senate and House of Representatives under the control of Republicans following the 2024 election. Senate Republicans elected Sen. John Thune (R-S.D.) as Senate Majority Leader, and House Republicans elected Rep. Mike Johnson (R-La.) to retain his position as Speaker of the House. The chairs of key congressional committees overseeing bankruptcy, debt and financial issues include the following members:

Senate Judiciary Committee

- Chair: Sen. Chuck Grassley (R-Iowa)
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- Ranking Member: Rep. Jamie Raskin (D-Md.)

Senate Banking Committee

- Chair: Sen. Tim Scott (R-S.C.)
- Ranking Member: Sen. Elizabeth Warren (D-Mass.)

House Financial Services Committee

- Chair: Rep. French Hill (R-Ark.)
- Ranking Member: Rep. Maxine Waters (D-Calif.)

Senate Health, Education, Labor & Pensions (HELP) Committee:

- Chair: Sen. Bill Cassidy (R-La.)
- Ranking Member: Sen. Bernie Sanders (I-Vt.)

At press time, leadership of key congressional subcommittees was still being assigned.

Sen. Joni Ernst Introduces Legislation to Continue Pursuit of COVID-19 Fraudsters

With the Special Inspector General for Pandemic Recovery (SIGPR) warning that its authority is expiring, U.S. Senate Committee on Small Business and Entrepreneurship Chair Joni Ernst (R-Iowa) introduced legislation on Jan. 9¹ to ensure that it will be able to continue to track down criminals who stole COVID-19 relief within the Coronavirus Aid, Relief, and Economic Security (CARES) Act of 2020, designed to assist small businesses. S. 68, the “Complete COVID Collections Act,” would extend authorization of the SIGPR through 2030 and expand its jurisdiction to cover other Small Business Administration (SBA) COVID-19-

related programs to empower it to go after fraudsters stealing from taxpayers.

“Con artists took advantage of small businesses’ pain during COVID to defraud government programs designed to help hardworking Americans,” said Sen. Ernst. “We especially cannot afford to leave more than \$200 billion floating around, especially in the hands of fraudsters.” The bill was sponsored by Sens. Todd Young (R-Ind.), Marsha Blackburn (R-Tenn.), James Lankford (R-Okla.) and John Curtis (R-Utah).

The SIGPR is facing a statutory sunset in March 2025 for oversight of CARES Act loans. “SIGPR’s investigations have thus far resulted in 66 federal indictments/informations, 49 arrests, 29 guilty pleas, and four sentencing,” Brian D. Miller, Special Inspector General for Pandemic Recovery, wrote in a letter² to Sen. Ernst. Miller said that SIGPR has achieved more than \$187.1 million in financial results since 2020, surpassing SIGPR’s total allocated budget by more than 300 percent.

“Of equal concern is an alarming rate of defaults by borrowers who are failing to pay even the interest payments on the loans for the Main Street Lending Program (MSLP) and the Direct Loan Program,” Miller wrote. More than 70 percent of the MSLP borrowers that SIGPR is investigating are in default, according to Miller. He said that now that initial MSLP principal payments have come due, loan losses have increased dramatically.

Prospects for congressional consideration of S. 68 are good, as Sen. Ernst is the chair of the committee of referral and Republicans maintain a majority in both chambers of Congress.

Bipartisan Legislation Introduced Aiming to Protect Consumers from Credit Card Repair Scams

Reps. Sarah McBride (D-Ala.) and Young Kim (R-Calif.) on Jan. 9 introduced³ H.R. 306, the “Ending Scam Credit Repair Act (ESCRA),” to combat fraudulent practices in the credit-repair industry. The bill targets credit-repair organizations (CROs) that exploit consumers by charging high fees without delivering on promises to improve credit scores.

Specifically, the bill prohibits CROs from charging consumers until six months after they have provided proof that their credit scores have improved, and it increases civil penalties for violations. The bill also prohibits CROs from “jamming” financial institutions with duplicative requests, which has prevented consumer-reporting agencies and data-furnishers from addressing legitimate credit report issues.

2 Letter by the office of the Special Inspector General for Pandemic Recovery to Sen. Joni Ernst (Jan. 2, 2025), ernst.senate.gov/imo/media/doc/sigpr_extension_letter.pdf.

3 “Congresswoman Sarah McBride Introduces Her First Bill in Congress,” Office of Rep. Sarah McBride (Jan. 10, 2025), mcbride.house.gov/media/press-releases/congresswoman-sarah-mcbride-introduces-her-first-bill-congress.

1 “Ernst Continues Pursuit of COVID Fraudsters,” Office of Sen. Joni Ernst (Jan. 13, 2025), ernst.senate.gov/news/press-releases/ernst-continues-pursuit-of-covid-fraudsters.

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BY VINCENT J. ROLDAN AND AVA GOLDBERGER

Eletson Results: SDNY Bankruptcy Court Issues Decision on New Value

It is well-established that creditors with higher priority must be paid in full before junior creditors can receive a distribution. The Bankruptcy Code codifies this so-called “absolute-priority rule,” and the result is this: Equity owners typically cannot retain their interests in a debtor unless creditors either consent or are paid in full.

However, courts have developed a common law exception to the absolute-priority rule under which equityholders may retain their interest in a debtor when they provide “new value.” In *Eletson Holdings Inc.*, the U.S. Bankruptcy Court for the Southern District of New York¹ provided a thorough analysis of the new-value exception and demonstrated roadblocks faced by equity owners, particularly when confronted with a competing plan.

Background

A nonconsensual plan can be confirmed under § 1129(b), as long as such a plan has at least one impaired accepting class, does not “discriminate unfairly and is fair and equitable, with respect to each class of claims or interests that is impaired under, and has not accepted, the plan.”² A plan is fair and equitable *vis-à-vis* unsecured creditors if the plan pays them in full or, alternatively, the plan satisfies the absolute-priority rule; junior creditors or equity interest-holders do “not receive or retain under the plan on account of such junior claim or interest any property....”³ However, under the new value exception to the absolute-priority rule, a debtor’s shareholders may retain an interest in the reorganized debtor — even if unsecured creditors have not been paid in full.

The Second Circuit Court of Appeals in *Coltex Loop Central Three Partners*⁴ set forth five requirements for the new-value exception.⁵ The capital contribution from equityholders must be (1) new (2) money or money’s worth (3) that is substantial and (4) necessary for a successful reorganization, and (5) reasonably equivalent to the property that equityholders of the debtor are retaining or receiving.⁶ In *Coltex*, the debtor’s plan

permitted the equityholders to contribute capital; in return, they could retain their interest in the reorganized debtor. The Second Circuit held that the equityholders’ contribution was not considered new value because the debtor had not pursued other avenues of funding.⁷ Consequently, the court found that the debtor’s plan allowed equityholders to receive an interest in the reorganized debtor on account of their prior subordinate position rather than on account of new value.⁸

In *203 N. LaSalle*,⁹ the U.S. Supreme Court further analyzed the absolute-priority rule and the new-value exception. The court established that junior interest-holders cannot receive opportunities to retain interest in a reorganized debtor without outside prospective bidders’ involvement.¹⁰ The Court reasoned that a competitive-bidding process ensures that equityholders are not given advantages over unsecured creditors in violation of the absolute-priority rule and, at the same time, serves as a market valuation of the reorganized debtor’s enterprise.¹¹

Eletson Holdings

Against this backdrop, *Eletson* is the latest court to opine on new value. In *Eletson*, the debtors were an international gas-shipping enterprise that owned and operated a fleet of gas tanker ships.¹² They were forced into bankruptcy involuntarily by a group of petitioning creditors after the debtors defaulted on two restructuring-support agreements.¹³ Following the termination of the debtor’s exclusivity period to propose a chapter 11 plan, the petitioning creditors put forward competing plans.

The debtors offered a new-value plan whereby their shareholders would receive 100 percent of the equity of the newly reorganized debtors (the “debtor plan”).¹⁴ In exchange, the shareholders proposed to contribute \$37 million in cash. The debtor plan would also provide creditors a percentage of pro-



**Coordinating Editor
Vincent J. Roldan**
Mandelbaum Barrett
PC; Roseland, N.J.



Ava Goldberger
Mandelbaum Barrett
PC; Roseland, N.J.

Vincent Roldan is a partner, and Ava Goldberger is an associate, with Mandelbaum Barrett PC in Roseland, N.J.

1 *In re Eletson Holdings Inc.*, No. 23-10322 (JPM), 2024 WL 4579441 (Bankr. S.D.N.Y. Oct. 25, 2024), at *1.

2 *Id.* at 28 (citing §§ 1129(a)(8), (a)(10), (b)(1)).

3 *Id.* (citing 11 U.S.C. § 1129(b)(2)(B)(ii)).

4 *In re Coltex Loop C. Three Partners LP*, 138 F.3d 39 (2d Cir. 1998), at 41.

5 *Id.*

6 *Id.*

7 *Id.* at 42.

8 *Id.* at 46.

9 *Bank of Am. Nat. Tr. and Sav. Ass'n v. 203 N. LaSalle St. P'ship*, 526 U.S. 434 (1999), at 443.

10 *In re Eletson Holdings Inc.*, No. 23-10322 (JPM), 2024 WL 4579441 (Bankr. S.D.N.Y. Oct. 25, 2024), at 30.

11 *Id.*

12 *In re Eletson Holdings Inc.*, No. 23-10322 (JPM), 2024 WL 4579441 (Bankr. S.D.N.Y. Oct. 25, 2024), at 11.

13 *Id.* at 16.

14 *Id.* at 19.

ceeds arising out of a contemplated award resulting from a pending arbitration relating to ownership of preferred shares. This distribution was to be guaranteed in the amount of \$40 million.¹⁵

The petitioning creditors proposed two plans. Their first plan was based on the debtor plan, except that the litigation trust would receive increased funding and the shareholder new-value contribution would be replaced by an outside infusion of capital. In addition, the petitioning creditors escrowed \$43.5 million in cash and provided a commitment letter from their funder to backstop up to \$53.5 million in cash in support of their plan.¹⁶

The petitioning creditors' other plan (defined in *Eletson* as the "petitioning creditor plan") was funded by a \$53.5 million equity rights offering. General unsecured creditors would be provided rights to purchase up to 75 percent of the reorganized debtors' equity.¹⁷ The petitioning creditors were to escrow \$43.5 million to provide assurance of performance. The rights offering was also supported by a backstop commitment agreement.¹⁸

The court allowed creditors to vote on more than one plan and rank the plans in order of preference. The petitioning creditor plan ultimately received the majority of votes from the impaired classes of claims.

The Debtor Plan's Viability Under the New-Value Exception

The petitioning creditors and the committee of unsecured creditors objected to the debtor plan on the grounds that it violated the absolute-priority rule, and the contributions proposed under the debtor plan did not qualify as "new value." The *Eletson* court then analyzed the debtor plan in the context of *Coltex* and *203 N. LaSalle*.¹⁹

First, the *Eletson* court considered whether the shareholders' proposed new value was in fact "new." Contributions are only "new" under *Coltex* if they come from outside the debtor's business.²⁰ In this case, the debtors proposed \$37 million of funding in cash and various other buckets of funds from shareholders. The court concluded that only the \$37 million cash qualified as "new." However, the funds from shareholders did not meet the standard for "new," since those funds were coming from inside the debtors' capital structure.²¹

Second, the court considered whether the debtors were offering "money or money's worth." To satisfy this requirement, the "new value" must be a *present* contribution; promises of future services and promissory notes do not constitute new value. Here, the debtor plan proposed several modes of contributions: "distribution of revenue from the nondebtor

¹⁵ *Id.* at 21.
¹⁶ *Id.* at 22.
¹⁷ *Id.*
¹⁸ *Id.*

¹⁹ *Id.* at 27.
²⁰ *Id.* at *33.
²¹ *Id.* at 31.

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BY STACY LUTKUS

Student Loan Discharge: Where Are We Headed?

The discharge and forgiveness of student loan debt has long¹ been a contentious topic, both inside and outside of bankruptcy circles. With escalating student loan debt levels² a focus of national attention, critics have called for a change to the legal landscape governing the dischargeability of student loan debt in bankruptcy. Courts considering the issue are bound to apply decades-old tests. Nonetheless, there are indications that change might be on the horizon, even as a new administration takes office.

Discharge of student loan debt³ in bankruptcy is governed by 11 U.S.C. § 523(a)(8). The provision requires a debtor to demonstrate that repaying the loan(s) at issue would impose “an undue hardship on the debtor and the debtor’s dependents.”⁴ The Bankruptcy Code does not define “undue hardship,” so its meaning has been left to the courts. Several decades of case law have resulted in the emergence of two tests to determine the dischargeability of student loans: the majority *Brunner* test, and the totality-of-the-circumstances test.

In *Brunner v. New York State Higher Educ. Servs. Corp.*,⁵ the U.S. Court of Appeals for the Second Circuit adopted a three-pronged test that a debtor must satisfy to obtain a discharge of student loan debt. The test requires a debtor to demonstrate that (1) he or she is unable, at his or her current level of income and expenses, to maintain a “minimal” standard of living if required to repay the loans; (2) additional circumstances exist indicating that his or her current state of affairs is likely to persist for a significant portion of the repayment period; and (3) he or she has made good faith efforts to repay

the loan.⁶ Significantly,⁷ the court observed that § 523(a)(8) indicates a “clear congressional intent to make the discharge of student loans more difficult than that of nonexcepted debt.”⁸

The *Brunner* test has since been adopted by the U.S. Courts of Appeals for the Third, Fourth, Fifth, Sixth, Seventh, Ninth, Tenth and Eleventh Circuits.⁹ The Eighth Circuit¹⁰ and the majority of lower courts in the First Circuit¹¹ apply the so-called totality-of-the-circumstances test, under which courts consider a debtor’s “past, present, and reasonably reliable future financial resources, reasonable and necessary living expenses, and any other relevant facts and circumstances.”¹² Despite this distinct nomenclature, the differences between the totality-of-the-circumstances test and the *Brunner* test are “modest, with many overlapping considerations.”¹³ Courts universally recognize the heavy burden of establishing undue hardship to obtain a discharge of student loan debt.¹⁴

Student loan borrowings account for roughly 9 percent of total U.S. household debt.¹⁵ Studies regarding the effect of increasing student debt levels on the broader economy abound. For example, according to one Federal Reserve Board study, a \$1,000 increase in student loan debt caused a decrease of approximately 1.5 percent in the home ownership rate among the study’s control group



Stacy Lutkus
McDermott Will
& Emery LLP
New York

Stacy Lutkus is a partner in McDermott Will & Emery LLP’s Business Restructuring Group in New York, and maintains an active pro bono practice, with a particular focus on representing the interests of children.

1 See Report of the Comm’n on the Bankr. Laws of the United States, H.R. Doc. No. 93-137, 93 Cong., 1st Sess. Pt. II (1973), reprinted in *Collier on Bankruptcy*, App. Pt. 4(c) at 4-710 (16th ed. 2024) (explaining that exception to discharge for student loan debt “responds to the rising incidence of consumer bankruptcies of former students motivated primarily to avoid payment of educational loan debt”).

2 See Federal Reserve Bank of New York Center for Microeconomic Data, Quarterly Report on Household Debt and Credit (November 2024) (reporting \$1.61 trillion in outstanding student loan debt in U.S. as of end of third fiscal quarter of 2024).

3 In *Homidan v. Sallie Mae Inc.*, 3 F.4th 595 (2d Cir. 2021), the U.S. Court of Appeals for the Second Circuit found that § 523(a)(8) does not apply to certain direct-to-consumer private loans that exceed the cost of attendance because they do not comprise “an obligation to repay the funds received as an educational benefit.” *Id.* at 601 (quoting 11 U.S.C. § 523(a)(8)(A)(ii) (internal quotation marks omitted)). Recognizing that § 523(a)(8)(B) excepts from discharge any loan that is a “qualified education loan” as defined in the Internal Revenue Code, the Second Circuit explained that “for a loan to be ‘qualified’ ... the student must attend an eligible educational institution and the loan must fund only higher education expenses.” *Id.* at 601, n.3 (citations omitted).

4 11 U.S.C. § 523(a)(8).

5 831 F.2d 395 (2d Cir. 1987).

6 *Id.* at 396.

7 Given the “fresh start policy” embodied in the Bankruptcy Code, *Grogan v. Garner*, 498 U.S. 279, 826-87 (1991), courts considering the dischargeability of other types of debt strictly construe exceptions to discharge against the creditor. See, e.g., *Pazdzierz v. First Am. Title Ins. Co.* (In re *Pazdzierz*), 718 F.3d 582, 586 (6th Cir. 2013) (citation omitted); *Okla. Dep’t of Sec. ex rel. Faught v. Wilcox*, 691 F.3d 1171, 1174 (10th Cir. 2012) (internal quotation marks and citation omitted); *In re Crosswhite*, 148 F.3d 879, 881 (7th Cir. 1998) (citation omitted); *In re Cohn*, 54 F.3d 1108, 1120 (3d Cir. 1995).

8 *Id.*

9 See *In re Frushour*, 433 F.3d 393, 400 (4th Cir. 2005); *In re Oyler*, 397 F.3d 382, 385 (6th Cir. 2005); *Educ. Credit Mgmt. Corp. v. Polleys*, 356 F.3d 1302, 1309 (10th Cir. 2004); *In re Gerhardt*, 348 F.3d 89 (5th Cir. 2003); *In re Cox*, 338 F.3d 1238, 1239 (11th Cir. 2004); *In re Pena*, 155 F.3d 1108, 1112 (9th Cir. 1998); *In re Faish*, 72 F.3d 298,306 (3d Cir. 1995); *In re Roberson*, 999 F.2d 1132, 1135 (7th Cir. 1993).

10 See *Long v. Educ. Credit Mgmt. Corp.*, 322 F.3d 549 (8th Cir. 2003).

11 See *Nash v. Conn. Student Loan Found.* (In re *Nash*), 446 F.3d 188, 190 (1st Cir. 2006) (declining to “pronounce our views of a preferred method of identifying a case of ‘undue hardship’”).

12 *Educ. Credit Mgmt. Corp. v. Jespersen* (In re *Jespersen*), 571 F.3d 775, 779 (8th Cir. 2009).

13 *Bronsdon v. Educ. Credit Mgmt. Corp.* (In re *Bronsdon*), 435 B.R. 791, 798 and n.12 (B.A.P. 1st Cir. 2010) (adopting totality-of-circumstances test and recognizing that “only practical difference between the two tests is that under *Brunner*, the debtor must establish that she made a good faith effort to repay the loans”) (citing *Educ. Credit Mgmt. Corp. v. Kelly* (In re *Kelly*), 312 B.R. 200, 206 (B.A.P. 1st Cir. 2004)); see also *Nash*, 446 F.3d at 190 (noting that bankruptcy court had applied totality-of-circumstances test “but was of the view that courts essentially looked at the same factors under either test”).

of borrowers¹⁶ (this is equivalent to an average delay of 2.5 months in home ownership¹⁷). Other studies have attributed student loan debt to a reduction in the likelihood of entrepreneurship¹⁸ and a reduction in the likelihood of stock ownership.¹⁹

Citing these factors and others as its bases, in 2022 the Biden administration commenced efforts to relieve student loan debt. In a June 2023 decision, the U.S. Supreme Court found that the comprehensive student loan forgiveness program established by the Secretary of Education was not authorized under the Higher Education Relief Opportunities for Students (HEROES) Act of 2003 — a bipartisan 2003 law addressing national emergencies invoked by the Secretary to carry out the program.²⁰ The program would have resulted in up to \$20,000 in debt relief to Pell Grant recipients and up to \$10,000 in debt relief to other qualified borrowers, in each case subject to income and other requirements and qualifications. Revised efforts, most of which met with varying degrees of opposition in the federal courts,²¹ followed.

Separately, the Department of Justice (DOJ) announced a revised process developed in coordination with the Department of Education (DOE) for handling cases in which borrowers seek to discharge federal student loan debt in bankruptcy.²² The process is set forth in a guidance memo provided to DOJ attorneys for reference in connection with the representation of the government in adversary proceedings filed by debtors seeking a discharge of student loan debt.²³ It advises that the government should stipulate to facts supporting undue-hardship claims and recommend discharge to the bankruptcy court where the debtor, based on information provided in a government-developed attestation form,

satisfies three stated conditions that effectively mirror the *Brunner* test (*i.e.*, “(1) the debtor presently lacks an ability to repay the loan; (2) the debtor’s inability to pay the loan is likely to persist in the future; and (3) the debtor has acted in good faith in the past in attempting to repay the loan”²⁴).

According to the guidance memo, the procedures are intended to ensure that “discharges are sought and received when warranted by the facts and law.”²⁵ The memo also provides that DOJ attorneys should consult with the DOE to evaluate the specific circumstances of each case.²⁶ According to the results of a survey of all 94 U.S. Attorneys’ Offices conducted after the first year of implementation of the revised process, borrowers have reaped myriad intended benefits, including an increased number of court judgments providing full or partial discharge.²⁷

24 *Id.* at 1.

25 *Id.* at 2.

26 *See id.*

27 *See* “Justice Department and Department of Education Announce Continuing Success of Student-Loan Bankruptcy Discharge Process,” U.S. Dep’t of Justice Office of Public Affairs (July 17, 2024), justice.gov/opa/pr/justice-department-and-department-education-announce-continuing-success-student-loan.

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14 *See, e.g., Jespersion*, 571 F.3d at 779 (8th Cir. 2009) (“The debtor has the burden of proving undue hardship ... [and] [t]he burden is rigorous.”); *Nash*, 446 F.3d at 191 (recognizing debtor’s “formidable task” in establishing undue hardship because “Congress has made the judgment that the general purpose of the Bankruptcy Code to give honest debtors a fresh start does not automatically apply to student loan debtors”); *Frushour*, 433 F.3d at 401 (“The second [*Brunner*] factor is ... a demanding requirement”); *Educ. Credit Mgmt. Corp. v. Curiston*, 351 B.R. 22, 29 (D. Conn. 2006) (“[T]he additional circumstances element [of the *Brunner* test] sets a high standard of proof.”); *Williams v. N.Y. State Higher Educ. Serv. Corp. (In re Williams)*, 296 B.R. 298, 302 (S.D.N.Y. 2003) (“A debtor carries a heavy burden when she seeks to establish an undue hardship under section 523(a)(8).”), *aff’d*, 84 Fed. App’x 158 (2d Cir. 2004); *In re Kelly*, 351 B.R. 45, 52 (Bankr. E.D.N.Y. 2006) (“Establishing undue hardship is a ‘heavy burden’ for any debtor.”) (footnote and citation omitted); *see also, e.g., Traversa v. Educ. Credit Mgmt. Corp.*, 2010 U.S. Dist. LEXIS 117559, at *9 (D. Conn. Nov. 5, 2010), *aff’d*, 444 Fed. App’x 472 (2d Cir. 2011); *Bridgeforth v. United States Dep’t of Educ. (In re Bridgeforth)*, 2022 Bankr. LEXIS 209, at *3 (Bankr. M.D. Pa. Jan. 26, 2022); *Magsino v. United States Dep’t of Educ. (In re Magsino)*, 2014 Bankr. LEXIS 1365, at *13 (Bankr. W.D.N.C. April 4, 2014); *Duval v. IRS (In re Duval)*, 2012 Bankr. LEXIS 1391, at *12 (Bankr. S.D.N.Y. April 3, 2012).

15 *See* Federal Reserve Bank of New York Quarterly Report on Household Debt and Credit (November 2024).

16 Alvaro A. Mezza, Daniel R. Ringo, Shane M. Sherlund & Kamila Sommer, “Student Loans and Homeownership,” Washington: Bd. of Governors of the Fed. Reserve Sys. 3 (2017), doi.org/10.17016/FEDS.2016.010r1 (unless otherwise specified, all links in this article were last visited on Dec. 27, 2024).

17 *Id.*

18 *See* Thomas Korankeye, “Student Loan Debt and U.S. Married Households’ Stock Investment Decisions,” *Econ. Analysis Letters* 2(4) 13-18 (2023); Karthik Krishnan & Pinshuo Wang, “The Cost of Financing Education: Can Student Debt Hinder Entrepreneurship?,” *Mgmt. Sci.* 65(10): 4522-4554 (2018).

19 *See* Jordan Coakley & Meng Li, “Impact of Student Loan Debt on Stock Ownership: An Analysis Based on the Survey of Consumer Finances,” 20(6) *J. Accounting & Fin.* 31 (2020).

20 *See Biden v. Nebraska*, 600 U.S. 477 (2023).

21 *See* Katie Lobosco, “Federal Appeals Court Could Rule Soon on Biden’s Student Loan Repayment Plan. Here’s What Borrowers Need to Know,” CNN (Oct. 24, 2024), cnn.com/2024/10/24/politics/student-loans-save-plan-court/index.html.

22 *See* “Justice Department and Department of Education Announce a Fairer and More Accessible Bankruptcy Discharge Process for Student Loan Borrowers,” U.S. Dep’t of Justice Office of Public Affairs (Nov. 17, 2022), justice.gov/opa/pr/justice-department-and-department-education-announce-fairer-and-more-accessible-bankruptcy.

23 “Student Loan Guidance,” U.S. Dep’t of Justice (2022), justice.gov/ust/student-loan-guidance.

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BY MICAH MARCUS AND JORY BERG

A Guarantor's Guide to Marshaling

For the benefit of the uninitiated, the equitable doctrine of marshaling has its roots in the creation of a mechanism to balance the competing interests of unevenly situated creditors to maximize recovery for all parties. In particular, the marshaling doctrine requires — in the right circumstances — a senior creditor with access to multiple sources of collateral to satisfy its claim from a particular asset in which it holds a security interest, thereby preserving other collateral for junior creditors holding security interests in another jointly secured asset.

Despite its seemingly straightforward objective, marshaling is a nuanced doctrine interpreted differently across jurisdictions, leading to variations in its application. This article explores the differing approaches taken by courts and analyzes the implications of these differences on creditors' rights and recovery strategies in bankruptcy cases. It also provides some critical guidance to unsuspecting guarantors to avoid finding out that they offered more than what they intended when executing a guaranty on behalf of a corporate debtor.

At its core, marshaling is intended to promote fairness and equity by ensuring that the junior creditor is not left without recourse due to the senior creditor's choice of collateral.¹ The doctrine "rests upon the principle that a creditor having two funds to satisfy his debt may not by his application of them to his demand defeat another creditor, who may resort to only one of the funds."² Generally, four elements must be satisfied before the doctrine may be applied: (1) the existence of two secured creditors of the same debtor; (2) the existence of two funds belonging to a common debtor (often referred to as the "common debtor" requirement); (3) only one of the creditors having access to both funds while the other creditors may resort to only one fund; and (4) the absence of prejudice to the senior secured creditor if the doctrine of marshaling is applied.³

Generally Accepted Exceptions to the "Common Debtor" Requirement

The second element is key to the first part of this article's discussion, as it provides, as a gen-

eral rule, that marshaling is unavailable in scenarios in which one fund consists of an interest in a debtor's estate property and the other fund consists of an interest in property of a nondebtor. As such, under the typical rule, a senior creditor generally cannot be forced by marshaling to resort to a fund that is "in the hands of a shareholder of the debtor or in the hands of a surety."⁴ In other words, in a typical case, a lender with a guaranty from an equityholder cannot be required to collect on that guaranty (or assets pledged thereon) before liquidating its collateral held by the debtor — certainly the better outcome for a guarantor to the extent the debtor's collateral can reduce, if not eliminate, their obligation under the guaranty. There are at least two generally accepted exceptions to this element.

First, courts may deviate from the "common debtor" requirement when the nondebtor (such as a corporate debtor's controlling shareholder who has guaranteed the debt and secured the guaranty with his or her own property) is the alter-ego of the debtor. In these instances, courts will disregard the corporate entity and view both the debtor and nondebtor guarantor as a singular unit (commonly referred to as "piercing the corporate veil").⁵ In this sense, the court is finding that the debtor and guarantor (or co-obligor) are, in effect, a singular debtor, thus supporting application of the doctrine. That said, this exception is seldom applied given the heavy burden required to warrant piercing the veil.⁶

Second, and following the same theme that *bad acts* may warrant exception to the rule, some courts may excuse the "common debtor" requirement when a guarantor has engaged in inequitable conduct, such as fraud, breach of fiduciary duty or unjust enrichment. For example, in *In re Tampa Chain Co. Inc.*,⁷ the U.S. Bankruptcy Court for the Southern District of New York found that fraud and inequitable conduct of shareholders-



Micah Marcus
McDonald Hopkins
LLC; Chicago



Jory Berg
McDonald Hopkins
LLC; Chicago

Micah Marcus is a member of McDonald Hopkins LLC's Litigation and Strategic Advisory and Restructuring Departments. Jory Berg is an associate in the firm's Strategic Advisory and Restructuring Department. They are both based in Chicago.

1 See *Meyer v. United States*, 375 U.S. 233, 237 (1963).

2 *Sowell v. Fed. Reserve Bank*, 268 U.S. 449, 456-57 (1925).

3 See *In re Evans*, No. 09-03763-NPO, 2011 WL 4712180, at *7 (Bankr. S.D. Miss. Oct. 7, 2011) (citing *Meyer*, 375 U.S. at 236-37); *In re Murdock*, 134 B.R. 417, 422 (Bankr. D. Mont. 1991) (citing *Victor Gruen Assoc. Inc. v. Glass*, 338 F.2d 826, 830 (9th Cir. 1964)).

4 *In re Gluth Bros. Const. Inc.*, 424 B.R. 379, 396 (Bankr. N.D. Ill. 2009).

5 When considering whether to pierce the corporate veil, courts consider whether the debtor corporation is a legal fiction, and courts evaluate a number of non-exclusive factors. See *Trustees of Nat. Elevator Indus. Pension, Health Benefit & Educ. Funds v. Lutyk*, 332 F.3d 188 (3d Cir. 2003) ("Under [the] federal alter-ego doctrine, factors in determining whether to pierce [the] corporate veil include: (1) gross undercapitalization; (2) failure to observe corporate formalities; (3) nonpayment of dividends; (4) insolvency of [the] debtor corporation; (5) siphoning of funds from [the] debtor corporation by dominant stockholder; (6) nonfunctioning of officers and directors; (7) absence of corporate records; and (8) whether corporation is merely facade for operations of dominant stockholder.")

6 See, e.g., *Vermont Toy*, 82 B.R. 258 at 320 (noting that most courts decline to apply this exception because of lack of proper allegation or evidence and listing cases that recognize but fail to apply marshaling due to insufficient evidence).

7 *In re Tampa Chain Co. Inc.*, 53 B.R. 772 (Bankr. S.D.N.Y. 1985).

guarantors of corporate debt warranted treating shareholders and the corporate debtor as a common debtor so as to allow the marshaling of assets, where the debtor's capitalization was removed and replenished by one shareholder, assets were transferred by shareholders to another family corporation, corporate funds were used to redeem personal jewelry of second shareholder, and the senior secured creditor would remain fully collateralized if it encountered any difficulties upon being required to resort to the guaranty to satisfy its claim.⁸

Simply put, the central theme toward the generally recognized exceptions to the marshaling doctrine is that an equityholder's bad acts toward the debtor may shift the equitable considerations of a court. However, absent engaging in conduct arising to the level of fraud or breach of fiduciary duty, most courts will generally not allow a junior creditor to force a senior creditor to collect on the guarantor's assets before reducing liability through collection from the debtor's estate.

Eighth Circuit's Special Exception to the "Common Debtor" Requirement

Two jurisdictions have adopted their own special exceptions to the elements for marshaling and warrant particular

scrutiny by any guarantor that might find themselves in the crosshairs of these outlier opinions.

First is the Eighth Circuit with its decision in *In re Jack Green's Fashions for Men — Big & Tall Inc.*⁹ and its progeny.¹⁰ In *In re Jack Green's*, the court's application of marshaling required a bank to foreclose on real estate pledged as collateral by the debtor's principals used to guarantee loans.¹¹ By doing so, the court's theory effectively converted the surety's pledge into a fund of the debtor. The Eighth Circuit stated that bankruptcy courts:

are courts of equity and may apply the doctrine of marshaling in proper cases.... In this case, it would be in the highest degree inequitable to allow the Bank to exhaust the business assets of the corporate bankrupt without first looking to the real estate mortgaged to it. To permit such a course would leave the general creditors of the business with nothing.¹²

In so ruling, the Eighth Circuit, in contravention of the previously discussed elements, marshaled collateral for the benefit of the debtor's general unsecured creditors (*i.e.*, not a junior *secured* creditor) and, in direct contravention of the "common debtor" requirement, without any showing of attendant *bad acts*. Under this standard, a court could argu-

⁸ This second exception is not without its critics, and various courts have criticized the exception as improperly extending the traditional scope of the marshaling doctrine. See *In re Corso Stein Enters. Inc.*, 79 B.R. 584 (Bankr. D.N.J. 1987) (rejecting this theory); *In re Robert E. Derektor of Rhode Island Inc.*, 150 B.R. 296 (Bankr. D.R.I. 1993) (citing cases critical of this theory).

⁹ *In re Jack Green's Fashions for Men — Big & Tall Inc.*, 597 F.2d 130 (8th Cir. 1979).

¹⁰ See, e.g., *Matter of Clary House Inc.*, 11 B.R. 462 (Bankr. W.D. Mo. 1981).

¹¹ *Id.*

¹² *In re Jack Green's Fashions for Men — Big & Tall Inc.*, 597 F.2d 130, at 133.

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The International Scene

BY STEVEN WEISZ AND DILINA LALLANI

SCC Clarifies Corporate Attribution Rules in Reviewable Transactions in Bankruptcy and Insolvency Cases

On Oct. 11, 2024, the Supreme Court of Canada (SCC) rendered a decision clarifying the doctrine of corporate attribution in the bankruptcy and insolvency context. This decision will have far-reaching and wide application in Canada that will guide lower courts in considering issues related to reviewable transfers by insiders — similar to the avoidance of preferences and fraudulent transfers in the U.S. — and the remedies that are available to creditors, monitors and trustees to attack transactions and recover assets or funds improperly removed from an insolvent estate.

*Aquino v. Bondfield Construction Co.*¹ involved a dispute regarding the recovery of money by a trustee and monitor of two companies on the basis that certain transactions were transfers at undervalue under the Bankruptcy and Insolvency Act (BIA).² In *Aquino*, the parties disagreed as to whether the companies met the requisite test of intent to establish a transfer at undervalue, and whether the intent of a directing mind of the companies could be attributed to the companies under the doctrine of corporate attribution. The SCC found that the directing mind of the companies met the requisite intent for a transfer at undervalue and that the doctrine of corporate attribution must be applied purposively, contextually and pragmatically to give effect to the policy of the law under which attribution is sought.

Aquino provides guiding principles for when the actions, knowledge, state of mind or intent of the directing mind of a corporation may be attributed or imputed to the corporation. These principles have provided flexibility to address most — if not all — situations of corporate attribution. The principles in *Aquino* have since been applied by the SCC in *Scott v. Golden Oaks Enterprises Inc.*³ to confirm that such principles also apply to one-person corporations.

A Look at the Doctrine of Corporate Attribution

The doctrine of corporate attribution permits courts to impute the actions or intent of the directing mind of a corporation to the corporation itself. In Canada, the doctrine was developed by the SCC in the context of corporate criminal liability in *Canadian Dredge & Dock Co. v. The Queen*⁴ and civil liability in *Deloitte & Touche v. Livent Inc. (Receiver of)*,⁵ and *Christine DeJong Medicine Professional Corp. v. DBDC Spadina Ltd.*,⁶ which established the following general principles:

1. A person's fraudulent acts may be attributed to a corporation if two conditions are met: (a) the wrongdoer was the directing mind of the corporation at the relevant times; and (b) the wrongful actions of the directing mind were performed within the sector of corporate responsibility assigned to them.
2. Attribution will generally be inappropriate when (a) the directing mind acted totally in fraud of the corporation (the fraud exception), or (b) the directing mind's actions were not by design or result partly for the benefit of the corporation (the no benefit exception).
3. In addition to the fraud and no-benefit exceptions, courts have discretion to refrain from attributing the actions, knowledge, state of mind or intent of the directing mind to the corporation when this would be in the public interest, in the sense that it would promote the purpose of the law under which attribution is sought.
4. Courts must apply the common law corporate-attribution doctrine purposively, contextually and pragmatically. The corporate attribution doctrine is not a "standalone principle"; there is no one-size-fits-all approach. Courts must always determine whether a person's actions, knowledge, state of mind or intent should be treated as those of the corporation for the purpose of the law under which attribution is sought. This might require the court to tailor the



Steven Weisz
Cozen O'Connor
Toronto



Dilina Lallani
Cozen O'Connor
Toronto

Steven Weisz is a member, and Dilina Lallani is an associate, with Cozen O'Connor in Toronto.

¹ *Aquino v. Bondfield Construction Co.*, 2024 SCC 31.

² Bankruptcy and Insolvency Act, RSC 1985, c B-3 at § 96. In Canada, trustees and monitors are court officers who administer claims in a company's estate.

³ *Scott v. Golden Oaks Enters. Inc.*, 2024 SCC 32.

⁴ *Canadian Dredge & Dock Co. v. The Queen*, 1985 CanLII 32 (SCC).

⁵ *Deloitte & Touche v. Livent Inc. (Receiver of)*, 2017 SCC 63.

⁶ *Christine DeJong Med. Prof'l Corp. v. DBDC Spadina Ltd.*, 2019 SCC 30.

general rule of attribution or its exceptions to the particular legal context. Attribution may be appropriate for one purpose in one context but may be inappropriate for another purpose in another context.⁷

Background

Bondfield Construction Co. Ltd. and its affiliate, Forma-Con Construction (together with Bondfield, the “companies”) worked on large-scale construction projects. John Aquino was the president and directing mind of the companies.

The companies entered into restructuring and bankruptcy proceedings for Bondfield and Forma-Con Construction, respectively. The monitor and trustee determined that Aquino had fraudulently taken tens of millions of dollars from the companies through a false invoicing scheme. The monitor and trustee challenged the transactions and applied to the Ontario Superior Court of Justice to recover the monies under § 96(1)(b)(ii)(B) of the BIA on the basis that the false invoice transactions were transfers at undervalue.

A transfer at undervalue is defined under the BIA as a “disposition of property or provision of services for which no consideration is received by the debtor or for which the consideration received by the debtor is conspicuously less than the fair market value of the consideration given by the debtor.”⁸ Section 96 of the BIA permits a trustee to apply to the court to declare a transfer at undervalue as void or order that the party to the transfer pay to the estate the difference between the value of the consideration received by the debtor and the value of the consideration given by the debtor. Section 96(1)(b)(ii)(B) of the BIA permits a trustee to apply to the court to recover money from a non-arm’s-length party as a result of a transfer at undervalue if the trustee can demonstrate that the debtor intended to “defraud, defeat or delay a creditor.” The same is permitted to a monitor during restructuring proceedings under § 36.1 of the Companies’ Creditors Arrangement Act.⁹

The Ontario Superior Court of Justice held that the false invoice payments were transfers at undervalue and the amounts were recoverable. The Ontario Superior Court of Justice found that (1) the companies made these payments with the intent to defraud, defeat or delay a creditor; (2) it could not be accepted that the companies could not have met the requisite intent because they were not insolvent or at risk of insolvency when the payments were made; (3) several badges of fraud were established to demonstrate that Aquino had fraudulent intent when the false invoice payments were made; (4) Aquino’s fraudulent intent could be attributed to the companies; and (5) the doctrine of corporate attribution established in *Canadian Dredge* did not apply under § 96 of the BIA.

The court of appeal dismissed the appeal and affirmed the decision that Aquino had intended to defraud, defeat or delay the companies, and attributed Aquino’s fraudulent intent to the companies under the BIA. The court of appeal commented that the doctrine of corporate attribution has been historically addressed in the criminal and civil context, but differs from the bankruptcy context.

The SCC’s Analysis

The court of appeal’s decision was appealed to the SCC. The key question was whether the trustee and monitor established the companies’ intent to defraud, defeat or delay a creditor under § 96(1)(b)(ii)(B) of the BIA. To do this, the SCC must first determine whether the evidence established Aquino’s intent to defraud, defeat or delay a creditor, then determine whether his intent should be attributed to the companies.

Intent to Defraud, Defeat or Delay a Creditor Under the BIA

The appellants argued that the application judge made an extricable error of law in finding that the companies intended to defraud, defeat or delay a creditor because the companies paid their creditors in full and on time, and because the court could not determine the companies’ financial position at the time. The appellants claimed that the SCC should have remitted the case to the application judge with instructions to determine the companies’ financial condition at the time of the transfers. The SCC rejected the appellants’ submission

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⁷ *Supra* n.1 at ¶ 82 (citing *Canadian Dredge* at pp. 712-13 and pp. 681-82; *Livent* at ¶¶ 97, 100, 102-104; *DeJong* at ¶ 2).

⁸ *Supra* n.2 at § 2.

⁹ Companies’ Creditors Arrangement Act, RSC 1985, c C-36 at § 36.1.

BY NICOLE HUGHES AND JEPH LEDDA

Navigating Corporate Transparency Act Requirements as Trustees

Since its enactment, the Corporate Transparency Act (CTA) has caused confusion for business entities and their beneficial owners regarding the necessary filing and compliance requirements. Among bankruptcy trustees, there also exists a high level of uncertainty about how to navigate the reporting requirements and penalties in their roles as fiduciaries for insolvent companies. Until more guidance becomes available, trustees can benefit from understanding what the CTA entails and requires, as well as an overview of the questions and issues it raises, and how it impacts their role as fiduciaries for reporting companies undergoing bankruptcy.



Nicole Hughes
Telpner Peterson
Law Firm, LLP
Council Bluffs, Iowa



Jeph Ledda
Stretto; Irvine, Calif.

Nicole Hughes is the managing partner with Telpner Peterson Law Firm, LLP in Council Bluffs, Iowa. Jeph Ledda is a director with Stretto in Irvine, Calif.

The CTA's History and Overview

The CTA was adopted by Congress on Jan. 1, 2021, as a bipartisan act to amend the Bank Secrecy Act, which was originally created to deter money-laundering activities, tax evasion, corruption and other financial crimes. It went into effect on Jan. 1, 2024,¹ and created new reporting requirements for a wide range of entities that must report beneficial ownership and registrant information to the U.S. Department of the Treasury's Financial Crimes Enforcement Network (FinCEN) in order to identify beneficial owners: those who exercise substantial control over the reporting company or individuals who own or control at least 25 percent of the reporting company's ownership interests.

Reporting companies include any entity created as a corporation or limited liability company, or any entity created by filing a document with the Secretary of State or any similar office under the law of a state or Indian tribe. Similar entities created under the laws of foreign countries and registered as businesses in the U.S. or any tribal jurisdiction also must comply with the CTA's reporting rules. The required information for inclusion in the report includes the company's legal name; trade name, such as a d/b/a; current street address of place of business (no mailing address or P.O. box); jurisdiction of formation; and the company's EIN/TIN and personal identifying information for each beneficial owner, including full legal name, birth date, legal address, an identifying number from a driver's

license, passport or other approved legal documents, and a photograph of that document.

Exemptions to the CTA reporting requirements apply to 23 types of entities, which include banks, credit unions, money-services businesses, registered broker-dealers, government authorities, exchanges and clearing agencies, insurance companies, public utilities and accounting firms, among others. Generally, if a business entity is already regulated, it is likely to be considered exempt. Tax-exempt organizations such as 501(c)(3) or political entities also are exempt, as well as large, U.S.-based operating companies with more than 20 full-time employees and more than \$5 million in gross receipts, and that maintain a physical presence at a business office in the U.S.

Companies formed before Jan. 1, 2024, had been permitted to file reports by Jan. 1, 2025. Entities that were formed and registered in 2024 had been required to file the necessary reporting within 90 days. Beginning Jan. 1, 2025, the deadline for filing the required report has been accelerated to 30 days after formation. If any corrections need to be made to the filing, the applicant must file them within 30 days of becoming aware of them. There also is a 30-day deadline to report any changes to beneficial ownership, including a change of address; renewal of a driver's license or passport; ceasing to be the beneficial owner due to death, sale of the business or bankruptcy; the addition of a beneficial owner through marriage, bankruptcy or assignment; or if the company becomes eligible or ineligible for an exemption.

For U.S. bankruptcy trustees, FinCEN issued a clarification on July 8, 2024, that entities ceasing to exist before Jan. 1, 2024, were not required to comply with the beneficial ownership information reporting rules. However, companies that were not formally dissolved before Jan. 1, 2024, were held to the requirements — even if they were dissolved before the deadline of the initial beneficial ownership information report.

Significant penalties apply for beneficial owners who are not compliant with the reporting requirements. When the violation continues or has not been remedied, beneficial owners can be fined \$591 per day and up to \$10,000. In addition, they risk legal penalties that can lead to sentencing of up to two years in prison. These same fines apply as a result of failing to file reporting of initial ownership information or for reporting changes and inaccuracies.

¹ 31 U.S.C.A. § 5336; see 31 C.F.R. § 1010.380.

It should be noted that these fines are most likely not dischargeable within bankruptcy.²

Questions and Challenges Presented by the CTA

While the CTA was enacted more than a year ago, questions remain for bankruptcy trustees regarding their roles in complying with the filing requirements under the CTA. When an entity files for bankruptcy, the trustee steps into the corporation's shoes but might not have the resources or access needed to fulfill the required reporting and related responsibilities. As of December 2024, further guidance is needed to assist trustees in determining the role they are expected to play as fiduciaries for reporting companies undergoing bankruptcy.

Among the challenges and questions raised by the CTA is the limited access to information required for beneficial ownership reporting. As a company undergoes bankruptcy, it is not an easy task to obtain personal identifying information for each person who owns 25 percent of the company. Ideally, these individuals should participate in the process by directly reporting personal information themselves.

Bankruptcy trustees must also contend with time constraints in their role as fiduciaries. With an added responsibility on top of their other duties, tracking down the necessary information for beneficial ownership reporting can be a significant time and cost burden.

Interestingly, litigation is underway challenging the CTA's constitutionality in at least six pending lawsuits around the U.S. On Dec. 3, 2024, the U.S. District Court for the Eastern District of Texas issued a preliminary injunction finding the CTA likely to be unconstitutional.³ The court ruled that it was a nationwide injunction, enjoining the CTA's enforcement and its impending Jan. 1, 2025, filing deadline.

As a result, FinCEN confirmed on Dec. 7, 2024, that reporting companies were not required to file beneficial ownership reporting while the nationwide injunction remains in place, and that reporting companies will not be penalized if they do not file these reports.

A turn of events at the end of December 2024 seemingly changed the course of this decision, but then reinstated it. On Dec. 23, 2024, the U.S. Court of Appeals for the Fifth Circuit struck down the injunction that paused the CTA's enforcement, once again requiring that business entities formed prior to 2024 submit beneficial ownership reporting by Dec. 31, 2024.

In response, FinCEN provided deadline extensions for reporting companies according to their formation dates. However, on Dec. 26, 2024, the Fifth Circuit entered an order "at the direction of the Court" that vacated the stay and again put the CTA's reporting requirements on hold.⁴

³ *Texas Top Cop Shop Inc. v. Garland*, 2024 U.S. Dist LEXIS 218294 (E.D. Tex. Dec. 3, 2024).
⁴ This information is current as of Jan. 8, 2025.

² 11 U.S.C. § 523(a)(7).

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Turnaround Topics

BY DOUGLAS J. BRICKLEY, JEFFREY GRANELL AND JOEL E. COHEN¹

The Impact of Regulators on Asset Sales Under a § 363 Process



Douglas J. Brickley
Stout Risius Ross,
LLC; Houston



Jeffrey Granell
Stout Risius Ross,
LLC; Miami



Joel E. Cohen
Stout Risius Ross,
LLC; New York

Douglas Brickley is a managing director with Stout Risius Ross, LLC in Houston. Jeffrey Granell is a director in the firm's Miami office. Joel Cohen is a managing director in and leader of the firm's New York office.

Section 363 sales under the Bankruptcy Code are designed to facilitate the sale of assets free and clear of existing liens and encumbrances. This legal provision offers companies a streamlined process to divest assets, enabling them to generate much-needed liquidity while addressing financial obligations. The sale of assets under § 363 also provides a mechanism to generate value back to interested parties and creditors during the bankruptcy process.

The expectation is that such sales can proceed without the usual encumbrances that might otherwise hinder asset transfers. However, this process is not always immune to external challenges. Regulatory bodies may intervene, could assert their authority and could raise concerns that can complicate the transaction.

This article explores two notable examples where regulatory opposition emerged during § 363 sales. These case studies serve as reminders of the importance of anticipating regulatory scrutiny and preparing for possible impediments when pursuing asset sales through the § 363 process. Both have commentary related to the specifics of these matters and do not indicate predictions for other scenarios with separate facts and circumstances.

Reasons that Regulators May Intervene

Regulators may utilize their right to oppose a § 363 sale for several reasons, primarily related to their mandate to protect public interests and ensure compliance with legal and regulatory standards. There are three common reasons.

Public Safety Concerns

Regulators may oppose a § 363 sale if they believe that the transaction could compromise public safety. For example, if the assets being sold include such critical infrastructure as utility lines or facilities that require ongoing maintenance and oversight, regulators might be concerned that the buyer lacks the capability of or commitment to maintaining safety standards.²

Service Reliability and Continuity

In cases where the assets are integral to public utilities or other essential services, regulators might scrutinize the buyer's ability to uphold service levels. A possible fear is that the sale could lead to disruptions, reduced service quality or inadequate investment in infrastructure, which could negatively affect consumers.³

Protecting Ratepayer Interests

Regulators often have a duty to protect the financial interests of consumers, particularly in such sectors as utilities, where services are provided at regulated rates. If a § 363 sale is perceived to result in higher costs for consumers or unfair financial burdens, regulators may intervene. They could be concerned that the new owner might seek to increase rates to recoup their investment or fail to invest sufficiently in maintaining or improving services, thereby negatively impacting ratepayers.⁴

Case Study 1: Polaris

Polaris Operating LLC was a privately held independent oil and gas company focused on acquiring, optimizing and developing conventional oil and gas properties with redevelopment and new development opportunities. Its core area of operations was in the Texas Panhandle, where they owned and operated hundreds of shallow oil and gas wells with a significant amount of infrastructure, including gathering systems, power lines, disposal wells, workover rigs and water trucks.

Polaris faced significant financial headwinds and filed for bankruptcy on July 28, 2023, in the U.S. Bankruptcy Court for the Southern District of Texas.⁵ Polaris planned to sell its assets, which included both producing and nonproducing wells under a § 363 sale process. However, the complexity of the asset portfolio, which included nonoperational wells needing significant investment for compliance, posed substantial challenges.

Impact of Regulators

The Railroad Commission of Texas (RRC) is the state agency that regulates the oil and gas industry, gas

¹ The information provided in this article is for general informational purposes only and does not constitute legal or tax advice. For disclosure purposes, the authors' firm provided financial-advisory and expert-witness services in the *Polaris Operating LLC* case discussed herein.

² David E. McNabb, "Chapter 1: Public utilities: essential services, critical infrastructure," *Public Utilities, Second Edition* (Elgar Publishing 2016), pp. 3-18.

³ *Id.*

⁴ *Id.*

⁵ Case No. 23-3281.

utilities, pipeline safety in the liquefied petroleum gas industry, and surface coal and uranium mining. Prior to and during bankruptcy, Polaris was subject to the rules and regulations of the state agency to continue operating oil-producing wells. Further, to transfer assets in a § 363 sale, Polaris was required to have a current P-5 Organization Report, which is the registration that an operator makes with the commission if they plan on conducting business within the jurisdiction of the RRC.

During the bankruptcy, the RRC determined that the P-5 Organization Report for Polaris could not be renewed because it had not complied with the inactive well requirements of Statewide Rule 15. RRC Statewide Rule 15 was adopted in 2010 to address the growing inventory of inactive wells and surface equipment clean-up and removal based on the length of time that a well has been reported as being shut in.⁶

The rule requires operators to address their inactive wells by restoring the wells to active status, plugging the wells, or obtaining plugging extensions for wells that have future utility.⁷ In Polaris's case, considerable financial resources would have been required to plug and abandon (P&A) all of the inactive wells to comply with Statewide Rule 15. Furthermore, the use of the estate funds was governed by the cash-collateral order, and funds had not been approved or allocated to P&A wells, as Polaris had no intentions of continuing as an operator; they intended to sell all assets in bankruptcy.

On July 19, 2024, an application by Polaris was brought before an administrative law judge (ALJ) with the RRC's Hearings Division contesting the RRC's determination that the P-5 Organization Report for Polaris could not be renewed. Expert testimony was solicited regarding Polaris's financial state, its intention to sell the oil-producing assets, the lengths that Polaris took to address well violations (excluding P&A obligations), and the implications of regulatory requirements on the sale of assets.

The expert witness's testimony highlighted the challenges that Polaris faced, particularly concerning compliance with the RRC's regulations, which included addressing well violations prior to the asset transfer. The expert illuminated the financial impracticalities of resolving all violations and the potential impact on Polaris Operating's ability to execute a successful asset sale.

Current Status of the Case

During the proceedings, Polaris sought an extension to address the violations or a reconsideration of the necessity to resolve these issues given their intention to transfer, rather than operate, the assets. While the RRC seemed to understand the challenges resulting from Polaris Operating's bankruptcy and its liquidity constraints, the applicable statutory framework does not allow for such an extension or merit-based exception.

The ALJ did not immediately issue a written opinion upon conclusion of the hearing. During the period between the conclusion of the hearing and the revocation of the P-5 Organization Report, Polaris was able to complete the asset sale transaction.

Case 2: Pacific Gas & Electric

PG&E Corp. is a holding company headquartered in San Francisco. It is the parent company of Pacific Gas and Electric Co. (PG&E), an energy company that serves 16 million Californians across a 70,000-square-mile service area in Northern and Central California. PG&E Corp. and the utility are separate entities with distinct creditors and claimants, and they are subject to separate laws, rules and regulations.⁸

PG&E filed for chapter 11 protection in January 2019, which was primarily driven by PG&E's billions of dollars in liabilities resulting from a series of devastating wildfires in California. This severely impacted PG&E's financial stability and necessitated a comprehensive restructuring plan.

Asset-Sale Details

To generate funds to address its debts and obligations related to wildfire liabilities, PG&E proposed a strategic asset sale. In late April 2024, PG&E announced its intention to sell certain assets to KKR, a prominent global investment firm.

⁸ "PG&E Files for Reorganization Under Chapter 11," PG&E Corp. (Jan. 29, 2019).

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⁶ Railroad Commission of Texas Statewide Rule 15, Thompson & Knight (Feb. 1, 2011).

⁷ *Id.*

BY DARA LEVINSON SILVEIRA¹

I Can See Clear(I)y Now

Sub V Filings Following § 523(a)'s Application to Corporate Debtors

The Small Business Reorganization Act of 2019, through which Congress created subchapter V of chapter 11 of the Bankruptcy Code, aims to “streamline the bankruptcy process by which small business debtors reorganize and rehabilitate their financial affairs”² in order to allow those debtors to remain in business.³ To that end, subchapter V contains provisions intended to make small business bankruptcy cases faster and less expensive than traditional chapter 11 cases, such as an abbreviated plan-confirmation timeline and the elimination of creditors’ committees. Subchapter V also generally favors small business owners because it eliminates the absolute-priority rule, such that they can retain equity at the successful conclusion of a case.

However, recent appellate decisions have introduced a distinctly creditor-friendly element into subchapter V. In *In re Cleary Packaging LLC*⁴ and *In re GFS Industries LLC*,⁵ the U.S. Courts of Appeals for the Fourth and Fifth Circuits, respectively, ruled that the nondischargeability provisions of § 523(a) — which, in a regular chapter 11, only apply to individual debtors except in very limited circumstances — apply to corporate debtors confirming nonconsensual plans.

What does this mean for potential small business debtors? Does the threat of postconfirmation litigation scare them away from subchapter V?

Statutory Framework

Under subchapter V, if a plan is confirmed nonconsensually, all debts specified in § 1141(d)(1)(A) are discharged except any debt “of the kind specified in section 523(a) of this title.”⁶ Section 523(a) reads, in relevant part, that a “discharge under section 727, 1141, 1192, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor”⁷ from enumerated types of debts.

Cleary Packaging and GFS Industries

In *Cleary Packaging*, decided in June 2022, the Fourth Circuit overturned a bankruptcy court opinion that had dismissed a nondischargeability complaint against a corporate debtor; the Fourth Circuit ruled that § 523(a) applies to corporate debtors and individual debtors.⁸ Basing its holding on the canons of statutory interpretation,⁹ other Bankruptcy Code discharge provisions,¹⁰ and an analysis of policy and equitable factors,¹¹ the Fourth Circuit “recognize[d] a certain lack of clarity” in the interplay between §§ 523(a) and 1192(2),¹² but read the two provisions to mean that

while § 523(a) does provide that discharges under various sections, including § 1192 discharges, do not ‘discharge an individual debtor from any debt’ of the kind listed, § 1192(2)’s cross-reference to § 523(a) does not refer to any *kind of debtor* addressed by § 523(a) but rather to a *kind of debt* listed in § 523(a).... Thus, we conclude that the debtors covered by the discharge language of § 1192(2) — *i.e.*, both individual and corporate debtors — remain subject to the 21 kinds of debt listed in § 523(a).¹³

In 2022 and 2023, the Ninth Circuit Bankruptcy Appellate Panel (BAP)¹⁴ and several bankruptcy



Dara Levinson Silveira
Keller Benvenuti
Kim LLP
San Francisco

Dara Levinson Silveira is a partner with Keller Benvenuti Kim LLP in San Francisco. Her practice focuses on complex bankruptcy litigation, including preference and fraudulent-transfer adversary proceedings.

1 The author thanks Alice Giang, an associate with Keller Benvenuti Kim LLP, for her assistance with this article.

2 H.R. Rep. No. 116-171, at 1, 5 (2019).

3 *Id.* at 4.

4 *Cantwell-Cleary Co. v. Cleary Packaging LLC (In re Cleary Packaging LLC)*, 36 F.4th 509 (4th Cir. 2022).

5 *Avion Funding LLC v. GFS Indus. LLC (In re GFS Indus. LLC)*, 99 F.4th 223 (5th Cir. 2024).

6 11 U.S.C. § 1192(2).

7 11 U.S.C. § 523(a) (emphasis added).

8 *Cantwell-Cleary Co. v. Cleary Packaging LLC (In re Cleary Packaging LLC)*, 36 F.4th 509 (4th Cir. 2022).

9 *Id.* at 513.

10 The Fourth Circuit analyzed chapter 11’s and 12’s discharge provisions. As to the former, the Fourth Circuit noted that § 1141(d)(6) excludes certain debts from discharge for corporate debtors, which it found irreconcilable with the debtor’s argument that the list of exceptions to discharge in a traditional chapter 11 proceeding would apply only to individuals by virtue of § 523(a)’s limiting language. *Id.* at 516. As to the latter, the Fourth Circuit found § 1228(a) to be “virtually identical” to § 1192(2). Courts analyzing § 1228(a) have concluded that its exceptions to discharge apply to both individual and corporate debtors, and “[i]dential words and phrases within the same statute should normally be given the same meaning.” *Id.* at 516 (citing *Sw. Ga. Farm Credit ACA v. Breezy Ridge Farms Inc. (In re Breezy Ridge Farms Inc.)*, Bankr. No. 08-12038-JDW, Adv. No. 09-01011-JDW, 2009 Bankr. LEXIS 1396 (Bankr. M.D. Ga. May 29, 2009); *New Venture P’ship v. JRB Consol. Inc. (In re JRB Consol. Inc.)*, 188 B.R. 373 (Bankr. W.D. Tex. 1995); quoting *Hall v. United States*, 566 U.S. 506, 519 (2012)).

11 *In re Cleary Packaging LLC*, 36 F.4th at 517 (“Given the elimination of the absolute-priority rule, Congress understandably applied limitations on the discharge of debts to provide an additional layer of fairness and equity to creditors to balance against the altered order of priority that favors the debtor. To this end, all Subchapter V debtors are textually subject to the discharge limitations described in § 523(a), not just individual Subchapter V debtors. To make a distinction between individuals and corporations for how Subchapter V is applied would not only undermine that balance, but would also make no sense and indeed would create perverse incentives.”).

12 *Id.* at 513.

13 *Id.* at 515 (emphasis added).

14 *Lafferty v. Off-Spec Sols. LLC (In re Off-Spec Sols. LLC)*, 651 B.R. 862, 867 (B.A.P. 9th Cir. 2023).

courts¹⁵ declined to follow *Cleary Packaging* and dismissed nondischargeability complaints against corporate debtors. The Ninth Circuit BAP ruled that “[s]ection 523(a) unambiguously applies only to individual debtors. The reference in § 1192 to debts ‘of the kind specified in section 523(a)’ can reasonably be construed to mean the list of debts, but nothing in § 1192 obviates the express limitation in the preamble of § 523(a) or otherwise expands its scope to corporate debtors.”¹⁶ The Ninth Circuit BAP analyzed the plain language of §§ 1192(2) and 523(a) and relevant canons of statutory interpretation,¹⁷ looked at the context of the two provisions within the Code,¹⁸ and conducted an equity and policy analysis.¹⁹

In April 2024, the Fifth Circuit entered the fray with *GFS Industries*, ruling with the Fourth Circuit that corporate subchapter V debtors are subject to § 523(a)’s nondischargeability provisions.²⁰ After *GFS Industries*, bankruptcy courts

facing the issue have followed it and *Cleary Packaging*, even though they are not binding on them.²¹

On Nov. 14, 2024, the U.S. District Court for the Northern District of Illinois reversed a bankruptcy court dismissal of a nondischargeability complaint and closely followed the reasoning of the Fourth and Fifth Circuits.²² Echoing *GFS Industries*, the district court held that “the ‘most natural reading’ of § 1192(2) applies to exceptions to discharge in the paragraphs of § 523(a) to both corporate and individual debtors.”²³ As of November 2024, the issue remains on appeal in front of the U.S. Court of Appeals for the Eleventh Circuit.²⁴

The *Cleary Packaging* Rule’s Potential Impact on Corporate Sub V Debtors

The *Cleary Packaging* rule — which appears to be on its way to becoming the dominant interpretation nationwide —

¹⁵ *BenShot LLC v. 2 Monkey Trading LLC (In re 2 Monkey Trading LLC)*, 650 B.R. 521 (Bankr. M.D. Fla. 2023); *Nutrien Ag Sols. Inc. v. Hall (In re Hall)*, 651 B.R. 62 (Bankr. M.D. Fla. 2023); *Avion Funding LLC v. GFS Indus. (In re GFS Indus.)*, 647 B.R. 337 (Bankr. W.D. Tex. 2022), *rev’d*, 99 F.4th 223 (5th Cir. 2024); *Lafferty v. Off-Spec Sols. LLC (In re Off-Spec Sols. LLC)*, Bankr. No. 22-00346-NGH, Adv. No. 22-06020-NGH (Bankr. D. Idaho Jan. 18, 2023); *Primary Invs. Grp. Inc. v. RA Custom Design Inc. (In re RA Custom Design)*, Bankr. No. 23-58494-SMS, Adv. No. 23-05193-SMS, 2024 Bankr. LEXIS 343 (Bankr. N.D. Ga. Feb. 13, 2024).

¹⁶ *Off-Spec Sols. LLC*, 651 B.R. at 867.

¹⁷ *Id.* at 867, 870.

¹⁸ Upon establishment of the Bankruptcy Code in 1978, the Ninth Circuit BAP noted that Congress intentionally departed from pre-Code practice by eliminating exceptions to discharge for corporate debtors. Congress expressly limited the corporate discharge in chapter 11 once, with the enactment of § 1141(d)(6), and the BAP found it improbable that Congress had incorporated 19 new exceptions to discharge in this fashion and this quickly. *Id.* at 868-69.

¹⁹ *Id.* at 871-73.

²⁰ *Avion Funding LLC v. GFS Indus. LLC (In re GFS Indus. LLC)*, 99 F.4th 223, 229-32 (5th Cir. 2024).

²¹ *Ivanov v. Van's Aircraft Inc. (In re Van's Aircraft Inc.)*, Bankr. No. 23-62260-DWH, Adv. No. 24-06011-DWH, 2024 Bankr. LEXIS 1392 (Bankr. D. Ore. June 11, 2024); *Christopher Glass & Aluminum Inc. v. Premier Glass Servs. LLC (In re Premier Glass Servs. LLC)*, 661 B.R. 939 (Bankr. N.D. Ill. 2024).

²² *Chi. & Vicinity Laborers' Dist. Council Pension Plan v. R & W Clark Constr., Inc. (In re R & W Clark Constr. Inc.)*, No. 24 CV 1463, 2024 U.S. Dist. LEXIS 207230 (N.D. Ill. Nov. 14, 2024).

²³ *Id.* at *20.

²⁴ *BenShot LLC v. 2 Monkey Trading LLC (In re 2 Monkey Trading LLC)*, 650 B.R. 521 (Bankr. M.D. Fla. 2023), *certified for direct appeal to Eleventh Circuit*, Bankr. No. 22-04099-TPG, Adv. No. 23-00007-TPG, 2023 Bankr. LEXIS 1528 (Bankr. M.D. Fla. June 12, 2023), *leave for direct appeal granted*, Case No. 23-90009 (11th Cir. July 19, 2023), *notice of appeal filed*, Case No. 23-12342 (11th Cir. July 19, 2023).

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Clerk Commentary

BY ARIELLE JACOBS AND EVAN MILLER¹

No Stay for You! Section 362(n) and Its Impact on Small Business Cases

Filing a bankruptcy petition usually triggers the protections of the automatic stay, which prohibits most efforts to collect from the debtor.² Creditors seeking relief from the stay typically commence a contested matter, requiring motions and potential hearings.³ However, for creditors of small business debtors, a subsection buried deep in § 362 might be the key to bypassing that process altogether.

As part of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Congress enacted § 362(n) to curtail small business serial filings by denying certain debtors the benefit of the automatic stay.⁴ Section 362(n) applies to debtors who filed a prior chapter 11 case and chose to proceed as a “small business case,”⁵ which is distinct from an election to proceed under subchapter V of chapter 11.

Although the phrase “small business debtor” may apply to debtors regardless of their election to proceed under subchapter V,⁶ a “small business case” for purposes of § 362(n) only exists when the case is filed under chapter 11 and the small business debtor has not elected to proceed under subchapter V.⁷ Therefore, a debtor’s *prior* subchapter V case will not trigger § 362(n), but a *current* subchapter V case could be subject to § 362(n). Section 362(n) enumerates four circumstances, any of which may be met, that prevent the debtor from enjoying the protections of the automatic stay: if the debtor (1) files a bankruptcy petition while it is currently in a pending small business case;⁸ (2) was a debtor in a small business case that was dismissed in the two-year period before the debtor filed the second bankruptcy;⁹ (3) was a debtor in a small business case in which a plan was confirmed within the two-year period before the order for relief;¹⁰ or (4) acquired substantially all of an entity’s assets, and that entity fits the description of any of the debtors described in the first three subsections of § 362(n)(1).¹¹

Exceptions to the Exception

Section 362(n)(2) extends the stay to some debtors who might otherwise be vulnerable to collection actions under § 362(n)(1). First, the stay continues to benefit debtors who find themselves in a nonconclusive, involuntary bankruptcy,¹² but most cases discussing § 362(n) do not involve involuntary petitions because such petitions are exceedingly rare.¹³ The second exception could apply to more debtors but suffers from some ambiguities.

Nonetheless, the stay might protect the debtor if he or she can show that the filed petition was the result of circumstances the debtor could not control “at the time the case then pending was filed,”¹⁴ and the debtor is “more likely than not to confirm a nonliquidating plan within a reasonable period of time.”¹⁵ These sections provide “exceptions to the exception” that the automatic stay does not protect the debtor at the petition filing.¹⁶

Unfortunately, § 362(n)(2) is ambiguous. It is not entirely clear who is required to show that there is no collusion in an involuntary filing, or that a nonliquidating plan is likely to be confirmed in a reasonable amount of time.¹⁷ Although the debtor must show by a preponderance of evidence that the filed petition occurred due to circumstances beyond its control,¹⁸ the evidentiary standard is nestled in § 362(n)(2)(B)(i) and does not seem to apply to § 362(n)(2)(B)(ii).¹⁹ Two courts have held that § 362(n)(2) requires a debtor to show that a plan is confirmable in a reasonable amount of time,²⁰ but another court seemed



Arielle Jacobs
U.S. Bankruptcy
Court (W.D. Mo.)
Kansas City



Evan Miller
U.S. Bankruptcy
Court (D. Haw.)
Honolulu

Arielle Jacobs is a term law clerk to Hon. Cynthia A. Norton of the U.S. Bankruptcy Court for the Western District of Missouri in Kansas City. Evan Miller is a term law clerk to Hon. Robert J. Faris of the U.S. Bankruptcy Court for the District of Hawaii in Honolulu.

1 The views expressed in this article belong solely to the authors and do not reflect the views of Judges Faris and Norton.

2 See generally 11 U.S.C. § 362.

3 See 11 U.S.C. § 362(d).

4 151 Cong. Rec. H1993-01, 151 Cong. Rec. H1993-01, H2019, 2005 WL 856697.

5 11 U.S.C. § 362(n)(1)(A).

6 11 U.S.C. § 101(51D); Fed. R. Bankr. P. 1020.

7 11 U.S.C. § 101(51C).

8 11 U.S.C. § 362(n)(1)(A).

9 11 U.S.C. § 362(n)(1)(B).

10 11 U.S.C. § 362(n)(1)(C).

11 *Id.*

12 11 U.S.C. § 362(n)(2)(A).

13 Involuntary cases make up about 0.05 percent of all bankruptcy filings. Richard M. Hynes & Steven D. Walt, “Revitalizing Involuntary Bankruptcy,” 105 *Iowa L. Rev.* 1127, 1128 (2020). Non-§ 362(n) cases describe improper involuntary petitions. See, e.g., *In re Mi La Sul*, 380 B.R. 546, 556 (Bankr. C.D. Cal. 2007) (petitioning creditor sought to take advantage of other creditors with automatic stay); *In re Delray Assoc. Ltd. P’ship*, 212 B.R. 511, 515 (Bankr. D. Md. 1997) (orchestrated involuntary filing to modify confirmed plan); *F.D.I.C. v. Cortez*, 96 F.3d 50, 51 (2d Cir. 1996) (attempted to circumvent ban on filing).

14 11 U.S.C. § 362(n)(2)(B)(i).

15 11 U.S.C. § 362(n)(2)(B)(ii).

16 See generally 11 U.S.C. §§ 362(a), 362(n)(1).

17 *But see In re Tim Wargo & Sons Inc.*, 869 F.2d 1128, 1130 (8th Cir. 1989) (holding that petitioning creditor bore burden of proof that it was entitled to relief); *In re Xpedior Inc.*, 325 B.R. 392, 398 (Bankr. N.D. Ill. 2005) (stating that movant bears burden of proof in other contexts).

18 Courts are divided on whether the statute refers to the first filing or second filing. See *infra* n.22-24.

19 The inapplicability of the evidentiary standard to § 362(n)(2)(B)(ii) is clear from the statute’s use of the term “and” and placement of the provision in its own section.

20 *In re Brendan Gowing Inc.*, 661 B.R. 565, 570 (Bankr. S.D. Tex. 2024); *In re Abundant Life Worship Ctr. of Hinesville, GA Inc.*, No. 20-40959-EJC, 2020 WL 7635272, at *16 (Bankr. S.D. Ga. Dec. 16, 2020).

to undertake the factual inquiry into the likelihood of plan confirmation itself.²¹

The phrase “the case then pending was filed” in § 362(n)(2)(B)(i) has created additional confusion. Some parties argue that the language applies to the first small business bankruptcy case filed.²² Some courts have rejected this argument, citing the phrase “then pending” and holding that the first case cannot be “then pending” because it would have already been dismissed before the second case had been filed.²³ Nevertheless, other courts have held that § 362(n)(2)(B) applies to the first case filed.²⁴ As such, it is unclear whether the “circumstances beyond the control of the debtor not foreseeable at the time the case then pending was filed” refers to the first or second bankruptcy.

Case Study: Abundant Life

In re Abundant Life Worship Center of Hinesville, GA Inc. illustrates § 362(n)’s contours.²⁵ In this case, a church resorted to bankruptcy to thwart its creditor’s foreclosure sales.²⁶ Shortly after its first chapter 11 case had been dismissed, the church filed another chapter 11 petition.²⁷ Relying on § 362(n), the creditor completed its sale and sought a comfort order confirming that no stay was in effect before recording the sale.²⁸ After the creditor filed its motion, the church amended its petition and elected to proceed under subchapter V of chapter 11.²⁹

Examining the church’s prior bankruptcy case, the U.S. Bankruptcy Court for the Southern District of Georgia held that because the church was a debtor in a prior small business case that was dismissed within the two years preceding the order for relief, § 362(n) applied to the church’s case.³⁰ Further, the court held that the debtor must prove that unforeseen circumstances beyond its control arose in a separate case pending at the same time as the newly filed case to satisfy § 362(n)’s exception.³¹ According to the court, in the absence of two simultaneously pending cases, § 362(n)’s exception does not apply.³² Nevertheless, even if the exception had applied, the church failed to show unforeseen circumstances beyond the debtor’s control.³³

Finally, the church’s subchapter V election in its second case did not prevent § 362(n)’s applicability because the statute applies when the debtor’s *prior* case was a small business case — not its current case.³⁴ Therefore, because the debtor’s first case was a small business case, § 362(n) was applicable to the second case and the automatic stay did not apply.³⁵

When Does § 362(n)(2)(B) Apply?

Section 362(n) restores the automatic stay in some limited circumstances, but the circumstances that tend to accompany distressed small businesses are usually insufficient to meet § 362(n)(2)(B)’s exacting standards. Debtors often complain that the filing at issue occurred due to circumstances beyond their control.

In the U.S. Bankruptcy Court for the Northern District of Georgia, Hon. **Sage M. Sigler** in *In re Little Dollar* stated that a looming foreclosure is not a situation outside the debtor’s control, but a scam might be something that is beyond the debtor’s control and would mean that the automatic stay could arise despite the debtor meeting the criteria of § 362(n)(1).³⁶ In other cases, a lender enforcing a security interest and a congregation’s failure to approve a loan were insufficient to find that the filed petition was not the debtor’s fault.³⁷

If the petition is not a collusive, involuntary petition, and the debtor is not at fault for the filing, then the debtor still needs to show that the plan is not a liquidating plan and is likely to be confirmed.³⁸ This means that the stay may not apply if the debtor is trying to use the bankruptcy to sell a piece of property. A debtor that backs out of settlements may also find itself outside of § 362(n)(2)’s protection.³⁹ Courts want the debtor to reorganize and not to wait for financial fortunes to change.⁴⁰

Takeaways

For both debtor’s and creditors’ counsel, the most important preliminary inquiry is whether § 362(n) is applicable to the case. Debtor’s counsel should identify past bankruptcies and whether the debtor proceeded in chapter 11 as a small business case within the prior two years. In the event that the debtor meets those criteria, counsel should understand what pushed the debtor into bankruptcy, as some courts will inspect the circumstances of the first bankruptcy.⁴¹ Counsel should also be ready to defend the circumstances surrounding the second petition, in case the bankruptcy judge reads “the case then pending” as the second case.

Section 362(n) might apply, and the client might already be without protection of the stay. Without the stay, an attempt to formally rehabilitate the debtor in bankruptcy court might be futile, and *Little Dollar* is a good illustration of this issue.⁴² The debtor filed its first case *pro se* as a small business case, which was dismissed shortly thereafter.

21 *In re MCC Humble Auto Paint Inc.*, No. 12-33907-H3-11, 2012 WL 5471984, at *2 (Bankr. S.D. Tex. Nov. 9, 2012).

22 See, e.g., *Palmer v. Bank of the W.*, 438 B.R. 167, 169 (E.D. Wis. 2010) (reciting debtor’s argument that language “case then pending” applied to first small business bankruptcy).

23 *Id.*; *Abundant Life*, 2020 WL 7635272, at *13 (adopting reasoning in *Palmer*).

24 *In re Little Dollar*, ECF 24, Case No. 24-54559-SMS (Bankr. N.D. Ga. May 23, 2024).

25 *Abundant Life*, 2020 WL 7635272.

26 *Id.* at *3.

27 *Id.* at *7.

28 *Id.* at *7-8.

29 *Id.* at *8.

30 *Id.* at *10-11.

31 *Id.* at *13.

32 *Id.*

33 *Id.*

34 *Id.* at *18.

35 *Id.*

36 *In re Little Dollar*, ECF 24, Case No. 24-54559-SMS (Bankr. N.D. Ga. May 23, 2024).

37 *In re MCC Humble Auto Paint Inc.*, No. 12-33907-H3-11, 2012 WL 5471984, at *2 (Bankr. S.D. Tex. Nov. 9, 2012) (creditor enforced franchise agreement and security interest); *In re Abundant Life Worship Ctr. of Hinesville, GA Inc.*, No. 20-40959-EJC, 2020 WL 7635272, at *13 (Bankr. S.D. Ga. Dec. 16, 2020) (alleging that congregation did not approve church’s agreement to loan).

38 11 U.S.C. § 362(n)(2)(B)(ii). This assumes that the debtor has the burden of showing that a non-liquidating plan will be confirmed. See *supra* n.17-21.

39 *Abundant Life*, 2020 WL 7635272, at *16.

40 See, e.g., *In re MCC Humble Auto Paint Inc.*, No. 12-33907-H3-11, 2012 WL 5471984, at *2 (Bankr. S.D. Tex. Nov. 9, 2012) (debtor did not file plan in either case, only spoke with his parents about funding plan, and had no equity in estate assets).

41 See *supra* n.22-24.

42 *In re Little Dollar*, ECF 24.

continued on page 39

Student Gallery

BY CHRISTOPHER J. SHERLOCK

Chapter 9: A Potential Life Jacket for Municipalities Drowning in the Aftermath of Cyberattacks

On May 3, 2023, the City of Dallas fell victim to a crippling ransomware attack, highlighting the vulnerabilities in municipal cybersecurity. The attack paralyzed key public services for days, leaving residents to grapple with the effects.¹ All city websites went offline, disrupting communication channels. The court system shut down, delaying legal proceedings. Even the 311 hotline (a 24/7 call center for Dallas residents to find local services) was unusable, leaving residents without a means to address concerns.

The financial toll amounted to a staggering \$8.5 million in recovery costs.² As the city scrambled to restore systems, the incident highlighted the disastrous effects that cyberattacks have on municipalities. The Dallas ransomware attack serves as a reminder of the need for legal frameworks to protect municipalities against such devastating attacks.

Strangely enough, the Bankruptcy Code might offer a potential solution. While chapter 9 currently does not address cyberattack-related insolvency, this article identifies this gap in the Code and proposes two amendments to chapter 9 to aid municipalities recovering from such crises: (1) grant priority status to cyberattack-related debts; and (2) require that municipalities adopt a cybersecurity plan as a prerequisite to filing for chapter 9 if the insolvency was caused by a cyberattack.

Overview of Chapter 9

Chapter 9 filings are quite rare. There were only four chapter 9 filings in 2019, compared to nearly 500,000 chapter 7 and 300,000 chapter 13 filings.³ Chapter 9 bankruptcy provides aid to insolvent municipalities similar to that which chapter 11 provides to businesses. It serves as a framework for municipalities to restructure their

financial obligations while maintaining essential public service functions.⁴

To qualify for chapter 9 bankruptcy, the municipality must be insolvent, and it must be a “political subdivision or public agency or instrumentality of a State.”⁵ This includes such government entities as public schools, police departments and utilities. Further, the municipality must be expressly authorized to file for bankruptcy under state law.⁶

Upon filing a petition for relief under chapter 9, the municipality must propose a reorganization plan. It must demonstrate that the plan is in the best interests of the creditors and that it was negotiated in good faith.⁷ Further, under the feasibility test, the court must find that the municipality can meet its obligations moving forward and continue providing public services under the plan. If both requirements are met, the court confirms the reorganization plan.⁸

Rising Threat of Cyberattacks Against Municipalities

The most popular forms of cybercrime include data breaches and denial of service (DoS) attacks. Data breaches are a type of cyberattack where a hacker gains unauthorized access to data.⁹ Ransomware attacks are a type of data breach where, upon gaining unauthorized access to data, the hacker prevents the victim from accessing their computer.¹⁰ The hacker then offers to restore access upon receipt of a ransom payment. DoS attacks attempt to disrupt a targeted server or network by overwhelming it with fabricated internet traffic.¹¹ DoS hackers can effectively exhaust a target’s bandwidth by deploying one or more compromised computers to flood a server with activity.



Christopher J. Sherlock
LSU Paul M. Hebert
Law Center
Baton Rouge, La.

Christopher Sherlock earned a bachelor’s degree in accounting from Southeastern Louisiana University, and is currently in his third year of law school at the Louisiana State University Paul M. Hebert Law Center in Baton Rouge, La.

- 1 Jacob Vaughn, “5 Hacks by Dallas Ransomware Attackers,” *Dallas Observer* (May 31, 2023), dallasobserver.com/news/5-hacks-by-dallas-ransomware-attackers-16696367 (unless otherwise specified, all links in this article were last visited on Dec. 27, 2024).
- 2 Ken Kalthoff, “Dallas Pays Millions for Ransomware Expenses After May Attack,” *NBCDFW* (Aug. 9, 2023), nbcdfw.com/news/local/dallas-pays-millions-for-ransomware-expenses-after-may-attack/3313643.
- 3 “Bankruptcy Statistics Data Visualizations,” U.S. Courts, uscourts.gov/data-news/reports/statistical-reports/bankruptcy-filing-statistics/bankruptcy-statistics-data-visualizations.

4 *Collier on Bankruptcy* (l) (16th ed. 2024), 263.

5 11 U.S.C. §§ 101(40), 109(c).

6 11 U.S.C. § 109(c).

7 *Id.*

8 *Id.*

9 Matthew Kosinski, “What Is a Data Breach?,” *Int’l Bus. Machines* (May 24, 2024).

10 “Scams and Safety — Ransomware,” Fed. Bureau of Investigation, fbi.gov/how-we-can-help-you/scams-and-safety/common-frauds-and-scams/ransomware.

11 “Understanding and Responding to Distributed Denial-of-Service Attacks,” Cybersecurity and Infrastructure Sec. Agency (March 21, 2024), cisa.gov/sites/default/files/2024-03/understanding-and-responding-to-distributed-denial-of-service-attacks_508c.pdf.

Municipalities are prime targets for hackers because they often utilize outdated technologies and have access to large amounts of sensitive data, such as Social Security numbers and bank account information.¹² It is estimated that “more than 70 percent of all reported ransomware attacks in the U.S. target state and local governments.”¹³

A municipality recovering from a cyberattack faces a long list of expenses. The City of Atlanta incurred \$17 million in recovery costs following a ransomware attack in 2019.¹⁴ The bulk of the cost related to “clawing back the systems [that] the hackers had frozen” and implementing incident-response measures.¹⁵ In addition to recovery costs, cyberattacks force municipalities to address future risk through “resource-intensive coordination, procurement, and contracting efforts.”¹⁶ Since municipalities are largely ill-equipped to manage cyber risks independently, they are often forced to partner with private companies, which further drives up costs.¹⁷ Moreover, when a municipality suffers a cyberattack, the effects ripple to everyone that the municipality serves.

Individuals are arguably the most impacted as a result of a cyberattack against a municipality. Cyberattacks may completely disable such essential services as emergency-response systems, school systems and public utilities. Without functional emergency-response systems, people lose access to lifesaving care. If a school’s system is compromised and the school temporarily closes, hundreds of parents will have to find last-second child care or take time off from work. If a cyberattack disables public utilities, those affected will lose access to water and electricity. Simply put, cyberattacks against municipalities impact entire communities.

Proposed Amendments to Chapter 9 to Address Cybersecurity

One way that chapter 9 could be amended to address the growing threat of cybercrime is by granting priority status to cyberattack-related debts, elevating them above unsecured debts. Priority status is awarded to specific debts that Congress considers important, and what is more important than public welfare?¹⁸

Cyberattacks could leave municipalities scrambling to restore public services and repair compromised systems. Granting priority status to cyberattack-related debts would incentivize creditors to lend funds to municipalities recovering from a cyberattack, thus expediting recovery and enabling municipalities to focus resources on immediate recovery needs.

12 Robert Muggah & Marc Goodman, “Cities Are Easy Prey for Cybercriminals. Here’s How They Can Fight Back,” World Economic Forum (Sept. 30, 2019), [weforum.org/stories/2019/09/our-cities-are-increasingly-vulnerable-to-cyberattacks-heres-how-they-can-fight-back](https://www.weforum.org/stories/2019/09/our-cities-are-increasingly-vulnerable-to-cyberattacks-heres-how-they-can-fight-back).

13 *Id.* (citing Fleming Shi, “Threat Spotlight: Government Ransomware Attacks,” Barracuda (Aug. 28, 2019), blog.barracuda.com/2019/08/28/threat-spotlight-government-ransomware-attacks).

14 Luana Pasqu, “At \$17 Million, Atlanta Network Recovery Six Times More Expensive than Estimated,” Bitdefender (Aug. 8, 2018), [bitdefender.com/en-us/blog/hotforsecurity/at-17-million-atlanta-network-recovery-six-times-more-expensive-than-estimated](https://www.bitdefender.com/en-us/blog/hotforsecurity/at-17-million-atlanta-network-recovery-six-times-more-expensive-than-estimated).

15 Lily Hay Newman, “Atlanta Spent \$2.6M to Recover from a \$52,000 Ransomware Scare,” WIRE (April 23, 2018), [wired.com/story/atlanta-spent-26m-recover-from-ransomware-scare](https://www.wired.com/story/atlanta-spent-26m-recover-from-ransomware-scare).

16 Rowland Herbert-Faulkner, “The Transaction Costs of Municipal Cyber Risk Management,” UC Berkeley — Center for Long-Term Cybersecurity (April 2024), cltc.berkeley.edu/wp-content/uploads/2024/04/Transaction-Costs-of-Municipal-Cyber-Risk-Management.pdf.

17 *Id.*

18 11 U.S.C. § 507.

Further, because municipalities are primarily funded with tax dollars, accessing funds typically requires some legislative or administrative action (*e.g.*, budget allocation, bond issuance, etc.). This can be time-consuming and impractical in the aftermath of a cyberattack. For example, it took three months for the City of Baltimore to allocate funding to remediation efforts following a ransomware attack in 2019.¹⁹ The need for access to quick funds is most evident for municipalities that provide essential services such as public utilities, emergency response and law enforcement, because any delays in such cases have life-threatening consequences for residents.

Granting priority status to cyberattack-related debts ensures that municipalities have immediate access to critical funds necessary for recovery, such as hiring information-technology specialists, upgrading cybersecurity software and even covering the ransom payment. This amendment to the Bankruptcy Code would reflect the apparent threat of cybercrime by ensuring that municipalities can focus on restoring operations, instead of dealing with creditor disputes.

In addition, chapter 9 could be amended to require cyberattack-related debtors to adopt a comprehensive cybersecurity plan prior to filing. Consider the financial-literacy course requirement under chapters 7 and 13.²⁰ By requiring that debtors complete a financial-literacy course, the Code directly addresses the root cause of insolvency and reduces the likelihood of repeated filings.

Requiring municipalities to adopt a cybersecurity plan in chapter 9 filings likewise addresses the root cause of insolvency because it forces municipalities to take proactive steps to safeguard against future attacks, thus reducing the likelihood of repeated chapter 9 filings. The cybersecurity plan should require municipalities to provide specific measures that it will implement.

For example, the plan might include a promise to hire more information-technology staff, update security controls and conduct cybersecurity training for employees. Together, these proposed amendments integrate practical recovery mechanisms with proactive protective measures. Thus, adopting these proposed amendments would further align the Code with the fresh-start principles underlying bankruptcy.

Policy Implications

Amending chapter 9 to grant priority status to cyberattack-related debts is not only a practical solution, it also furthers the general policy of protecting public welfare. A single cyberattack can financially ruin a community. Ensuring that cyberattack-related debts have priority status empowers municipalities to reorganize their financial situations more effectively. As a result, municipalities will be better positioned to address operational failures and restore public services.

19 Ellen Cranley, “8 Cities that Have Been Crippled by Cyberattacks — and What They Did to Fight Them,” *Bus. Insider* (Jan. 27, 2020), [businessinsider.com/cyberattacks-on-american-cities-responses-2020-1](https://www.businessinsider.com/cyberattacks-on-american-cities-responses-2020-1) (subscription required to view article).
20 11 U.S.C. §§ 727(a)(11), 1328(g)(1).

Mediation Matters

BY LESLIE A. BERKOFF AND HON. JAMES J. TANCREDI

How Mindfulness Can Prevent Mediation Failures



**Coordinating Editor
Leslie A. Berkoff**
Moritt Hock
& Hamroff LLP
New York



**Hon. James J.
Tancredi**
U.S. Bankruptcy
Court (D. Conn.)
Hartford

Leslie Berkoff is a partner with Moritt Hock & Hamroff LLP in New York and chairs the firm's Dispute Resolution Practice Group. Hon. James Tancredi is a U.S. Bankruptcy Judge for the District of Connecticut in Hartford.

With an ever-increasing number of civil suits being filed each year in federal courts, coupled with the realities of the enormous costs and litigation risks, judges' case-management skills have been elevated to administer those cases in a meaningful and timely manner. The challenges posed for parties and courts by the volume and contours of civil litigation have pushed many to consider utilizing mediation to progress toward meaningful and timely resolutions.

The volume of cases pending in the federal courts is daunting, and the number of federal judges required for their due administration is ever-growing.¹ Total filings in U.S. district courts rose 18 percent to 405,878 in 2023.² Bankruptcy filings went up 13 percent to 433,658 in 2023.³ The preliminary statistics of the federal courts for 2024 bode for comparable or greater increases in such filings.⁴ As a result, an elementary and essential tool of modern-day litigation management is the referral to a mediation forum.

The federal courts have long moved beyond the notion that judges' constitutional functions are limited to mere judging. The Alternate Dispute Resolution Act of 1998⁵ unequivocally established the authority of federal judges to facilitate the settlement process through alternate-dispute resolution.⁶ U.S. courts have widely institutionalized voluntary or involuntary mediations before their judicial and nonjudicial colleagues as a gateway to enhancing rational dialogue and facilitating the narrowing of issues or the prompt resolution of disputes. Whether mediations are conducted in facilitative or evaluative modalities, their effectiveness in addressing growing dockets has become indisputable.

Despite such efficacy, disappointment for the parties sometimes looms in the mediation process

because of the ostensible failure to achieve settlements. This article examines some of the more significant reasons that mediations fail and raise the consciousness of the parties and the mediator as to dynamics that might be considered and addressed to enhance the power of reason, practicality and risk-management.

Timing/Ripeness

Although early intervention mediation can mitigate the dilemma of sunk costs of litigation that have drained settlement resources and fueled litigation frustrations, mediations will not be poised to succeed where the parties have not mustered basic facts and identified key legal issues. By encouraging or allowing for the voluntary exchanges of information, limited discovery or even proffers among the contenders, the parties and the mediator may ensure a leveling of the playing field necessary for an intelligent exchange on legal positions.

Equally important is an understanding of the range of outcomes that might be generated by unsettled law, which might fuel calculated risk assessments of outcomes. However, discernable splits in authority might require that central issues be briefed before the court or decided before polar positions are motivated to move beyond advocacy toward settlement. Timing is a primary consideration in structuring a successful mediation process.

Mediator Selection

The right mediator is the one who settles the case. Productive mediations are rooted in trust, competence, communication and affinity. Although many conventional cases might merely require an objective and impartial neutral to scrutinize the issues and facilitate a measured examination of them by the parties, litigations bound in complexities, personalities, backstories and emotions require strategic consideration in the selection of a mediator who might match the profile of the case and parties to enhance the operative human dynamics of this process.

These matching assessments invariably include whether a sitting judge, experienced practitioner, sector expert or neutral mediator will likely relate to the parties and disputes. Attorneys for parties need to consider not just the facts and issues in dispute, but their own clients and who may relate to or reach

1 See Suzanne Monyak, "House Passes Bill to Add Trial Judges Despite Veto Threat," Bloomberg Law (Dec. 12, 2024), news.bloomberglaw.com/us-law-week/house-passes-bill-to-add-trial-judges-despite-biden-veto-threat; see also Nate Raymond, "U.S. Judiciary's Leadership Laments Biden's Veto of Bill to Add Judges," Reuters (Dec. 24, 2024), reuters.com/legal/government/us-judiciarys-leadership-laments-bidens-veto-bill-add-judges-2024-12-24 (discussing U.S. federal judiciary's disappointment that Biden vetoed bill that would have added 66 new judges to understaffed federal courts). Unless otherwise specified, all links in this article were last visited on Dec. 27, 2024.

2 "Report: Judicial Business 2023," U.S. Courts, uscourts.gov/statistics-reports/judicial-business-2023.

3 *Id.*

4 *Id.*

5 28 U.S.C. §§ 654-658.

6 "Code of Conduct for United States Judges, Canon 4A(4)," Guide to Judiciary Policy (March 12, 2019), uscourts.gov/sites/default/files/code_of_conduct_for_united_states_judges_effective_march_12_2019.pdf; see also Fed. R. Civ. P. 16.

them in a productive manner. So, too, should each attorney consider a mediator who will be able to connect with and encourage the “other side” to move toward resolution — not just the attorney’s own individual client. Although issues of costs, availability and interest of the mediator could impact whether these considerations are practical, the failure to examine and act on these very human attributes can facilitate failures and disconnections in the mediation process.

Lack of Objective Sensitivities/ Zealous Advocacy

The mediation modality is usually calculated to measure the quantum of risks and costs of litigation. In contrast, our system of litigation, including its mantras, is structured around zealous professional advocacy calculated to “win.” This disjuncture can deprive the courtroom’s zealous advocate from the necessity of an objective business and risk assessment, only to ensure impasse in any dialogue. Both the authorized representative and lawyers handling the mediation must engage in the process with an attitude that hears and weighs the *bona fide* consideration of the opponent’s point of view. In that regard, trading the litigation team for a “settlement” team might enhance the prospects for success. Mediation is a time to put down the sword and courtroom bluster and refocus the lenses on potential paths to resolution and truly hear the other side to evaluate the risks and rewards of litigation.

Lack of Preparation by the Parties and Counsel

Professionalism and preparation are the critical disciplines that ensure that the mediator and parties’ counsel have reviewed the case, strategically assessed its merits and complied with the rules of engagement, including fulsome submissions to the mediator that are, if requested, provided to the other side in a timely fashion. Failure comes quickly and obviously when these measures are shortchanged. The parties and their counsel must put in the time to analyze the case and applicable case law and to perform a reasoned analysis of the same, as well as the other side’s submissions.

Equally important is preparing the client representative’s expectations, and reviewing and examining the best and worst outcomes to ease natural frustrations about progress. Clients should understand how the process itself works, especially the timing, the caucuses and the gaps in active participation or engagement with the mediator, so that they are not surprised and come prepared to spend the day effectively.

Lawyers committed to preparation should create opportunities for the mediator to understand client dynamics and business goals. Collaborative efforts to structure a mediation process consistent with other reasonable expectations that may have been overlooked (including institutional interests, a desire to testify or discuss matters with experts, or even a desire to explore other dimensions of business or interpersonal outcomes) might need advanced examination to understand the values that might not be obvious, but could hinder the process.

The enhancement of preparation exercises, including pre-mediation submissions, offline dialogues on key issues or

the consideration of possibly utilizing nonmonetary remedies (e.g., apologies and business contracts) might ensure that a failed-but-promising linear solution can be saved by communication, business practicality, or measures of humility and humanity. At a minimum, even if you do not settle the case, effective preparation and analysis can lead to a greater understanding of your case and its risks and rewards, and perhaps lay the groundwork for future resolution, or even allow for the resolution of a portion of the claims in dispute.

Failure to Prepare Effective Mediation Statements

The mediation statement is not a litigation brief. Parties that cannot change gears to prepare a settlement-focused, risk-analysis set of papers are missing an opportunity to educate not just the mediator but also the other side. In mediation, you are not looking for the mediator to decide a case but rather to showcase the strength of your position and facts, and encourage the other side to settle. The tone and content are simply different. Regardless of whether it is a private submission to the mediator, failing to acknowledge and recognize weakness in your case is simply not helpful. Not only do you appear to not understand the case (and your mediator will question how you are truly approaching the process), you are undercutting the ability to settle by wasting time arguing ridiculous positions and/or even diminishing your credibility for the points that are in your favor.

Mediation is the time to do a real analysis of the facts, law and case, and seize the opportunity to have these evaluated by the mediator objectively and vetted in fulsome negotiation with the other side. Wasting this opportunity wastes a client’s money and time, not to mention the money and time of all the other parties involved in the process. It also can ensure that the mediation will be unsuccessful.

The Impact of Ineffective Counsel

Bad lawyers and bad lawyering can plague the mediation process. Although bad lawyers may be rogues, bad lawyering is marked by personal grudges, lack of sufficient depth of knowledge or competence, and misconceived notions of how obfuscation, delay, hidden agendas and personal attacks serve the interests of clients. Courts are duty-bound to call out both bad lawyers and bad lawyering as violations of the Rules of Professional Conduct and mediation-referral orders.

Unfortunately, the mediator may also need to address any inappropriate conduct with the lawyer and the principal if profound failure in the mediation process is to be avoided. In some situations, not until the lawyer is changed out by the earnest client can a mediation advance constructively.

Missing Key Players/Parties at the Table

The failure of the parties to identify and ensure that the right parties are at the mediation also impacts its effectiveness and success. This goes hand in hand with good preparation, as previously discussed. Knowing and understanding

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Lien on Me

BY GEORGE H. SINGER

Tax and You Shall Receive

How the Federal Priority Statute Can Upset Receiver and Lender Expectations

The Federal Priority Statute (FPS), codified at 31 U.S.C. § 3713, is an often-overlooked statute applicable in nonbankruptcy insolvencies, including receiverships and assignments for the benefit of creditors. The FPS “is almost as old as the Constitution, and its roots reach back even further into English common law.”¹ A failure on the part of receivers, corporate fiduciaries, lenders and counsel to understand the FPS and appreciate its potential impact in financings or insolvencies can have serious consequences.

Under the federal priority statute, the federal government enjoys a right of priority in payment upon distribution of an insolvent debtor’s estate who is not in bankruptcy. When applicable, the FPS subordinates the debts of others to the claims of the federal government. The statute also imposes personal liability on fiduciaries, such as officers, directors and receivers, in certain circumstances for failing to comply with the law’s mandate.

Receiverships

A receivership is a remedy often employed by a secured creditor upon the default or insolvency of a borrower. Receivers are appointed by federal and state courts in a variety of contexts with duties that include the collection, preservation, administration and, often, liquidation and distribution of assets.

A receiver in possession of the assets of the debtor typically is treated as having stepped into the debtor’s shoes. Often put in place upon the request of a secured creditor, a receiver owes a fiduciary duty to all parties-in-interest, including taxing and other governmental authorities, not just the party who sought the appointment of the receiver.

The Rule of Priority

The FPS — which is applicable if a debtor has insufficient assets to cover all debts — mandates that a “claim of the [U.S.] Government shall be paid first when — (A) a person indebted to the Government is insolvent and — (i) the debtor with-

out enough property to pay all debts makes a voluntary assignment of property; (ii) property of the debtor, if absent, is attached; or (iii) an act of bankruptcy is committed; or (B) the estate of a deceased debtor, in the custody of the executor or administrator, is not enough to pay all debts of the debtor.”²

However, the statute is silent with respect to its impact on creditors that hold prior liens perfected on the debtor’s property. As such, its application to priority battles and the defenses thereto are currently still in the gray area.³

A “claim” under the FPS is broadly defined as “any amount of funds or property that has been determined by an appropriate official of the Federal Government to be owed to the United States.”⁴ The statute applies whether the government’s claim is liquidated, matured or neither.⁵ Its breadth means that any federal tax liability or financial claim of the U.S. having priority must be paid before a fiduciary pays other creditors.

The priority rule contained in the statute supersedes requirements of inconsistent state law, including those that require withholding and payment of past-due sales taxes, as one example.⁶ The statute does not, however, apply to cases under title 11, as the Bankruptcy Code has established priorities for allowed claims.⁷ Where multiple entities owned by the same person have assigned assets to a third party for the benefit of creditors, but only one of the two companies was subject to claims of the federal government, the government’s priority also only extends to that segment of the proceeds corresponding to the value of the assets subject to the FPS claim.⁸

The FPS is intended to secure adequate revenue to satisfy burdens on the federal treasury; as such, it is generally construed liberally in the government’s



George H. Singer
Holland & Hart LLP
Denver

George Singer is a partner with Holland & Hart LLP in Denver and practices in corporate and commercial law, including corporate finance, lending, bankruptcy, receiverships and other insolvency matters. He is a Fellow of the American College of Bankruptcy.

1 *United States v. Moore*, 423 U.S. 77, 80 (1975). See Claire Schenk, “Addressing the Language and Scope of the Federal Priority Act,” 44 *The Fed. Lawyer* (May 2015) (indicating that FPS was enacted shortly after Revolutionary War, at a time when “many persons had necessarily become indebted to the United States”).

2 31 U.S.C. § 3713 (emphasis added).

3 See Claire Schenk, “The Federal Priority Act: How ‘Secure’ Is a Secured Creditor if the Debtor Is Subject to a Federal Claim or Investigation?,” Thompson Coburn LLP Blog (Oct. 10, 2018), thompsoncoburn.com/insights/blogs/credit-report/post/2018-10-10/the-federal-priority-act-how-secure-is-a-secured-creditor-if-the-debtor-is-subject-to-a-federal-claim-or-investigation (last visited Nov. 19, 2024).

4 31 U.S.C. § 3701(b)(1). Courts have expansively interpreted the term and “applied the priority statute to Government claims of all types.” *United States v. Moore*, 423 U.S. 77, 80 (1975). *Cf.*, 11 U.S.C. § 101(5)(A), (B) (broadly defining term “claim” under Bankruptcy Code).

5 *Moore*, 423 U.S. at 80-83.

6 See, e.g., *United States v. Cole*, 733 F.2d 651, 654 (9th Cir. 1984).

7 31 U.S.C. § 3713(2)(b); 11 U.S.C. §§ 506, 507.

8 *Cole*, 733 F.2d at 651.

favor.⁹ The statute has been deemed “almost as old as the Constitution” itself, but, notwithstanding its age, priority disputes between secured creditors and the federal government remain. In addition, the issue of whether the FPS has any application to antecedent perfected liens has never been answered definitively.¹⁰

Exceptions

The federal statute granting priority to claims of the U.S. does not create a lien upon the debtor’s property, it merely grants a right of priority in payment of the funds in the estate. Despite the statute’s seemingly simple and unequivocal language, courts have acknowledged the existence of certain exceptions to the absolute-priority rule under the FPS.

One exception that has developed is for a *bona fide* transfer, pledge or lien that is perfected *before* the right of preference of the U.S. attaches — in other words, a claim that is sufficiently specific and perfected before the right of preference accrued to the U.S. generally prevails.¹¹ The rule then can be generally expressed as follows: In nonbankruptcy insolvencies, such as receiverships and assignments for the benefit of creditors, the U.S.’s claim is entitled to priority over any creditor claim except for those claims of properly perfected lien creditors.¹²

The priority afforded the federal government under the FPS is triggered unless another federal statute creates an exception or alternate framework. In other words, the FPS does not apply to disputes that fall under other statutes. For example, the Internal Revenue Code includes its own priority and enforcement mechanisms under which a tax lien arises on the date when unpaid taxes are assessed.¹³ The lien attaches to all taxpayer property and becomes effective against third parties on the date that notice of the lien is recorded.

The Federal Tax Lien Act of 1966 (FTLA), like the Uniform Commercial Code, adopts a “first-in-time” rule such that a purchaser, holder of a security interest, mechanic’s lien or judgment lien creditor is protected against a federal tax lien where notice of the tax lien has not been filed, notwithstanding actual knowledge of the tax lien.¹⁴ A federal tax lien will take priority over most other valid liens in property that has not yet come into existence — after-acquired property, for example — unless such property represents proceeds of the asset subject to an earlier, perfected lien.¹⁵

In view of the statutory scheme created by the FTLA, the U.S. Supreme Court in *United States v. Estate of Romani* held that the FTLA was the governing statute when the government claimed a preference in the insolvent estate of a

delinquent taxpayer based on a tax lien; therefore, an unrecorded federal tax lien did not have priority over a judgment lien that had been perfected under state law.¹⁶ Where the federal tax claim has been found to be governed by the FTLA, the FPS has been held inapplicable to defeat a competing priority claim.

The *Romani* Court noted that the FTLA solidified Congress’s intent to broaden the protection of secured creditors from federal liens when no notice of those liens would have been available to the secured creditor. As such, a lien properly perfected under state law will have priority over a later-filed federal tax lien. However, a lien that is not choate or is unperfected under state law does not have priority over a filed federal tax lien.

Personal Liability

A failure on the part of a receiver or other representative to foresee the applicability of the FPS or FTLA can be costly. Under the FPS, a fiduciary who knew (or should have known) of the existence of federal claims, including tax claims, might be held personally liable for paying any debt of the person or estate before paying a federal claim to the extent of the unpaid federal claim.¹⁷ In other words, it is clear that the knowing failure to honor the priority in nonbankruptcy insolvencies is done at the fiduciary’s personal risk.¹⁸

There is one exception to this rule. While the FPS’s mandate imposes liability on representatives of insolvent estates for making disbursements to anyone ahead of the government,¹⁹ courts have ruled that costs of administration take precedence over the government’s priority.²⁰ It nevertheless remains good practice to inform the Internal Revenue Service or other government creditor of various administrative payments to ensure that there are no issues and to have the court approve the payments and make a finding as to their reasonableness.

Breadth of Statute

It is important to recognize that the FPS affords priority to the federal government for “claims” in contexts other than unpaid income taxes. Different government agencies have invoked the FPS in a variety of situations. Debts arising from withholding taxes,²¹ estate taxes, breach of contract,²² financ-

9 *Bramwell v. United States Fid. & Guar. Co.*, 269 U.S. 483, 487 (1926).

10 See *United States v. Key*, 397 U.S. 322, 332, n.11 (1953).

11 See *Straus v. United States*, 196 F.3d 862, 864 (7th Cir. 1999). *Accord*, *In re Metzger*, 709 F.2d 32, 34-35 (9th Cir. 1983) (priority right of government did not attach until after competing interest and claim was perfected).

12 See generally *United States v. Kimbell Foods Inc.*, 440 U.S. 715, 718-30, 740 (1979) (“[A]bsent congressional directive, the relative priority of private liens and consensual liens arising from ... Government lending programs is to be determined under nondiscriminatory state laws.”); *KS Fin. Grp. Inc. v. Schulman*, 73 F. Supp. 2d 1373, 1377 (N.D. Ga. 1999) (acknowledging that Supreme Court itself indicated that issue remained undecided, but refusing to give priority to government tax liens because secured creditor “did all that it could do under [state] law to perfect its lien, [so] its lien was therefore perfected in the sense that there is nothing more to be done to have a choate lien”).

13 See 26 U.S.C. §§ 6321, 6322.

14 See *Revenue Ruling 2003-108*.

15 See *United States v. McDermott*, 507 U.S. 447, 449-50 (1993).

16 523 U.S. at 533-34.

17 31 U.S.C. § 3713(b). See *Internal Revenue Serv. Manual*, Part 5 § 5.5.1.6(4). See also *United States v. Cole*, 733 F.2d 651, 654 (9th Cir. 1984).

18 When it is a company distributing its assets prior to satisfying its debts to the government, the potentially liable representatives of the company are its directors, officers and managers. See *United States v. Golden Acres*, 684 F. Supp. 96, 101-02 (D. Del. 1988). See also *United States v. Neuberger*, No. EA-22-2977, 2024 U.S. Dist. LEXIS 154264, at 1 (D. Md. Aug. 27, 2024) (United States initiated action to assert claim of personal liability against individual who served as director, officer and counsel to company that had outstanding tax liability for making payments to other creditors under FPS).

19 The purpose for imposing personal liability on a debtor’s representative “is to make those into whose hands control and possession of the debtor’s assets are placed, responsible for seeing that the Government’s priority is paid.” *King v. United States*, 379 U.S. 329, 337 (1964).

20 See, e.g., *Abrams v. United States*, 274 F.2d 8, 12 (8th Cir. 1960); *In re Receivership of Hollingsworth*, 386 N.W.2d 93, 97 (Iowa 1986) (ruling that “government’s priority is subject to proper receivership expenses”). The Internal Revenue Service has appeared to concede this point. See *Internal Revenue Serv. Manual*, Part 34 § 4.1.7 (discussing 31 U.S.C. § 3713(a) and providing that “[e]xceptions to 31 U.S.C. § 3713(a) include ... b. Administrative Expenses”).

21 See, e.g., *United States v. Sperry*, No. 1:12-CV-0020-JMS, 2013 WL 1768664, *3 (S.D. Ind. April 24, 2013).

22 See, e.g., *United States v. Renda*, 709 F.3d 472, 485 (5th Cir. 2013) (affirming court order finding insolvent company liable to government under FPS for amount of assets transferred to creditors in breach-of-contract case).

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BY ANDREW BATES¹

Giving Debtors Their Fair Shake

What Happens to Nonexempt Equity Increases in Debtors' Homes in Converted Chapter 7 Cases

Following decisions from the Eighth and Ninth Circuits, chapter 13 filers could find themselves in a difficult predicament: losing non-exempt equity that accrues in their home during the course of a chapter 13 plan. Outcomes in chapter 13 vary, with the majority of debtors failing to complete their plans.² Hoping to still receive the benefits of a discharge, debtors who fail to complete their plans can exercise their statutory right to convert to chapter 7.³ If debtors elect not to convert, then they face the prospect of leaving bankruptcy altogether.

Chapter 13 plans stretch over the course of years. As housing prices continue to rise, a debtor may find that the value of its home has significantly increased from the petition date to the date that a chapter 7 trustee moves to sell the home. A debtor may now have additional nonexempt equity in the home upon conversion to chapter 7 than what existed on the petition date.

This phenomenon has created an argument as to whose benefit this increase in nonexempt equity inures. Chapter 7 trustees have argued that the increase inures to the benefit of the converted estate and should be used to pay creditors, while debtors argue that the increase is a new property interest that inures to their personal benefit. This article analyzes both sets of arguments and proposes a middle-ground solution.

Pro-Estate Argument: Nonexempt Equity Inures to the Estate

Although lower courts have come out on different sides of this issue, circuit courts of appeals appear to have coalesced around the idea that the accrual of nonexempt equity in a debtor's home during a chapter 13 plan inures to the benefit of the converted chapter 7 estate.⁴ The argument begins

with the plain text of the Bankruptcy Code. If the text is unambiguous, then it controls.⁵

Pro-estate proponents claim that the debtor's interest in their home is captured as of the date of filing the bankruptcy petition under § 541(a). Under this provision, property of the estate is defined to include "all legal or equitable interests of the debtor in property as of the commencement of the case."⁶ The expansive language of § 541(a) certainly captures a debtor's legal interest in the home.⁷ With little squabble as to whether the home is part of the initial bankruptcy estate, a more controversial question arises when considering § 348(f).

Courts have grappled with the question of whether increases in the nonexempt equity of a debtor's home is property of the converted chapter 7 estate under § 348(f). Section 348(f)(1)(A) states that when a case is converted from chapter 13, "property of the estate in a converted case shall consist of property of the estate, as of the date of filing the petition, that remains in the possession of or is under the control of the debtor on the date of conversion."⁸

The pro-estate argument would claim that equity is not a distinct asset from the underlying asset itself. Therefore, any increase in equity is merely a reflection of a changing characteristic of the asset, but not the creation of a new property interest itself.⁹ Section 348(f)(1) requires property that was in the debtor's possession on the petition date to remain in the debtor's possession upon conversion. Since the legal interest in the home was in the debtor's possession on both the petition and the conversion dates, the home and any increase in equity are part of the converted chapter 7 estate.¹⁰

In addition, there is no Code provision that suggests that anything less than the entire asset is incorporated into the bankruptcy estate, or that any asset is reduced merely to the qualities that asset has on the petition date.¹¹ Since equity and the asset are not



Andrew Bates
Willkie Farr
& Gallagher LLP
New York

Andrew Bates is a law clerk (admission pending) in the Restructuring Department of Willkie Farr & Gallagher LLP in New York. He is interested in both consumer and corporate bankruptcy topics.

¹ This article neither contains legal advice nor establishes an attorney/client relationship in any form. The opinions expressed herein are attributable to the author alone, and they do not reflect the views, positions or opinions of Willkie Farr & Gallagher LLP or other attorneys at the firm.

² Ed Flynn, "Success Rates in Chapter 13," XXXVI *ABI Journal* 8, 38-39, 56-57, August 2017, abi.org/abi-journal/success-rates-in-chapter-13.

³ 11 U.S.C. § 1307(a).

⁴ See *Matter of Castleman*, 75 F.4th 1052, 1054 (9th Cir. 2023), cert. denied sub nom. *Castleman v. Burman*, 144 S. Ct. 813, 218 L. Ed. 2d 26 (2024); *In re Goetz*, 95 F.4th 584, 587 (8th Cir. 2024), cert. denied sub nom. *Goetz v. Weber*, No. 23-1289, 2024 WL 4426643 (U.S. Oct. 7, 2024); *Coslow v. Reisz*, 811 F. App'x 980, 983 (6th Cir. 2020).

⁵ *Puerto Rico v. Franklin Cal. Tax-Free Tr.*, 579 U.S. 115, 125, L. Ed. 2d 298 (2016).

⁶ 11 U.S.C. § 541(a)(1).

⁷ *In re Goetz*, 647 B.R. 412, 416 (Bankr. W.D. Mo. 2022), aff'd, 651 B.R. 292 (B.A.P. 8th Cir. 2023), aff'd, 95 F.4th 584 (8th Cir. 2024), cert. denied sub nom. *Goetz v. Weber*, No. 23-1289, 2024 WL 4426643 (U.S. Oct. 7, 2024); *Matter of Castleman*, 75 F.4th at 1056.

⁸ 11 U.S.C. § 348(f)(1)(A).

⁹ *In re Goetz*, 95 F.4th at 590.

¹⁰ *Matter of Castleman*, 75 F.4th at 1058.

¹¹ *Potter v. Drewes*, 228 B.R. 422, 424 (B.A.P. 8th Cir. 1999).

different interests, §§ 541(a)(1) and 348(f)(1) incorporate it into the converted chapter 7 estate. In other words, the home was incorporated into the estate on the petition date, and the home remained in the debtor's possession until the conversion date. Although additional equity in the home exists on conversion, the home itself was in the debtor's control and there is no new interest. Thus, the home is property of the converted estate under § 348(f)(1)(A).

Even if equity was separable from the underlying asset, the Ninth Circuit held that the equity would still have been property of the estate as of the petition date, because § 541(a)(6) incorporates all “[p]roceeds, product, offspring, rents, or profits of or from property of the estate.”¹² Therefore, whether or not the equity is a distinct interest, it is a part of the bankruptcy estate under § 541(a)(6).

There is also a concern regarding the risk implication of the pro-debtor's argument from a fairness perspective. Creditors can forcefully argue that a pro-debtor approach would unfairly shift all risk of a market price change onto creditors. Under the debtor's framework, market decreases would result in creditors receiving a lower recovery on the asset, whereas market increases would fail to provide any additional recovery.

Pro-Debtor Argument: Nonexempt Equity Inures to the Debtor

On the other hand, the pro-debtor supporters argue that the increase in equity is a distinct property interest that arises after the petition date. Debtors encourage a court to look at what was captured the moment the bankruptcy petition was filed. Instead of viewing the home as a legal interest, the home should be viewed as having the exact characteristics as to what entered the estate on the petition date. The debtor can further argue that the equity never entered the bankruptcy estate.

Looking to the beginning of the case, the “Snapshot Rule” provides evidence that what is captured on the petition date under § 541(a) is the valuation of the home.¹³ If value is frozen on the petition date, then this valuation also should be used for purposes of the converted case. In addition, the debtor can argue that following plan confirmation, the property vests in the debtor and is free and clear of any claim or interest of any creditor.¹⁴ Accordingly, if the increase in equity was not incorporated into the bankruptcy estate under § 541(a), then it is not part of the converted chapter 7 estate under § 348(f)(1). Therefore, the increase in equity was not a part of the bankruptcy estate on the petition date and accrued while the property was vested in the debtor, having never entered the bankruptcy estate at all.

Although there is limited case law to support the pro-debtor argument, the Tenth Circuit's decision in *In re Barrera* is instructive. *Barrera* deals with a similar, but not analogous, situation where the debtors sold their home during the course of their chapter 13 plan.¹⁵ Because the home

was no longer in the debtor's possession and the home was sold while the property was vested in the debtor, the court determined that the increase in equity belonged to the debtor and not the converted chapter 7 estate.¹⁶

Pro-debtor proponents will argue that the legislative history of § 348(f) further indicates that equity inures to the debtor. The legislative history details how Congress sought to resolve a circuit split regarding property of the estate in a converted chapter 7 case.¹⁷ Congress sought to reject the ruling of the Seventh Circuit's *Matter of Lybrook* in favor of the Third Circuit's decision in *In re Bobroff*.¹⁸

In *Matter of Lybrook*, the court improperly incorporated assets that the debtor had inherited after filing for bankruptcy into the converted chapter 7 estate.¹⁹ The court in *In re Bobroff* properly excluded a tort action that accrued during the course of the debtor's chapter 13 plan from the converted chapter 7 estate.²⁰ Pro-debtor proponents can argue that like the unaccrued tort action in *Bobroff*, the newly accrued equity is a distinct property interest and is not part of the converted chapter 7 estate.²¹ The legislative history unambiguously attempts to encourage debtors to repay their creditors through chapter 13 and remove any disincentives to doing so.²² Although statutory analysis begins with the plain meaning of a statute when the literal application of a statute would “produce a result demonstrably at odds with the intentions of its drafters,” the plain meaning should not control.²³ In addition, pro-debtor proponents claim that if equity inures to the benefit of the estate, it creates a disincentive for individuals to file for chapter 13:

Congress has given the debtor who attempts to repay his debts in chapter 13, albeit unsuccessfully, a sort of guarantee that he will be no worse off for having tried a repayment plan, as long as he converts in good faith. This guarantee comes in the form of allowing the debtor to retain his post-petition assets, which of course he would never have had to contribute if he had originally filed a chapter 7 case.²⁴

The potential loss of nonexempt equity can serve as a substantial disincentive to file under chapter 13. After all, a debtor who elects to convert a chapter 13 case will thereby allow creditors to reap the benefits of the debtor's post-petition cure and pay-down of a mortgage on nonexempt property.²⁵ To prevent this outcome, debtors may opt to file for chapter 7 initially to ensure that they receive a discharge and maintain their disposable income instead of committing it to a plan. Debtors may also be able to reaffirm their mortgage or have it “ride through” the bankruptcy.

16 *Id.* at 1222-23.

17 H.R. Rep. No. 103-835, at 57 (1994), as reprinted in 1994 U.S.C.A.N. 3340, 3366.

18 *Id.*

19 See generally *Matter of Lybrook*, 951 F.2d 136 (7th Cir. 1991).

20 *In re Bobroff*, 766 F.2d 797, 804 (3d Cir. 1985).

21 *United States v. Ron Pair Enters. Inc.*, 489 U.S. 235, 242 (1989) (internal quotation omitted) (“The plain meaning of legislation should be conclusive, except in the ‘rare cases [in which] the literal application of a statute will produce a result demonstrably at odds with the intentions of its drafters.’”).

22 *In re Leon & Elionder Harmon*, No. 18-10579, 2022 WL 20451952, at *9 (Bankr. E.D. La. June 9, 2022).

23 *Ron Pair Enters. Inc.*, 489 U.S. at 242.

24 *In re Barrera*, 620 B.R. 645, 648 (Bankr. D. Colo. 2020), *aff'd*, No. BAP CO-20-003, 2020 WL 5869458 (B.A.P. 10th Cir. Oct. 2, 2020), *aff'd*, 22 F.4th 1217 (10th Cir. 2022).

25 *Id.* at 654.

12 11 U.S.C. § 541(a)(6); *Matter of Castleman*, 75 F.4th at 1056-57.

13 11 U.S.C. § 522(a).

14 11 U.S.C. § 1327(b)-(c); see *Bullard v. Blue Hills Bank*, 575 U.S. 496, 502-03 (2015).

15 22 F.4th 1217, 1222 (10th Cir. 2022).

continued on page 57

ABC Update

BY BRIAN L. DAVIDOFF

American Board of Certification Looks Ahead

As the newly installed president of the American Board of Certification (ABC), I am honored to write this column. Many of us bankruptcy attorneys and financial professionals might not be familiar with the ABC and its mission. I found my way into the ABC as a young lawyer when I decided to become certified as a business bankruptcy attorney in 1994. For the longest time, I renewed my ABC certification annually but did not actively become involved.

In 2015, **J. Scott Bovitz** of Bovitz & Spitzer (Los Angeles), a past ABC president, encouraged me to get more active. I decided to do so and have not looked back. I joined the Accreditation Committee, then ably headed by **Patricia B. Fugée** of FisherBroyles, LLP (Perrysburg, Ohio) and **Wesley H. Avery** of the Law Offices of Wesley H. Avery, APC (Pasadena, Calif.), and also the Standards Committee, at the time led by **Jimmy D. Parrish** of BakerHostetler (Orlando, Fla.). Getting involved with the ABC allowed me to connect with and develop lasting relationships with ABC-certified lawyers around the country.

So, who and what is the ABC? Known initially as the American Board of Bankruptcy Certification (ABBC), ABI sponsored the ABC in 1992 as a nonprofit organization “dedicated to improving the quality of the bankruptcy bar.” The ABI Annual Report in 1991-92 stated: “The rigorous ABBC certification standards are designed to encourage bankruptcy practitioners to strive toward excellence and to recognize those attorneys who are especially knowledgeable in the bankruptcy field.”

The initial officers and directors of the ABC were an extraordinary group that included **Keith J. Shapiro** of Greenberg Traurig, LLP (Chicago), **Samuel J. Gerdano** (who was ABI’s Executive Director from 1991-2019), **Thomas J. Salerno** of Stinson LLP (Phoenix), Hon. **Samuel L. Bufford** of the U.S. Bankruptcy Court for the District of Colorado (Keystone) and Sen. Elizabeth Warren¹ (D-Mass.), among other luminaries. In 1993, the American Bar Association (ABA) approved accreditation standards for private attorney certifying organizations such as the ABC. We obtained ABA accreditation and have maintained it since, and it

also has been approved by many states as an authorized board for certification purposes.

While ABI was working toward the ABBC, as it was initially known, the Commercial Law League of America developed a separate program to identify commercial law practitioners with special expertise, which was ultimately merged on Jan. 1, 1998, into the ABC. Accordingly, ABC certification now includes certification in business bankruptcy law, consumer bankruptcy law and creditors’ rights law, and is designed to recognize lawyers who have met discrete, objective certification standards.

The ABC, which has certified more than 1,000 professionals in its membership, is the sole national organization providing board certification for insolvency lawyers, and its certification provides an objective standard that assists the public in making informed decisions about choosing counsel while encouraging attorneys to strive toward excellence and recognizing those who have met ABC’s rigorous standards.

ABC is proud to have a long list of U.S. Bankruptcy Judges among its members. In addition, Congress has recognized the value of certification by amending § 330 of the Bankruptcy Code to provide that board certification is a factor to be considered in determining compensation.² The present board of the ABC is made up of ABC-certified attorneys from all over the country.

We welcome new board members **Andrew V. Layden** of BakerHostetler (Orlando, Fla.), **Daniel H. Puryear** of Puryear Law Group PLLC (Nashville, Tenn.) and **Michael R. Dal Lago** of Dal Lago Law (Naples, Fla.). The officers for 2024-25 are as follows:

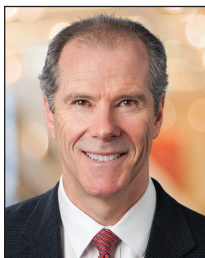
Chair: **Randy Nussbaum** of The Cavanagh Law Firm (Phoenix);

President: **Brian L. Davidoff** of Greenberg Glusker Fields Claman & Machtinger LLP (Los Angeles);

President-Elect and General Counsel: **Justin M. Luna** of Latham, Luna, Eden & Beaudine, LLP (Orlando, Fla.);

Treasurer: **Jimmy D. Parrish** of BakerHostetler (Orlando, Fla.); and

Secretary: **Luis E. Rivera** of GrayRobinson, PA (Fort Myers, Fla.).



Brian L. Davidoff
Greenberg Glusker
Fields Claman
& Machtinger LLP
Los Angeles

Brian Davidoff is chair of Greenberg Glusker Fields Claman & Machtinger LLP’s Bankruptcy, Reorganization and Capital Recovery Department in Los Angeles and is ABC’s president.

¹ Sen. Warren used to be an ABI member before joining the Senate in 2013. She used to co-author a column for the *ABI Journal* called “Warren and Westbrook” when she was a professor at Harvard Law School.

² 11 U.S.C. § 330(a)(3)(E).

Committee chairs are as follows:

Standards Committee: **Erika R. Barnes** of Stites & Harbison PLLC (Nashville, Tenn.);

State Bar Liaison Committee: **Wesley H. Avery** of the Law Offices of Wesley H. Avery, APC (Pasadena, Calif.);

Long-Range Planning: **Robert C. Furr** of Furr Cohen, PA (Boca Raton, Fla.);

Marketing: **Salene R. Mazur Kraemer** of MazurKraemer Business Law (Pittsburgh);

Membership: **David Prella Eron** of Prella Eron & Bailey PA (Wichita, Kan.) and **Patricia B. Fugée** of FisherBroyles, LLP (Perrysburg, Ohio); and

ABA at Large Representative: ABI Executive Director **Amy A. Quackenboss** (Alexandria, Va.).

Thank you to my predecessor and immediate past ABC president **Randy Nussbaum** for his hard work last year in steering the organization through another year. Under his leadership and with the invaluable help of the committee members, we have made efforts to make the ABC more visible and accessible.

You can find a complete board listing at abcworld.org/about-abc/board-directors. I invite you to take a moment to look at our website and see whether there are colleagues you may know on the board or on one of our committees. I also invite you to consider becoming ABC-certified to get the recognition that comes with certification and to be part of a community of certified lawyers from around the country. **abi**

Clerk Commentary: No Stay for You! Section 362(n) and Its Impact

from page 29

The debtor retained counsel and filed a second petition, and Judge Sigler held that the automatic stay did not apply. Given these challenges, the debtor may have benefited more from a strictly out-of-court resolution instead of a bankruptcy with no stay as to the foreclosing creditor.⁴³

Section 362(n) is a powerful tool for creditor's counsel. One major benefit is the ability to streamline the foreclosure process and even cure potential stay violations. For example, in *Abundant Life*, the foreclosing mortgagee held the foreclosure sale despite the debtor filing its second bankruptcy petition.⁴⁴ Since § 362(n) applied, the foreclosure sale

did not violate the stay. This exemplifies how § 362(n) can cleanse actions that would otherwise violate the stay had § 362(a) applied.

Conclusion

Section 362(n) is a powerful tool for creditors and a sizable obstacle for certain debtors trying to reorganize in bankruptcy court. Hence, in cases where § 362(n) applies, well-counseled debtors may prefer to resolve issues outside the bankruptcy forum. **abi**

Editor's Note: *ABI's Subchapter V Task Force's Final Report and recommendations to Congress is posted at subvtaskforce.abi.org. All members are invited to submit their experiences with subchapter V at abi.org/subvstories.*

⁴³In *Little Dollar*, the court granted the debtor's motion for an "entry of order approving sale" of real property. See *id.* at ECF 43. The court then granted the debtor's motion to dismiss the case about three months after filing. See *id.* at ECF 52.

⁴⁴*Abundant Life*, 2020 WL 7635272, at *1.

Student Gallery: Municipalities Drowning in the Aftermath of Cyberattacks

from page 31

It cannot be overstated that municipalities often have access to thousands of Social Security numbers and bank account information records. A successful cyberattack not only compromises the municipality's operations, it also places every individual in its system at risk of identity theft. This domino effect further highlights the need for a fast and efficient recovery.

Moreover, requiring the adoption of a cybersecurity plan as part of chapter 9 reform would bolster municipal cybersecurity. Cyberattacks target weak infrastructure. On a micro level, the cybersecurity plan requirement would ensure that municipalities take proactive safety measures to safeguard their systems. On a macro level, it would align with national security interests by contributing to a culture that emphasizes cybersecurity.

Conclusion

In this digital age, the threat of cybercrime poses a clear and present danger to municipalities. When cyberattacks target municipalities, the consequences extend far beyond

operational disruptions by threatening the public safety and stability of entire communities. The 2023 ransomware attack against the City of Dallas illustrates the potential devastating effects of these incidents, from halting essential services to incurring millions in recovery costs.

Amending chapter 9 to award cyberattack-related debts with priority status ensures that municipalities can quickly access the funding necessary for recovery. Equally important is requiring the adoption of a comprehensive cybersecurity plan as a precondition to filing for chapter 9. By addressing the root cause of insolvency, this requirement would reduce the likelihood of repeated filings and promote a proactive and vigilant approach to cybersecurity.

The rising threat of cyberattacks on municipalities demands a coordinated effort among federal, state and local governments to combat cybercrime. While bankruptcy reform alone is not enough to combat the threat of cybercrime, adopting these proposed amendments can ensure that municipalities, and the individuals that they serve, are well-equipped to handle future cyberattacks. **abi**



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*Reflects the sponsorships available at print time. Contact Sharisa Sloan at ssloan@abi.org to check on availability.

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President's Column

ABI Conferences, Start Your Engines!

Like the race car season, ABI takes a short hiatus from its conference schedule after the annual Winter Leadership Conference in December. It is much-earned down time for the ABI staff, who work tremendously hard throughout the year — not just on conferences but on membership, publications and the resources that we all rely on to support our practices. Having the opportunity to relish in the success of ABI's 2024 year while spending time with their family, friends and colleagues is hardly enough of a thank you for all that they do for ABI.

At the time of publication, I am finishing the first in-person conference of 2025: ABI's International Caribbean Insolvency Symposium, held Jan. 23-25 at The Westin Grand Cayman Seven Mile Beach Resort & Spa. It was my and Christine's first trip to the Caymans, and it was uniquely beautiful, plus we got to enjoy a few extra days of sunshine after escaping the cold Northeast winter.

I also had the honor of speaking on a panel regarding "Alternatives to Bankruptcy, Including Receiverships and ABCs" with Niall Ledwidge of Stout Risius Ross, LLC (New York), **Rudy J. Cerone** of McGlinchey Stafford, PLLC (New Orleans), **Jennifer Fox** of Ogier (Camana Bay, Cayman Islands) and Mitchell Mansfield of Kroll, LLC (George Town, Grand Cayman, Cayman Islands). As I previously covered, out-of-court restructurings is the new world for bankruptcy and insolvency professionals, as private-equity sponsors and traditional lenders are steering their distressed borrowers and debtors out of the courtroom and away from traditional chapter 11 proceedings and toward nonbankruptcy alternatives.

I will also use this opportunity to shamelessly plug one of ABI's newest publications, *The Professional's Guide to Nonbankruptcy Alternatives*, which was sponsored by my firm, Polsinelli. It was authored by **Michael V. DiPietro** (Wilmington, Del.), **Ashley D. Champion** (Atlanta) and Michael Riedl (Kansas City, Mo.) from Polsinelli, and edited by **Meredith R. Theisen** of Rubin & Levin, PC (Indianapolis) and myself. It is available for purchase at store.abi.org/the-professional-s-guide-to-nonbankruptcy-alternatives.html.

After a robust 2024 ABI travel schedule, as my presidency winds down, so will my professional travel. After ABI's International Caribbean Insolvency Symposium, you

can find me at the 33rd Annual Duberstein Bankruptcy Moot Court Awards Gala on March 3 in New York to honor the participants and finalists of the annual moot court competition, as it is always a treasure to see the next generation of restructuring professionals in their rawest form.

Other ABI conferences of note include the Alexander L. Paskay Memorial Bankruptcy Seminar Feb. 27-28 at the Tampa Marriott Water Street in Tampa, Fla., and the second annual Distressed Real Estate Symposium, happening March 26-28 at the Pendry Newport Beach in Newport Beach, Calif.

My presidency will conclude at ABI's Annual Spring Meeting, being held April 24-26 at the Marriott Marquis in Washington, D.C. For more information on these and other ABI conferences, please visit abi.org/events.

ABI Partners

This is also a great opportunity to thank all of the ABI Partners. I know that Polsinelli has recently finished its partnership agreement to remain an ABI Executive Partner. Our firm relishes the benefits and opportunities it gains by being a partner with ABI. This past year has seen a significant increase in partnerships between ABI and member firms. This is thanks to the arduous work of **Barbara Grant Bereskin**, **Yasmin Agudelo**, **Megan Loper** and **Sharisa Sloan** of ABI's Business Development Team, not to mention ABI Executive Director **Amy Quackenboss** and ABI Chief Operating Officer **Karim Guirguis**.

This year, ABI welcomed new Executive Partners Deloitte Turnaround and Restructuring, Getzler Henrich & Associates LLC, a Hilco Global Company and Inspira Financial, and Capital Partners Dundon Advisers LLC and Spencer Fane, to name a few. We appreciate the continued support of the following firms:

- Presidential Partners: Bloomberg Law, FTI Consulting, Inc. and Wilmington Trust Company;
- Executive Partners: agencyIP/Sherwood Partners, Inc., Cozen O'Connor, Deloitte Turnaround & Restructuring, Getzler Henrich & Associates LLC, a Hilco Global Company, Inspira Financial, Pachulski Stang Ziehl & Jones LLP and Polsinelli; and
- Capital Partners: AlixPartners, LLP, ASK LLP, Axos Global Fiduciary Banking, B. Riley Advisory Services, BakerHostetler, Blank Rome LLP, The Brattle Group, CR3 Partners, LLC, CSC, Development Specialists, Inc., Dundon



**ABI President
Christopher A. Ward**
Polsinelli
Wilmington, Del.

Chris Ward is chair of Polsinelli's Bankruptcy and Restructuring Practice and managing partner of the firm's Wilmington, Del., office. He previously served as ABI's Vice President-Development.

Advisers LLC, Gray Reed, Hilco Global, Reid Collins & Tsai LLP, SC&H Capital, Skadden, Arps, Slate, Meagher & Flom LLP, Spencer Fane, Squire Patton Boggs and Stretto.

The contributions of our ABI Partners are what set this organization apart from all other organizations. An industry community is only as good as its members, and ABI's members are second to none! Learn more about these firms at abi.org/about-us/partners. If your firm is interested in becoming an ABI Partner, please contact **Barb Bereskin** at bbereskin@abi.org or partners@abi.org.

Winding Down

I truly cannot believe that I am down to my last few President's Columns. Time sure does fly when you are having fun. Next month's column will be an interview with ABI President-Elect Hon. **Bruce A. Harwood** (ret.). He is one-half of one of ABI's power couples with his wife, Hon. **Hannah L. Blumenstiel** (who serves on ABI's Executive Committee as Vice President-Research Grants). I could not think of a better person to hand over the reins of ABI to than Judge Harwood. Please be sure to catch up on "Star Trek" and star-gazing with this true bankruptcy star himself. **abi**

Members in the News

Two law partners with Christian & Small, LLP in Birmingham, Ala., have been recognized in the 2025 edition of *Benchmark Litigation* as Litigation Stars. **Bill D. Bensinger** has been an ABI member since 2012. **Daniel D. Sparks** has been an ABI member since 1999.

Tara C. Pakrouh of Morris James LLP (Wilmington, Del.) has been elected partner. She has been an ABI member since 2023.

Leah M. Eisenberg has joined Pashman Stein Walder Hayden PC's Bankruptcy, Restructuring and Creditors' Rights Practice as a partner in South Orange, N.J. She has been an ABI member since 2002. In addition, **David E. Sklar** and **Dwij Patel** have joined the firm as associates in Hackensack, N.J. They have been ABI members since 2022.

Matthew W. Cheney of the Office of the U.S. Trustee (Grand Rapids, Mich.) has been appointed by Attorney General Merrick B. Garland as the Acting U.S. Trustee for Maryland, South Carolina, Virginia, West Virginia and the District of Columbia (Region 4). He has been an ABI member since 2004.

Allison Arotzky of Moritt Hock & Hamroff LLP (Garden City, N.Y.) has been elevated to counsel. She has been an ABI member since 2018.

Mark D. Collins has been named chair of Richards, Layton & Finger, PA's Bankruptcy and Corporate Restructuring Department in Wilmington, Del. He has been an ABI member since 1993.

David L. Eastlake of Greenberg Traurig, LLP (Houston) has been appointed chair of the Bankruptcy Law Section of the State Bar of Texas. He has been an ABI member since 2023.

Jennifer K. Malow has joined Blank Rome LLP's Finance, Restructuring and Bankruptcy Group in Wilmington, Del., as an associate. She has been an ABI member since 2021.

Jennifer Wertz of Jackson Walker LLP (Austin, Texas) has been named to *Austin Monthly's* list of Austin's Top Attorneys for 2024. She has been an ABI member since 2023.

Three attorneys have been named to *Benchmark Litigation's* 2024 Top 250 Women in Litigation and recognized as Litigation Stars. Based in New York, **Lauren A. Moskowitz** of Cravath, Swaine & Moore LLP has been an ABI member since 2020, and **Lisa M. Schweitzer** of Cleary Gottlieb Steen & Hamilton LLP has been an ABI member since 2000 and was named a National Practice Area Star by the publication. **Lisa S. Tsai** of Reid Collins & Tsai LLP has been an ABI member since 2010 and is based in Austin, Texas.

Hon. **Katharine M. Samson** of the U.S. Bankruptcy Court for the Southern District of Mississippi (Gulfport) has been reappointed by the Fifth Circuit to another 14-year term. She has been an ABI member since 2010.

Two attorneys with Sills Cummis & Gross PC in Newark, N.J., have been ranked in the 2024 edition of *IFLR1000*, each individually ranked as Highly Regarded. **Andrew H. Sherman** has been an ABI member since 1996. **Boris I. Mankovetskiy** has been an ABI member since 2003.

Mungo J. Lowe of Baker and Partners (St. Helier, U.K.) has been recognized by *Who's Who Legal* as a global leader in asset recovery. He has been an ABI member since 2016.

Michael Kwiatkowski of Cullen and Dykman LLP (Plainview, N.Y.) has been promoted to partner in the firm's Bankruptcy and Creditors' Rights Practice Group. He has been an ABI member since 2010.

Two law partners have joined Latham & Watkins LLP in New York. **Ray C. Schrock** will serve as global chair of the firm's Restructuring and Special Situations Practice and has been an ABI member since 2018. **Andrew M. Parlen** will serve as head of the firm's U.S. Restructuring; he has been an ABI member since 2021.

Michael Arrowsmith of National Franchise Sales (Tampa, Fla.) has been promoted to partner. He has been an ABI member since 2024.

Six attorneys with Pachulski Stang Ziehl & Jones LLP have been ranked in the 2024 edi-



Tara C. Pakrouh



Mark D. Collins



Jennifer Wertz



Michael Kwiatkowski



Jill L. Nicholson



David M.S. Shaiken



Leyza Florin Blanco



Marc J. Carmel



Hon. Cecelia G. Morris

tion of *IFLR1000*, each individually ranked as Highly Regarded. **Debra I. Grassgreen** has been an ABI member since 1993 and is based in San Francisco. **Laura Davis Jones** has been an ABI member since 1998 and is based in Wilmington, Del. Based in Los Angeles, **Richard M. Pachulski** has been an ABI member since 1992; **Jeffrey N. Pomerantz** has been an ABI member since 2001 and is a past ABI President; and **James I. Stang** has been an ABI member since 1995. **Bradford J. Sandler** has been an ABI member since 2002 and is based in New York.

Jill L. Nicholson has joined Dentons US LLP's Restructuring, Insolvency and Bankruptcy Practice in Chicago as a partner. She has been an ABI member since 1998.

Jonathan P. Friedland of Much Shelist, PC (Chicago) has been included among *Law360's* list of six essential bankruptcy books for his work on two Thomson Reuters treatises for which he served as principal author and editor-in-chief. He has been an ABI member since 1995 and is a past member of ABI's Board of Directors.

Alan R. Crane of Furr Cohen, PA (Boca Raton, Fla.) has been selected as a Top Lawyer in Palm Beach County by *Palm Beach Illustrated Magazine*. He has been an ABI member since 2013.

Lisa L. Lambert has been appointed by Attorney General Merrick B. Garland as the U.S. Trustee for the Northern and Eastern Districts of Texas (Region 6). She has been an ABI member since 2022 and is based in Dallas.

David M.S. Shaiken of Shipman, Shaiken & Schwefel, LLC (West Hartford, Conn.) has been included in the 2025 edition of *The Best Lawyers in America*. He has been an ABI member since 1989.

Grant L. Cartwright of May, Potenza, Baran & Gillespie, PC (Phoenix) has been selected as a lawyer representative (bankruptcy) to the Ninth Circuit Judicial Conference for a three-year term by the U.S. District Court for the District of Arizona. He has been an ABI member since 2008 and serves on the advisory board of ABI's Southwest Bankruptcy Conference.

Jeffrey M. Schlerf has joined Stinson LLP's Bankruptcy and Creditors' Rights and Sports and Recreation Practices in Tampa, Fla., and will maintain an office in Wilmington, Del., to support work in that jurisdiction. He has been an ABI member since 1998.

Leyza Florin Blanco of Sequor Law (Miami) has been recognized as one of *Latinvex's* Top 100 Female Lawyers in Latin America for 2024. She has been an ABI member since 2001.

Two attorneys with Meland Budwick, PA in Miami have been recognized in the 2025 *Lawdragon 500 Leading Litigators in America Guide*. **Michael S. Budwick** has been an ABI member since 2003. **Solomon B. Genet** has been an ABI member since 2012.

Robert F. Elgidely of Fox Rothschild LLP (Miami) has been appointed vice chair of the Broward County Bar Association's Bankruptcy Law Section. He has been an ABI member since 2010.

Marc J. Carmel of McDonald Hopkins LLC (Chicago) has been recognized by *Crain's Chicago* as a Notable Leader. He has been an ABI member since 2001.

Yelena E. Archiyan of Katten Muchin Rosenman LLP (Dallas) has been promoted to partner. She has been an ABI member since 2024.

Lloyd A. Sprung has joined East Coast-based Star Mountain Capital, LLC as senior advisor. He has been an ABI member since 2003.

Marshall S. Huebner of Davis Polk & Wardwell LLP (New York) has been named among *Financier Worldwide Magazine's* Power Players: Bankruptcy and Insolvency 2024 — Distinguished Advisers. He has been an ABI member since 2024.

Marcin Czarnocki of Deloitte (Grand Cayman, Cayman Islands) has been promoted to partner. He has been an ABI member since 2022.

Isaac Sasson of Paul Hastings LLP (New York) has been selected to participate in the 2024 National Conference of Bankruptcy Judges' Next Generation Program. He has been an ABI member since 2024.

Miles A. Taylor of Dechert LLP (New York) has been recognized by the National Conference of Bankruptcy Judges as a 2024 Blackshear Presidential Fellow. He has been an ABI member since 2023.

David K. Bowsher of Balch Bingham LLP (Birmingham, Ala.) received the 2024 Forever Duke Award from Duke Alumni. He has been an ABI member since 2003.

Hon. **Cecelia G. Morris** has been recalled to serve as a U.S. Bankruptcy Judge in the Southern District of New York from Jan. 1, 2025, through Dec. 31, 2025. In addition, she was also recently presented with the Lifetime of Service Award from the Honorable Tina Brozman Foundation. Judge Morris has been an ABI member since 2003 and is based in (Poughkeepsie, N.Y.).

Shareef Simaika has joined Cascade Partners as a managing director, focused on leading the firm's Detroit Restructuring Practice. He has been an ABI member since 2020.

Scott B. Lepene has joined ArentFox Schiff LLP's Financial Restructuring and Bankruptcy Practice in New York as a partner. He has been an ABI member since 2005.

Richard M. Gaal has joined Jones Walker LLP's Litigation Practice Group in Mobile, Ala., as a partner. He has been an ABI member since 2010.

Douglas C. Bernstein of Plunkett Cooney (Bloomfield Hills, Mich.) has been named to *Michigan Super Lawyers' 2024* list of Super Lawyers. He has been an ABI member since 1997.

Jane Dietrich has been appointed a judge of the Superior Court of Justice of Ontario in Toronto. She was previously with Cassels Brock & Blackwell LLP and has been an ABI member since 2011.

Jeffrey L. Jonas of Brown Rudnick LLP (New York) has been chosen as a *Law360 2024* Bankruptcy MVP. He has been an ABI member since 1995.

Tobias S. Keller of Keller Benvenuti Kim LLP (San Francisco) has been recognized as a California Litigation Star/Bankruptcy Litigator in California and the U.S. by *Benchmark Litigation* for 2025. He has been an ABI member since 2009.

Twelve law partners with Reid Collins & Tsai LLP have been selected by *Benchmark Litigation* as among the top commercial trial lawyers for 2025. Based in Austin, Texas, **Joshua Bruckerhoff** and **Gregory S. Schwegmann** have been ABI members since 2014; **Keith Y. Cohan** has been an ABI member since 2023; **Ryan M. Goldstein** has been an ABI member since 2021; **Nathaniel J. Palmer** has been an ABI member since 2016 and is co-chair of ABI's Commercial Fraud Committee; **William T. Reid** has been an ABI member since 2007; **Lisa S. Tsai** has been an ABI member since 2010; and **Jeremy Wells**

has been an ABI member since 2020. Based in Dallas, **Brandon V. Lewis** has been an ABI member since 2016, and **Eric D. Madden** has been an ABI member since 2000 and is a member of ABI's Board of Directors. **Yonah Jaffe** has been an ABI member since 2020 and is based in New York. **Michael Yoder** has been an ABI member since 2018 and is based in Cody, Wyo.

Sean R. Burns has joined Gray Reed's Corporate Restructuring and Bankruptcy Team in Dallas as an associate. He has been an ABI member since 2024.

Joshua D. Silver has joined Markowitz, Ringel, Trusty & Hartog, PA's Restructuring and Insolvency Practice Group in Fort Lauderdale, Fla., as a partner. He has been an ABI member since 2022.

Alpesh A. Amin has joined Riveron as a senior managing director in Chicago. He has been an ABI member since 2009.

Prof. **Nancy B. Rapoport** of the University of Nevada, Las Vegas School of Law (Las Vegas) and **Joseph R. Tiano** of Legal Decoder (Scottsdale, Ariz.) have been awarded *The American Bankruptcy Law Journal's* Editors' Prize Outstanding Article for 2023 for their article, "Reimagining 'Reasonableness' Under Section 330(a) in a World of Technology, Data and Artificial Intelligence." Prof. Rapoport has been an ABI member since 1994 and is a past ABI Vice President-Research Grants. Mr. Tiano has been an ABI member since 2020.

Bradley D. Pack of Engelman Berger, PC (Phoenix) has been named to *Phoenix Magazine's* 2024 Top Lawyers list. He has been an ABI member since 2015 and is a coordinating editor for the *ABI Journal*.

Ryan A. Burgett of Husch Blackwell LLP (Chattanooga, Tenn.) has been elected partner. He has been an ABI member since 2018.

Holly Felder Etlin of AlixPartners, LLP (New York) has been selected as Boston Corporate Finance Community's 2024 honoree. She has been an ABI member since 1992 and is a past member of ABI's Board of Directors.

Kristen Evans has joined Spencer Fane LLP's Banking and Financial Services Practice Group in Kansas City, Mo., as an associate. She has been an ABI member since 2024.

Roy S. Kobert has launched Roy Kobert Mediation, which offers expert bankruptcy and commercial dispute resolution with real-time scheduling. Based in Orlando, Fla., he has been an ABI member since 1998.

Kenneth Kraft of Dentons Canada LLP (Toronto) has been featured the inaugural *Lexpert Special Edition on Insolvency and Restructuring*. He has been an ABI member since 1999. **abi**



Scott B. Lepene



Jane Dietrich



Joshua D. Silver



Holly Felder Etlin



Roy S. Kobert

Got News?

Send your announcements
to be featured in
Members in the News.

Email
Elizabeth at
estoltz@
abi.org.



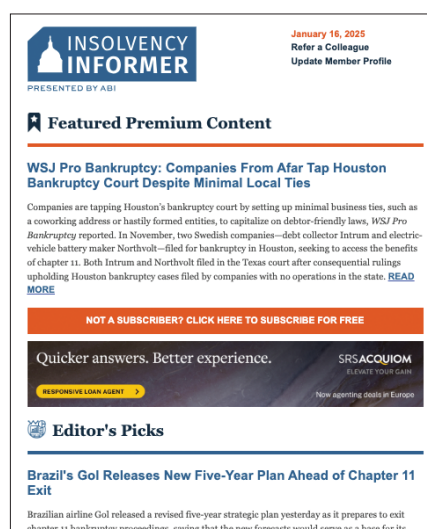
What's Happening at ABI

Share Your Subchapter V Experiences

Calling all bankruptcy professionals! ABI is continuing its study of subchapter V, and it needs your help. We are particularly interested in learning more about the real-world impact of subchapter V. So our question is, do you have a story about a distressed business or creditor who has used or benefited from the subchapter? If so, could that case still happen under the lower debt cap for subchapter V debtors?

Any and all responses are welcome. Share your experiences today at abi.org/subvstories.

ABI Launches *Insolvency Informer* e-Newsletter!



The *ABI Insolvency Informer* was launched on Jan. 6 to succeed the *ABI Daily Headlines* as an upgraded source of daily news and information resources. Readers can enjoy daily curated bankruptcy headlines via email, as well as expert insights and exclusive, premium content from some of the nation's largest legal publishers.

ABI members were automatically upgraded to the *Insolvency Informer* daily email as part of their membership. We hope you are enjoying the new format!

In addition, ABI members can refer the *Insolvency Informer* to non-member colleagues so they can start receiving the latest bankruptcy news each morning in their inboxes. A FREE *Insolvency Informer* subscription is as simple as visiting abi.org/insolvency-informer and providing an email address to start receiving the newsletter.

ABI Welcomes New Partners to the ABI Partner Program

ABI is proud of its Partner Program and appreciates our partnerships in planning for 2025. We further value the collaboration we have with and the creativity of our Partners' practice leaders and marketing and business development professionals! Please join us in welcoming the following new Partners for 2025:

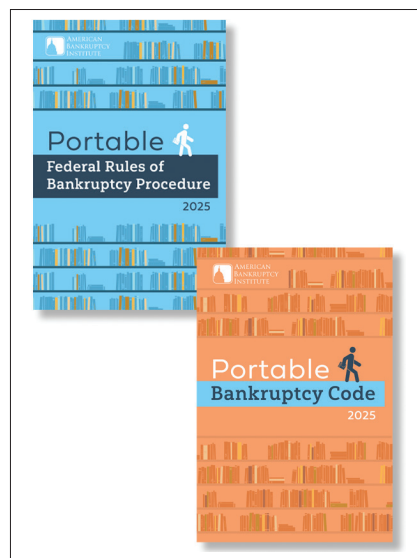
- Dundon Advisers: Capital Partner
- Inspira Financial: Executive Partner
- Spencer Fane: Capital Partner

We also congratulate longtime Capital Partners Deloitte Turnaround and Restructuring and Getzler Henrich, a

Hilco Global Company, both of which have elevated their ABI involvement to become Executive Partners. Please visit abi.org/about-us/partners to get to know ABI's 29 Presidential, Executive and Capital Partners, which also can be found streaming across ABI's homepage and on the opposite page.

If your firm would like to become a Partner, contact, ABI Director of Business Development and Partner Programs **Barbara Grant Bereskin** at bbereskin@abi.org.

ABI Portable Code and Rules Books Now Available



ABI has just published new editions of the Bankruptcy Code and Federal Rules of Bankruptcy Procedure. These 2025 editions replace the books formerly known as the *Mini-Code* and *Mini-Rules*. Both the *Portable Bankruptcy Code* and *Portable Federal Rules of Bankruptcy Procedure* are updated to include amendments made through

Dec. 1, 2024. There is also a discounted bundle if the books are purchased together.

To purchase your copies, and to browse all of ABI's current publications, go to store.abi.org. To receive member pricing, be sure to log into the site with your ABI member credentials.

Become Part of ABI's Diversity and Inclusion Mentoring Program

ABI's Diversity and Inclusion Mentoring Program (June 2025 to June 2026) is accepting applications for its fourth class of mentors. The program seeks to build personal and professional relationships while promoting diversity and leadership within ABI.

If selected, mentees commit to attending all six structured meetings/programs. **Applications are due Feb. 24.** For eligibility requirements and program expectations,



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apply today at diversity.abi.org/mentoring/apply. For questions about the process, please contact support@abi.org.

Networking from Your Desk? Join Us on LinkedIn

Are you on LinkedIn? Join ABI on the world's largest professional online network, with more than 450 million members in more than 200 countries and territories. Professionals like you join LinkedIn every day to interact with industry experts, colleagues, potential clients and business partners. Want to connect? We have two options:

- *Become a member of ABI's LinkedIn group.* Did you know there are active discussions on insolvency going on right now on LinkedIn? Don't miss out on the latest trends, topics and more. To join the conversation, please visit linkedin.com/groups/59140.
- *Follow ABI on LinkedIn.* Get regular updates on news you can use. Go to linkedin.com/company/american-bankruptcy-institute and hit the "Follow" button.

ABI Promotes Staff Member to New Director of Software Engineering Role



Satish Kodali

In January, **Satish Kodali** was promoted to Director of Software Engineering. Based in Aldie, Va., he holds a master's degree in electrical engineering from the University of North Texas. Before his promotion, Satish had worked as a Senior Software Engineer at ABI for more than a decade. Outside of work, Satish enjoys spending quality time with his wife and two daughters, as well as playing cricket. He reports to ABI Chief Operating Officer **Karim Guirguis**.

Could INSOL International's Next CEO Be You? Apply Today!

INSOL International is currently seeking to recruit a chief executive



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officer (CEO). This person will play a key role in shaping the future of INSOL International by implementing the organization's strategy, delivering initiatives, and expanding its influence and membership.

Leading a dedicated team of experts, the CEO will partner with a range of international stakeholders (member associations, members, regulators, the judiciary, lenders, academics and INSOL International's board) while providing strategic leadership, direction and guidance. The role includes overseeing overall operations, P&L, and making high-level managerial decisions to shape and safeguard the future direction of the organization.

Areas of Focus and Accountability

- *Strategic Leadership:* Developing with the board and communicating INSOL's strategy and vision to mem-

bers, stakeholders, and the insolvency and restructuring community.

- *Membership Growth:* Driving the growth of INSOL's membership and identifying new opportunities for member engagement.
- *Organization Leadership:* Inspiring a high-performing team that fosters a culture of collaboration, excellence and professional development.
- *Financial Stewardship:* Protecting INSOL's financial stability and sustainable growth through effective budget management and income-diversification strategies.
- *Marketing and Communications:* Driving innovative and high-quality marketing and communications strategies to enhance the organization's visibility and impact within the industry.

About the Candidate

INSOL International is looking for an inspiring, intelligent, proactive and visionary leader who is confident, media- and technology-savvy, and capable of representing INSOL at the highest levels and effectively engaging with stakeholders. Specifically, candidates will bring the following:

- Extensive senior strategic leadership experience, including accountability for a P&L and full oversight of business operations. This could have been gained through running a similar industry body.
- A proven track record of engaging effectively with a wide range of stakeholders at a senior level and working collaboratively with a board and leading multiple programs of work.
- Experience in working across multiple jurisdictions. An understanding of the restructuring and insolvency markets would be advantageous.
- A strong advocate and role model for diversity, collaboration and innovation within the organization.

How to Apply

Please send your CV and cover letter explaining your motivation and interest, highlighting your relevant expertise and including your salary expectations, to HopkinsLongworth Ltd. jane@hopkinslongworth.com. More details can be found at insol.org/about/job-vacancies.

ABI Endowment Fund Update

Join Our Regional Committee and Make a Difference!



As the Anthony H.N. Schnelling Endowment Fund continues to grow and strengthen its efforts, we are excited to invite passionate individuals like you to join our Regional Committee. This is a wonderful opportunity to make an impact by shaping programs, initiatives and events that benefit our community and beyond. Whether you are a longtime ABI Endowment supporter or newly interested in becoming more involved, we would be thrilled to have your voice at the table.

Why Join?

- *Influence Regional Initiatives:* Your insights and ideas can help guide key projects.

- **Connect with Leaders:** Collaborate with a diverse group of professionals dedicated to meaningful change.
- **Make a Difference:** Be part of a team committed to advancing our mission and goals.

What's Involved?

As a committee member, you'll attend quarterly virtual meetings; provide input on regional programming and engagement strategies; and serve as an ambassador, sharing our mission with your network.

To express your interest or to learn more, please reach out to ABI Endowment Manager **Erin Green** at egreen@abi.org, and we will follow up with next steps. Together, we can continue to build a strong and vibrant community. Thank you for considering this opportunity to contribute in such an impactful way.

Endowment Hockey Game at Paskay Now Has Waitlist



The ABI Endowment hockey game on Feb. 27 at Amalie Arena in Tampa, Fla., being held in conjunction with ABI's Alexander L. Paskay Memorial Bankruptcy Seminar, is sold out and has a waitlist. If you are interested in being added to the waitlist, please contact ABI Endowment Manager **Erin Green** at egreen@abi.org.

A huge thank you goes to Shumaker, Loop & Kendrick, LLP/**Steven M. Berman** for donating the suite and tickets. Learn more abi.org/events/paskay-endowment-hockey-event.

Another Way to Give to the Endowment: ABI Founders Society

By becoming a member of the ABI Founders Society, you can continue to support the Endowment and ABI for years to come through estate-planning. All the proceeds benefit the ABI Endowment Fund and are 100 percent tax-deductible. When you include ABI in your estate plan, your generosity helps provide additional funding for the Endowment so that it can continue to support current and future industry members.

Please visit the Founders Society section on ABI's website at abi.org/endowment for more information. If you have any questions, please reach out to ABI Endowment Manager **Erin Green** at egreen@abi.org.

Save the Date for a Baseball Game the Night Before ABI's Annual Spring Meeting!

Watch the Washington Nationals take on the Baltimore Orioles at 6:45 p.m. EST on April 23 in Washington, D.C., on the eve of ABI's Annual Spring Meeting. A luxury suite is being generously donated and sponsored by



BakerHostetler. Tickets are \$300, which includes food and beverages. Sponsorship Tickets are \$1,000 and include two tickets plus acknowledgment.

Proceeds benefit the ABI Endowment. If your firm would like to sponsor this event, please contact ABI Endowment Manager **Erin Green** at egreen@abi.org.

New Endowment Year-End Donors Recognized

- **Hon. Laurel Myerson Isicoff** of the U.S. Bankruptcy Court for the Southern District of Florida;
- **Brandy M. Rapp** of Whiteford Taylor Preston LLP;
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- **Nancy J. Whaley** (Standing Chapter 12 and 13 Trustee); and
- **Clifford A. Zucker** of FTI Consulting, Inc. **abi**

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Vacancies Available with D. Utah, SDNY and D. Minn. Bankruptcy Courts

The U.S. Court of Appeals for the Tenth Circuit seeks applications to fill two bankruptcy judgeships in the District of Utah. The positions are located in Salt Lake City. One will be available July 1, 2025, and the other will be available Sept. 5, 2025.

Before appointment, the selected applicants must successfully complete a background investigation. Bankruptcy judges are appointed to 14-year terms pursuant to 28 U.S.C. § 152. The current annual salary is \$227,608.

Please visit ca10.uscourts.gov/hr/jobs to view the position requirements and download the application. The deadline for applications is **Feb. 12, 2025**.

The U.S. Court of Appeals for the Second Circuit invites applications from qualified candidates for a 14-year appointment as U.S. Bankruptcy Judge for the Southern District of New York, with a duty station in Manhattan. The selection process will be confidential and competitive. Applicants will be considered without regard to race, color, religion, sex, national origin, age, sexual orientation or disability. The current annual salary is \$227,608.

The Second Circuit uses an open and competitive selection process. All applications are screened by a Merit Selection Committee, which will review applicants using the following criteria: legal competence evidenced by experience with complex legal issues; an aptitude for legal scholarship and writing; familiarity with the courts and court processes; commitment to equal justice under the law; characteristics indicative of a sound judicial temperament; a reputation for integrity, good character and ethical behavior; and physical and mental health sufficient to meet the demands and tenure of the position. The committee will select a limited number of applicants for interview and will conduct appropriate due diligence inquiries into the candidates' backgrounds and qualifications.

Upon a majority vote of the Second Circuit Judicial Council, the council will forward the Merit Selection Committee's Report with any recommendations or comments to the active judges of the court of appeals. The selected nominee will be required to satisfy FBI and IRS background investigations prior to appointment. Basic qualifications for consideration include (1) membership in good standing of at least one state bar, the District of Columbia bar, or the Commonwealth of Puerto Rico bar, and never other than membership in good standing of every bar of which the applicant has ever been a member; and (2) a minimum of five years of legal practice experience.

Application forms are posted at www.ca2.uscourts.gov. Completed application packages must be in the format required by the Second Circuit by **Feb. 28, 2025**.

The U.S. Bankruptcy Court for the District of Minnesota is recruiting a term law clerk to Chief Bankruptcy Judge Katherine

A. Constantine. A law clerk to a U.S. Bankruptcy Judge performs substantive review, research and writing on matters pending before the court. Tenure will be two years with the possibility of renewal. Term will not exceed four years. This is a full-time, 40-hour-per-week position based in Minneapolis. Salary range is \$80,609 - \$149,359 (based on qualifications).

Representative duties include reviewing complaints, petitions, motions and other pleadings that come before the court to determine the issues involved and the basis for relief; reviewing dockets of pending litigation and monitoring progress; screening motions and drafting orders for the judge's review; performing legal research; identifying issues before the court and making recommendations; providing information to the judge in connection with pending cases; drafting bench memos for the judge's consideration; proofreading orders and opinions, and verifying citations; keeping abreast of changes in the law and briefing the judge on those changes; assisting the judge during courtroom proceedings; sharing in the administrative tasks of chambers; and performing other duties as assigned.

Preferred qualifications include a strong academic background; excellent legal research skills and the ability to communicate effectively, both orally and in writing; exceptional organizational, computer, computer-assisted legal research and word processing skills; ability to maintain confidentiality, uphold the court's ethical rules and exhibit good judgment, maturity, dependability and responsibility; ability to work effectively and harmoniously with others in a team-based environment; ability to manage and prioritize time and tasks and meet all deadlines; and familiarity of bankruptcy law.

This is a sensitive position, and the candidate will be required to undergo an FBI fingerprint check. Appointment is provisional, and retention depends on a suitability determination based on the fingerprint check. Only those selected to interview will be contacted. Interview and relocation expenses will not be reimbursed.

Applications should include the following: a cover letter, detailed resume with exact dates of employment, law school transcript (only from recent graduates), and one recent writing sample in a single .pdf document if sending by email. Three letters of recommendation are also required. Applicants selected for an interview may be asked to provide a completed Application for Judicial Branch Federal Employment (Form AO 78) and a list of references. Please refer to announcement #2025-01 in the email transmittal if sending by email. Applicants should submit documents through OSCAR or email to mnb_applications@mnb.uscourts.gov.

Only qualified applicants will be considered for this position. No telephone calls, please. Interview dates will be determined on an individual basis. Closing date for applications is **July 1, 2025**; **preference will be given to applications received by May 1, 2025**. This position will be available in December 2025.

Mediation Matters: How Mindfulness Can Prevent Mediation Failures

from page 33

the issues and facts in dispute ensures that you identify the necessary parties. A mediation can be scuttled merely by not having the right party with authority and knowledge at the table and can raise the issue of a lack of good faith.

Bad Faith

Most courts require, or at the very least expect, that mediations proceed in good faith. The concept of good faith can be misunderstood, as it generally means that the parties are approaching the process with the intent and goal of settlement, without a hidden agenda or intent to deceive the other side, and instead they merely glean information, then turn back to litigation. Whether explicit or not, the absence of *bona fide* intention to engage in a deliberative dialogue, the failure to comply with the mandates of a mediation order, or the advancement of discourteous or unprofessional behaviors will scuttle any mediation, wasting the parties' resources, trust and patience.

Bad faith does not mean that a party fails to make a meaningful or even reasonable settlement offer, or refuses to acknowledge a weakness in their case. However, it can mean that no thought was given as to who should attend the mediation and/or that the party who attends is without the requisite authority and/or knowledge to advance the process, and as such, a party has come in "bad faith" to the process.

Such behaviors can also punish the unwitting principal who possesses the rogue lawyer, and ensure the alienation of opponents and the mediator. To this end, mediators must be vigilant in responding to claims of bad faith, educating the parties as to what this means, and if identified, the court must act to address the conduct in question.

In order to give meaning to the process, bad faith must be addressed by the presiding court or mediator. This might include imposing sanctions to the extent that explicit rules or governing orders have been violated; otherwise, the integrity of the process and the authority of the mediator are undermined. This leaves the abiding party disgruntled and less likely to engage in the process in the future.

Hence, it is essential that lawyers guide their principals, and that the principals guide (and plainly see) their lawyers proceed in good faith. Although the mediation parties are not compelled to settle, the federal courts can compel and expect civility, professionalism, balanced deliberation, and abiding by the mediator's directives to think, communicate and weigh the merits of litigated outcomes. A referring judge's failure to message these expectations can only fuel frustration and the likelihood of failed mediation efforts.

The Right to Trial/Holdouts

Although rational business judgment may compel a party to resolve a dispute, access to justice principles and the U.S. Constitution ensure aggrieved parties of the right to trial. Some parties may insist on it as a matter of a merit's assessment, some as a matter of public vetting or accountability, and even some as a matter of institutional resolve or a com-

mitment to the development of the law. Those polar positions deserve respect, weight and resourceful creativity in messaging a rational facilitation of a dispute.

On occasion, only the imminence and enormous costs of trial mitigate this sort of resolve. Failure to mediate or resolve under these circumstances might need to be recognized as fulfilling a gatekeeping function for civil justice at trial, as contemplated by the Constitution and federal laws.

Failure to Consider the Business Case for Settlement

The parties often will get to a range of settlement numbers, then stop. At this point, there is first an "analysis" of the cost of litigation: It will only cost "X" to finish the case (usually these are not realistic numbers and can be skewed perhaps by other considerations). What the parties do not always consider is the "lost opportunity cost": the cost of the parties and their employees responding to discovery demands, attending depositions, hearings and trials, and doing anything but running their respective businesses. The cost of human capital and downtime from focused business operations is a cost that exists and should be evaluated, and considered before a party walks away from the settlement table.

Conclusion

The lack of sophistication of parties and counsel, the presence of hidden agendas, or the advancement of untruths will also assuredly facilitate an inability to achieve resolution. However, those conditions often evaporate as litigation ensues, and those sorts of failures may only enhance the weight, position and leverage of the counterparty during trial or on a later reconvened mediation.

Failure has been defined by a lack of success in meeting a desired objective. An inordinate number of mediations succeed because of the commitment of the parties and the communication acumen, balance and perseverance of the mediator.

Mediation resources uniformly report settlement rates of 75 percent or more. However, the quantification of mediation failures is impossible to measure, because mediation can serve as an intermediate tool to enhance rational incremental assessments and resolutions now, later or on appeal after trial. It can alternatively serve to narrow misunderstandings, clarify facts and identify interests, or target dispositive issues.

The few true failures that might occur are the casualties of noncollaboration, scant communication, flawed professionalism, or a failure to recognize the wide and dynamic essence of a communication strategy that invites the parties to construct their own rational, human, business-like solutions, consistent with their distinct interests. In contrast, a well-intentioned trial judge might never see or have authority to mold those considerations into a judicial resolution by trial. In the end, only a mindful approach by counsel and the mediator to the dynamics and dimensions of their mediation will optimally serve the parties and the process. **abi**

A Guarantor's Guide to Marshaling

from page 19

ably order the marshaling of a nondebtor's guaranty every time unsecured creditors would otherwise be unable to fully recover on their claims.¹³

Virtually every jurisdiction outside of the Eighth Circuit has disavowed the court's analysis.¹⁴ However, if you have provided a guaranty on a corporate debt and are planning on filing for bankruptcy protection within the Eighth Circuit law, *caveat emptor*.

Wisconsin Courts' Special Exception to the "Common Debtor" Requirement

Second is case law out of Wisconsin avoiding the "common debtor" requirement by deeming certain guaranties of corporate obligations as capital contributions. It has come to be known (however unoriginal of a title as it may be) as the "Wisconsin Exception." In particular, in a series of cases emanating from *Moser Paper Co. v. North Shore Publishing Co.*,¹⁵ Wisconsin courts have held that where a guarantor is an officer, director or shareholder of a corporate debtor (hereinafter a "guarantor-principal") and has pledged assets in support of its guaranty, those pledged assets can be "deemed" capital contributions to the debtor and not merely assets available to a surety under the guaranty.¹⁶

For example, in *In re Multiple Services Industries Inc.*, a bank had a secured claim against the assets of the debtor, and it had a security interest in property belonging to the corporation's principal officers.¹⁷ Upon a request for marshaling by the bankruptcy trustee on behalf of a junior creditor in the debtor's estate, the bank objected, arguing that it was entitled to collect from assets it deemed more desirable and less costly to pursue (*i.e.*, the debtor's collateral).¹⁸ The court discussed the "common debtor" requirement and concluded that although the corporate debtor possessed only one fund, considerations of equity permitted the court to consider pledges of shareholder property as though they are capital contributions to the corporation. The Wisconsin Exception was further elaborated on (if not narrowed) in *In re Wm. Pietsch Co.*¹⁹

Wm. Pietsch acknowledged that "[t]raditionally, when an individual guarantees a corporate debt, the corporation and the guarantor are not considered a 'common debtor'" for

purposes of marshaling "because the corporation is a separate entity," but nevertheless the company applied an exception that considers a "corporation's guarantor's property, pledged to secure a corporate obligation but not solely the guarantor's obligation ... as contribution to the capital of the corporation and thus subject to marshaling."²⁰ Accordingly, a fair argument to be made is that the Wisconsin Exception applies only where a guarantor pledges collateral on the debtor's underlying debt and *not* where the collateral is pledged only on their guaranty.

Similar to the Eighth Circuit's analysis in *In re Jack Green*, the Wisconsin Exception has been heavily criticized outside of the jurisdiction.²¹ Again, should a corporate insider of a Wisconsin business be asked to pledge collateral in support of a guaranty, they may find themselves the unwitting donor of additional equity in the debtor that becomes available to satisfy the debts of junior lienholders and/or unsecured creditors in a subsequent bankruptcy proceeding.

Implications for Guarantors

The variations in courts' applications of marshaling pose implications for creditors' strategies in bankruptcy proceedings. To mitigate risks, guarantors can negotiate terms that limit creditors' abilities to prioritize their assets. For example, where feasible, a guarantor can negotiate for a requirement that the creditor exhaust all collateral securing the borrower's debt before pursuing the guaranty.²² In addition, for guarantors subject to Wisconsin law, any required pledge of collateral should be limited to securing the guaranty and *not* the debtor's underlying obligation.²³ Finally, any bankruptcy filing requires sound planning, which necessarily includes consideration of prevailing law in potential jurisdictions.

Conclusion

The doctrine of marshaling underscores the tension between equity and efficiency in bankruptcy proceedings. While its central purpose is to promote fairness among creditors, its varied application across jurisdictions creates both opportunities and challenges. By understanding the nuances of marshaling and tailoring their strategies accordingly, guarantors can better protect themselves from the unintended extensions of their own liability to a corporate debtor's bankruptcy estate. **abi**

¹³ There are arguments to be made as to the true extent of the ruling — for example, the *Jack Green's* court seemed focused on the unsecured creditors receiving nothing. However, the opinion does not draw a bright line as to what amount of recovery by unsecured creditors is required before marshaling would no longer be appropriate.

¹⁴ See *In re Computer Room Inc.*, 24 B.R. 732, 734 (Bankr. N.D. Ala. 1982) (noting that Eighth Circuit reasoning is "contra to the overwhelming majority rule which requires a secured creditor, not an unsecured creditor, to invoke the marshaling doctrine"); *Matter of Dealer Support Servs. Int'l Inc.*, 73 B.R. 763, 765 (Bankr. E.D. Mich. 1987) (stating that "*Jack Green's* has been severely criticized by commentators and rejected by several bankruptcy courts" and refusing to follow its reasoning); *In re San Jacinto Glass Indus. Inc.*, 93 B.R. 934, 939 (Bankr. S.D. Tex. 1988) (rejecting Eighth Circuit's reasoning and stating that "[t]he *Jack Green's* decision does not offer findings or otherwise justify relaxing the common-debtor/two-fund requirement").

¹⁵ *Moser Paper Co. v. North Shore Publ'g Co.*, 83 Wis. 2d 852, 864, 266 N.W. 2d 411 (1978).

¹⁶ See *contra In re Gluth Bros.*, 424 B.R. at 396.

¹⁷ 18 Bankr. 635 (Bankr. E.D. Wis. 1982).

¹⁸ *Id.* at 636.

¹⁹ *In re Wm. Pietsch Co.*, 200 B.R. 207, 210-11 (Bankr. E.D. Wis. 1996).

20 2000 B.R. at 210-11 (emphasis added).

²¹ See *In re Sunset Hollow Props. LLC*, 359 B.R. 366, at 379-82 (refusing to marshal assets because "common debtor" requirement was not met, and noting that courts outside of Wisconsin have declined to follow its rationale). See also *In re XYZ Options Inc.*, 217 B.R. 912, 926 (Bankr. N.D. Ala. 1998) (criticizing cases that fail to consider injustice "caused by the taking of a guarantor's or other third party's property to marshal ahead of that of the primary obligor's"); *In re Childers*, 44 B.R. 23, 26 (Bankr. N.D. Ala. 1984) (citing, *e.g.*, *In re Ludwig Harold Mfg. Co.*, 33 B.R. 724, 727, 728 (Bankr. E.D. Pa. 1983) ("[T]he cases that have ignored the 'common debtor' requirement have been criticized as being based on a misapplication of the spirit behind the marshaling doctrine."); *In re Derecktor of Rhode Island*, 150 B.R. 296, 301 (Bankr. D.R.I. 1993) ("[W]e find that such guarantees do not meet the 'two funds' requirement of marshaling.").

²² See, *e.g.*, *Prod. Credit Ass'n of Madison v. Jacobson*, 131 Wis. 2d 550, 388 N.W. 2d 655, 1 U.C.C. Rep. Serv. 2d 1376 (Ct. App. 1986) (holding that two-fund requirement of marshaling was not met where guaranty was operable only after guarantor liquidated all other security).

²³ *In re Wm. Pietsch Co.*, 200 B.R. at 210-11.

Turnaround Topics: The Impact of Regulators on Asset Sales

from page 25

This proposed transaction was part of PG&E's broader strategy to streamline operations and raise the necessary capital to fulfill its financial commitments, including settlements with wildfire victims and other creditors. The sale was intended to bolster PG&E's financial footing, enabling the company to emerge more robustly from bankruptcy and address the substantial financial claims against it.

Regulators' Impact

The proposed asset sale to KKR faced scrutiny and opposition from California regulators, specifically the California Public Utilities Commission (CPUC). In May 2024, the CPUC expressed concerns regarding the transaction, emphasizing potential adverse impacts on public safety, service reliability and the interests of ratepayers.

The CPUC argued that the divestiture of certain assets might undermine PG&E's ability to maintain safe and reliable utility services, which are critical to the well-being of California's residents. In addition, there were apprehensions about how the sale might affect ratepayers, potentially leading to increased costs or reduced service quality. Consequently, the CPUC's opposition introduced significant

regulatory hurdles to the proposed sale, necessitating further negotiations and adjustments to address these concerns. As of November 2024, PG&E's restructuring plan (including the proposed asset sale to KKR) remains under examination.

Closing Thoughts

Section 363 sales offer a critical mechanism for distressed companies to sell assets free and clear of existing liens and encumbrances, thus providing a vital means to generate liquidity and address financial obligations. However, as demonstrated by Polaris Operating LLC and PG&E, the process is not immune to regulatory inquiry and intervention.

These case studies serve as important reminders for companies pursuing § 363 sales. They emphasize the need to anticipate regulatory scrutiny and prepare for potential impediments that could arise. By understanding the regulatory landscape and engaging in proactive dialogue with relevant authorities, companies can better navigate these challenges, ultimately facilitating smoother transactions that align with both financial objectives and regulatory expectations. **abi**

SCC Clarifies Corporate Attribution Rules in Reviewable Transactions

from page 21

and found that there was no reviewable error in the finding that the requisite intent under § 96(1)(b)(ii)(B) of the BIA had been established.

In its analysis, the SCC reviewed case law and various texts to discuss the meaning and purpose of transfers at undervalue and of the BIA. Section 96 of the BIA provides a mechanism to reverse transfers at undervalue that occurred in a specific period of time with a purpose to protect creditors. The remedy is directed against the person who received the transfer of property from the debtor and others who were privy to the transfer. The SCC discussed that:

- *Transfers at undervalue undermine the integrity of the bankruptcy process.* Transfers at undervalue frustrate the BIA's purpose: the equitable distribution of the bankrupt's assets among his or her creditors and the bankrupt's financial rehabilitation. Transfers at undervalue prejudice creditors by diminishing the value of a debtor's estate and reducing the funds available for distribution.
- *The debtor's intent to defraud, defeat or delay a creditor can be proved through the badges of fraud.* To prove a debtor's intent to defraud, defeat or delay a creditor under § 96(1)(b)(ii)(B) of the BIA is a question of fact to be decided based on all of the circumstances that existed at the time of the transfer. The requisite intent is often proved through badges of fraud. The presence of one or more badges of fraud does not require courts to infer an intent to defraud, defeat or delay a creditor, nor does the absence of a particular badge of fraud prevent a court from finding this intent.

• *Insolvency is not a prerequisite to finding that a debtor intended to defraud, defeat or delay a creditor.* It is no answer to an application under § 96(1)(b)(ii)(B) to say that the debtor was not insolvent and was paying creditors in full and on time at the time of the transfers. The SCC did not remit the case to the application judge to determine the financial condition of the companies at the time of the transfer, including a determination of whether the creditors were paid in full. Section 96(1)(b)(ii) of the BIA is disjunctive: The debtor must *either* be insolvent at the time of the transfer (subsection A) or intend to defraud, defeat or delay a creditor (subsection B). The debtor's financial condition at the time of the transfer is one badge of fraud that might be relevant.

The SCC noted that the application judge considered the debtor's financial condition, among other badges of fraud, and found "no innocent explanation for a false invoicing scheme."¹⁰ The SCC saw no basis to interfere with the conclusion that Aquino intended to defraud, defeat or delay a creditor under the false invoicing scheme.

Attributing the Intent of the Directing Mind of the Corporation to the Companies

To meet the requirements under § 96(1)(b)(ii) of the BIA, the trustee and monitor must demonstrate that the companies intended to defraud, defeat or delay a creditor. Once finding that

¹⁰ *Ernst & Young Inc. v. Aquino*, 2021 ONSC 527, at ¶ 162.

Aquino, the directing mind of the companies, met the requisite intent, the SCC turned to the question of whether Aquino's fraudulent intent could be attributed to the companies.

The appellants argued that intent could not be attributed to the companies, as the fraud and no benefit exceptions applied, as established in *Canadian Dredge*. The SCC rejected these submissions based on the following reasons:

- *Applying the doctrine of corporate attribution.* The doctrine of corporate attribution must be applied purposively, contextually and pragmatically to promote the purpose of the law under which attribution is sought to give effect to the policy goals of the law under which a party seeks to attribute to a corporation the actions, knowledge, state of mind or intent of its directing mind.
- *Remedial purpose of § 96.* Section 96 of the BIA serves as a remedial tool for asset-stripping by a debtor by clawing back assets that were improperly transferred to others before a bankruptcy to protect the assets available for creditors. This remedial purpose is served by attributing the actions, knowledge, state of mind or intent of the directing mind to the corporation. This applies even if the directing mind acted in fraud of the corporation, and even if the corporation did not benefit from the actions of the directing mind.
- *Applicability of exceptions to corporate attribution on § 96 of the BIA.* The fraud and no-benefit exceptions to corporate attribution should not apply to a transfer at undervalue claim under § 96. The fraud and no-benefit exceptions were inappropriate and inapplicable to transfers at undervalue under § 96 because these exceptions undermine the creditor-protection purpose of § 96.
- *Test for corporate attribution.* The test for corporate attribution under § 96 of the BIA is whether the person was the directing mind and whether their actions were performed within the sector or corporate responsibility assigned to them. If this test is met, the actions, knowledge, state of mind or intent of the directing mind should be attributed to the corporation, regardless of whether the fraud and no-benefit exceptions are met. Aquino was the directing mind of the companies and acted in the sector of corporate responsibility assigned to him.

The SCC found that Aquino intended to defraud, defeat or delay creditors of the companies. While conducting the false invoicing scheme, Aquino acted in his assigned sector of corporate responsibility of engaging with suppliers and overseeing the provision of services and materials. Therefore, the SCC attributed Aquino's intent to the companies and dismissed the appeal with costs.

Future Directions

Aquino v. Bondfield Construction Co. has since been applied by the SCC and has demonstrated that the principles established provide sufficient flexibility to address most — if not all — situations of corporate attribution. *Golden Oaks* was released with *Aquino v. Bondfield Construction Co.* and dealt with the issue of whether the doctrine of corporate attribution should be applied to one-person corporations. *Golden Oaks* dealt with a Ponzi scheme run through Joseph Gilles

Jean Claude Lacasse, the company's sole officer, shareholder and directing mind. It was argued that since Lacasse was the sole shareholder and director, his knowledge should be imputed to the company.

The SCC held that the same principles for corporate attribution established in *Aquino v. Bondfield Construction Co.* apply to all corporations, including one-person corporations.¹¹ To accept the argument that the knowledge of the sole directing mind must always be attributed to the corporation would disregard the bedrock principle of corporate separateness.¹² There is no rule that the knowledge or state of mind of the directing mind of a one-person corporation must invariably be imputed to the corporation; context and purpose always serve as the primary considerations.¹³

Even a one-person corporation can have an existence that is separate from that of their sole owner and directing mind.¹⁴ Citing *Aquino v. Bondfield Construction Co.*, the SCC reiterated that courts have discretion to refrain from attributing the actions, knowledge, state of mind or intent of the directing mind to the corporation when it would be in the public interest, in the sense that it would promote the purpose of the law under which attribution is sought.

The SCC refused to attribute Lacasse's knowledge to the company because it would not promote the purposes of the laws under which attribution was sought. Furthermore, to attribute Lacasse's knowledge to the company would undermine the BIA's purpose and would allow investors to retain proceeds of their wrongful value of the assets available for distribution to other creditors. The SCC cited the court of appeal in its decision, noting that attribution in this case would "lead to the perverse outcome of saving the appellants from the consequences of their collection of usurious interest, as well as depriving the trustee of a civil remedy that would inure solely for the collective benefit of legitimate creditors." This would not be in the public interest.¹⁵

The SCC's decisions in *Aquino v. Bondfield Construction Co.* and *Golden Oaks* serve as binding precedents for all provincial courts across Canada. These cases are novel decisions that establish a road map to guide legal practitioners and lower courts as to how courts should apply the doctrine of corporate attribution to the bankruptcy and insolvency context, and evaluate the applicability of transfers at undervalue in this context.

Both cases serve as a tool to distinguish the doctrine of corporate attribution from criminal and civil cases, and illustrates how the doctrine applies to bankruptcy and insolvency proceedings. These decisions also demonstrate the flexibility of the doctrine of corporate attribution, which permits courts to adopt a purposive, contextual and pragmatic approach to corporate attribution and give effect to the BIA's underlying policy objectives. Beyond these specific findings, *Aquino v. Bondfield Construction Co.* and *Golden Oaks* contribute to a broader framework of insolvency law, offering a comprehensive road map for future cases. **abi**

11 *Supra*n.3 at ¶71.

12 *Id.* at ¶65.

13 *Id.* at ¶71.

14 *Id.* at ¶65.

15 *Id.* at ¶80 (citing *Golden Oaks Enters. Inc. v. Scott*, 2022 ONCA 509, at ¶57).

Lien on Me: Tax and You Shall Receive

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ings under government loan programs, or health care settings and environmental laws²³ would be examples.²⁴

While the term “claim” in the FPS is intentionally expansive, it is not unlimited in scope. The government only has a claim if the debt owed to the federal government exists at the time of the “act of insolvency.”²⁵ Debts that do not arise until after the act of bankruptcy have occurred do not meet a definition of a “claim” under the FPS.²⁶ In addition, the government’s claim of priority might be applicable even when it is contested, or it is not yet formally assessed or is reduced to an amount certain. Therefore, sometimes it might be difficult to determine the timing of the “claim” given the fact that the

claim of priority may exist regardless of whether the amount of debt has been precisely determined.

Therefore, the risk of personal liability and responsibilities attendant in administering a receivership estate requires extra vigilance in determining when a claim in the U.S.’s favor exists. The FPS’s potential application mandates care and considerations relative to adequate notice, communication with the federal government, and language of proposed court orders. For example, the record should be supported by adequate factual findings when funds of the estate will be used and distributions are made.

Conclusion

The FPS is not a widely known statute despite the fact that it existed at the time when America was formed. Yet it can have immense importance for insolvent companies and their officers, directors and receivers, as well as creditors expecting an ultimate distribution. The statute’s scope and narrow class of available exceptions, most of which have developed due to courts interpreting the FPS, need to be understood by those dealing with insolvent companies. **abi**

23 See, e.g., *Burns v. Burns Iron & Metal Co.*, No. S-12-024, 2013 WL 2152524 (Ohio Ct. App. May 17, 2013) (observing that Environmental Protection Agency invoked FPS when Comprehensive Environmental Response, Compensation, and Liability Act claim was asserted against company and insiders entered into stock redemption agreements providing for payment).

24 See, e.g., *United States v. Adaptive Microsystems LLC*, 914 F. Supp. 2d 1331, 1335 (Ct. Int’l Trade 2013) (government claiming priority for unpaid dues attributable to misclassified imports).

25 31 U.S.C. § 3713(a)(1)(A)(iii).

26 See, e.g., *In re Metzger*, 709 F.2d 32 34-35 (9th Cir. 1983) (concluding that because debt owed to U.S. did not exist until after act of bankruptcy, government could not state claim under FPS).

Trustee Talk: Navigating Corporate Transparency Act Requirements

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Trustee Actions and FinCEN Feedback

To date, bankruptcy professionals have utilized some effective strategies to navigate the new requirements. In *YLG Partners Inc.* and *BOA Nutrition Inc.*,⁵ Bankruptcy Administrators filed motions with the court to be excused from fulfilling the responsibilities imposed by the CTA due to limited access to the necessary information. FinCEN filed responses and entered into consent orders that indicated that chapter 7 trustees generally are not required to submit the debtor’s beneficial ownership reporting.

In their response, FinCEN stated that “a chapter 7 bankruptcy trustee is not typically responsible for fulfilling a debtor reporting company’s duty to report beneficial ownership to FinCEN: the responsibility is the reporting company’s duty.” In addition, “the obligation to report beneficial ownership information to FinCEN under the CTA lies with reporting companies themselves.” FinCEN further indicated that “[s]imply becoming a chapter 7 trustee does not make an individual a ‘senior officer’ of the reporting company, *i.e.*, ‘any individual holding the position or exercising the authority of a president, chief financial officer, general counsel, chief executive officer, chief operating officer, or any other officer, regardless of official title, who performs a similar function.’”⁶

On the other hand, FinCEN stated that chapter 7 trustees might be liable in situations with “unusual circumstances,” such as the trustee had indicated to the debtor that they would file the requisite beneficial ownership reporting and failed to do, or where the trustee prevented the debtor from filing the information. FinCEN also noted that “a bankruptcy estate is not a ‘reporting company’ obligated to file beneficial ownership information with FinCEN.” This is due to the criteria that a “domestic entity is a reporting company only if it was created by the filing of a document with [the] secretary of state or similar office.”

Another cautious and conservative approach that trustees have taken in other recent cases involves submitting a letter to the debtor’s attorney informing them that the debtor could be required to report beneficial ownership information to FinCEN pursuant to the CTA, and noting that, as the trustee, they do not have the requisite information to complete the beneficial ownership information report. In doing so, the debtor’s attorney is asked to advise their client to take any timely, necessary action.

Conclusion

While further guidance from FinCEN is anticipated, there has been none issued to provide greater clarification as to the trustee’s role and responsibilities as of December 2024. Until this is provided, bankruptcy trustees would be well-served to take a careful approach in each case, considering the practices in recent cases that have been effective, and to stay attuned to any future updates from FinCEN. **abi**

5 *In re YLG Partners Inc.*, No. 23-10709 (Bankr. M.D.N.C.); *In re BOA Nutrition Inc.*, No. 23-03665-5-PWM (Bankr. E.D.N.C.).

6 31 C.F.R. § 1010.380(f)(8) of the CTA.

Consumer Corner: Student Loan Discharge: Where Are We Headed?

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It remains to be seen whether the new administration will alter, roll back or leave the revised process in place. Notably, in 2018 the DOE under the prior Trump administration published a request for public comment on factors to be considered in evaluating undue-hardship claims in connection with its reconsideration of its then-current policy regarding the discharge of student loan debt in bankruptcy.²⁸

Regardless of the view eventually espoused by the new administration, the government's position with respect to discharge is not binding on the bankruptcy court. Similar to the described actions of the Executive Branch, recent jurisprudence may indicate a trend toward flexibility in the determination of whether a debtor has demonstrated undue hardship. Circuit and other courts have questioned the stringency of the *Brunner* requirements.²⁹

Congress also is tuned in to the issue of dischargeability in bankruptcy. In August 2021, Sens. Dick Durbin (D-Ill.), John Cornyn (R-Texas) and Josh Hawley (R-Mo.) introduced a bipartisan bill amending § 523(a).³⁰ A key provision of the

bill would allow for the discharge of student loan debt 10 years after the first loan payment is due while retaining the current concept of dischargeability at any time in cases of undue hardship.³¹ A separate provision would require institutions of higher education that have at least one-third of their students receiving federal student loans to partially repay a discharged loan to the DOE, with the repayment amount dependent on the institution's average rates of student loan default and repayment.³² While the bill died in committee after no action was taken, the measure bears watching, as it is common for legislative text to be reintroduced in subsequent sessions of Congress.³³

Conclusion

It is impossible to predict executive or legislative action or court decisions on any topic, but the fact that issues regarding dischargeability and forgiveness of student loan debt will persist as long as students continue to borrow is a sure bet. As judicial precedent continues to evolve and policymakers continue to respond to the challenges posed by mounting student debt levels, outcomes will continue to significantly impact borrowers and, arguably, the entire economic landscape. The issue warrants close attention. **abi**

28 See United States Department of Education, Request for Information on Evaluating Undue Hardship Claims in Adversary Actions Seeking Student Loan Discharge in Bankruptcy Proceedings, 83 Fed. Reg. 7460 (Feb. 21, 2018).

29 See, e.g., *Krieger v. Educ. Credit Mgmt. Corp.*, 713 F.3d 882 (7th Cir. 2013) ("The statutory language is that a discharge is possible when payment would cause an 'undue hardship.' It is important not to allow judicial glosses ... to supersede the statute itself.")

30 See Fostering Responsible Education Starts with Helping Students Through Accountability, Relief and Taxpayer Protection (FRESH START) S. 2598, 117th Cong. (2021) (referred to committee on judiciary).

31 See *id.*

32 See *id.*

33 See S. 2598, 117th Congress: FRESH START Through Bankruptcy Act, govtrack.us/congress/bills/117/s2598.

Giving Debtors Their Fair Shake: Nonexempt Equity Increases in Homes

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Bifurcating the Equity: Market Appreciation and Mortgage Paydown

To add another caveat to this difficult question, some courts have viewed the way in which nonexempt equity is created as critical to which party the equity will inure. This path forward offers an approach that is textually sound, while not unduly harsh on the debtor.

Although in *Matter of Castleman* all of the debtors' increase in equity came from market appreciation,²⁶ many debtors have increased nonexempt equity as a result of payments made in compliance with chapter 13 plans. For example, in *In re Wegner*, during the time that the case was in chapter 13, the debtor's home gained \$9,500 from market appreciation and \$2,100 in equity from paying down the home mortgage.²⁷ Following conversion, the court applied § 348(f)(1)(A) to hold that the house was property of the chapter 7 estate. It held that the \$2,100 equity gain by virtue of the debtor's payments was included in the chapter 7 estate,

stating that § 348 "does not explicitly protect an equity cushion that is created by payments made during the pendency of the [chapter] 13 case."²⁸ *Wegner* demonstrates how some courts will incorporate all new equity, whether it is from market appreciation or chapter 13 payments, into the converted chapter 7 estate.

However, other courts have held that equity created through mortgage payments made in compliance with a debtor's chapter 13 plan should inure to the debtor's benefit.²⁹ This approach strikes a middle ground that lessens the disincentive for debtors to file for chapter 13, while not allowing creditors to be in a better position than they would have been had the debtor filed for chapter 7 initially.

Although some courts have found that equity cannot be bifurcated in this manner,³⁰ others have determined that equity created by a paydown of the debtor's mortgage (the "paydown equity") can be textually delineated in that it was

26 75 F.4th at 1054, fn.1. In this case, it appears that the increase in equity was attributable primarily — if not exclusively — to market appreciation. Due to the deferral of mortgage payments during the COVID-19 pandemic, the Castlemans actually owed more at the time of filing for conversion (\$390,763) than they did at the time of their initial filing.

27 243 B.R. 732, 735 (Bankr. D. Neb. 2000).

28 *Id.*

29 *In re Adams*, 654 B.R. 703, 713 (Bankr. M.D.N.C. 2023); *In re Goins*, 539 B.R. 510, 511, 515 (Bankr. E.D. Va. 2015); *In re Hodges*, 518 B.R. 445, 448-51 (E.D. Tenn. 2014).

30 *In re Barrera*, 620 B.R. at 653.

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Giving Debtors Their Fair Shake: Nonexempt Equity Increases in Homes

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never part of the bankruptcy estate as of the petition date.³¹ The paydown equity is a result of post-petition income, which is not property of the estate under § 541(a); rather, it is property of the estate under § 1306(a).³² This means that the paydown equity would not be property of the converted chapter 7 estate under § 348(f)(1) because it was not in the debtor's possession as of the petition date. In other words, creditors should not benefit from property that they would not have had access to but for the debtor attempting, and failing, a chapter 13 plan. This point is especially salient if the recovery of the nonexempt equity is realized by the debtor's unsecured creditors. Debtors should not be punished by allowing creditors to benefit from the debtor's attempt to pay their debts.

In addition, this approach does not change creditors' expectations with respect to recovery. Had the debtor filed

31 *In re Adams*, 654 B.R. at 713; *In re Goins*, 539 B.R. at 511, 515; *In re Hodges*, 518 B.R. at 448-51, 3211 U.S.C. § 1306(a).

for chapter 7 initially, there would be no paydown equity. Correspondingly, creditor recovery would not be diminished if nonexempt equity inures to the benefit of the debtor. The secured creditor would have its debt paid down, while the unsecured creditors would be no worse off than if the debtor had filed for chapter 7 on day one.

Conclusion

The legal landscape on this issue is fractured. However, after analyzing the text of the Bankruptcy Code, legislative history and case precedent, courts can strike an equitable balance by (1) allowing nonexempt equity that accrued through market appreciation to inure to the benefit of the estate; and (2) allowing equity that accrues through chapter 13 mortgage payments to inure to the debtor. This approach will still provide incentives for debtors to choose to file for chapter 13 while maintaining a consistent textual approach to the Code. **abi**

Legislative Update: The \$7.5M Sub V Debt Limit Should Be Reinstated

from page 9

pared to traditional chapter 11 small business cases, subchapter V cases have enjoyed nearly double the percentage of confirmed plans, half the percentage of dismissals, and a shorter path to plan confirmation.¹⁵

Moreover, the ability of distressed small businesses to survive reorganization serves a broader economic purpose. Small businesses are vital to the American economy. As of 2023, the U.S.'s 33.2 million small businesses employ more than 61 million people.¹⁶ Unfortunately, about half of small businesses close within their first five years of opening.¹⁷

Subchapter V's increased debt limit would augment the number of those small businesses that may qualify for subchapter V's protections. The businesses of many subchapter V debtors continue to operate after bankruptcy. For example, a recent study found that the survival rate for companies that emerge from chapter 11 with subchapter V confirmed plans as of December 2023 is 86 percent, or 16 percent higher than traditional chapter 11 cases.¹⁸

As previously highlighted, subchapter V has proven to be a vehicle that works exceedingly well for businesses that are on the higher end of the eligibility threshold. As filings grow, it is imperative for those businesses to be availed of the opportunity of choosing a bankruptcy process specifically tailored with those needs in mind.

15 *Id.*

16 "Frequently Asked Questions About Small Businesses," Small Bus. Admin. (March 2023), advocacy.sba.gov/wp-content/uploads/2023/03/Frequently-Asked-Questions-About-Small-Business-March-2023-508c.pdf.

17 See "Small Business Statistics," Chamber of Commerce (July 24, 2024), chamberofcommerce.org/small-business-statistics.

18 See Hotchkiss, *et al.*, *supra* n.11.

A Majority of the Industry Supports a Heightened Subchapter V Debt Limit

Bankruptcy professionals have long valued expediency and efficiency,¹⁹ and subchapter V's heightened debt limit proved to be just that. While critics of a higher limit have focused on debtors that have sought to abuse the process by disputing the debts owed to stay under the debt limit, the majority of the insolvency industry generally favors a permanent increase. Importantly, ABI created the Subchapter V Task Force, which unveiled its final report of recommendations. The key recommendation was establishing a permanent filing eligibility debt limit of \$7.5 million in aggregate, non-contingent, liquidated debt to reorganize under subchapter V.²⁰

ABI recognized bankruptcy professionals' and judges' repeated compliments on subchapter V. Hon. **Michael E. Romero** of the U.S. Bankruptcy Court for the District of Colorado remarked that subchapter V "has opened up the ability for financial rehabilitation to entities previously priced out of the more standard Chapter 11 process. The value of extending a survival opportunity to financially challenged but valuable members of our communities can never be underestimated."²¹

Moreover, the lower debt limit not only reduces the amount of eligible debtors, it is bad for those practitioners who have gained specialty experience in subchapter V fil-

19 See Christopher D. Hampson & Jeffrey A. Katz, "The Small Business Prepack: How Subchapter V Paves the Way for Bankruptcy's Fastest Cases," 92 *Geo. Wash. L. Rev.* 851 (2024).
20 See ABI Final Report, *supra* n.3.

21 Written Statement of Hon. Michael E. Romero, at 6, ABI Subchapter V Task Force Hearing (Operation of the Case) (July 28, 2023), subvtaskforce.abi.org/hearings/july-28-2023-virtual-public-hearing.

ings. According to **Steven Weiss**, a frequent subchapter V trustee, “nearly half of his subchapter V cases fell out of eligibility due to the debt limit.”²² The majority of financial restructuring and bankruptcy professionals, as well as judges, are urging Congress to restore the increased debt limit. As the ABI Subchapter V Task Force reinforced in its report, small businesses are at the core of the American economy, and a permanent increased debt limit would maximize predictability and trust in small business reorganizations.

Conclusion

Despite being relatively new and growing, subchapter V has had an impact on the financial restructuring and bankruptcy industry. Notably, subchapter V has been tested through one of the most devastating economic recessions in recent history: the beginning and aftermath of a global

22. See Steven Weiss, “Has Subchapter V Solved the Problems of Small Business Bankruptcies? Views and Reflections of Subchapter V Trustees on the First Two Years of the New Law: Thoughts on Subchapter V,” 31 No. 3 *Norton J. Bankr. L. & Prac. Art.* 1 (2022).

pandemic. Subchapter V consistently offered the essential bankruptcy option for distressed small business debtors in the U.S. with their unique concerns in mind.

The \$7.5 million debt limit was in place for the majority of subchapter V’s lifetime, covering a period of all but the first six weeks after its effective date (Feb. 19 to March 26, 2020) and two months in 2022 (March 27 to June 21, 2022).²³ The \$7.5 million limit is part of subchapter V’s success, and such a heightened debt limit must stay, as (1) the sunset of the \$7.5 million debt limit caused negative effects on the small business community; (2) a heightened subchapter V debt limit increases the probability of successful reorganizations; (3) subchapter V has greater reorganization access to small business debtors through simplified procedures; (4) subchapter V has proven its success; and (5) subchapter V has been broadly supported by professionals in the bankruptcy industry. **abi**

23. See ABI Final Report, *supra* n.3.

On the Edge: Eletson Results: SDNY Court Issues Decision on New Value

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subsidiaries,” a percentage of recovery on a judgment from an arbitration award, and a guaranty by the debtor’s shareholder of up to \$40 million to be escrowed at \$1 million per month for the next 40 months.²² The court agreed with the petitioning creditors that these contributions may not be considered “money or money’s worth” because they are all “contingent future payments.”²³ However, the \$37 million cash portion of the new-value contribution might be regarded as “money or money’s worth,” since it is up-front cash.²⁴

Third, the court analyzed whether the shareholder new-value contribution was considered substantial. Courts analyze whether a new-value contribution is “substantial” by comparing the contribution to the unsecured claims being disposed of under the plan.²⁵ Under the debtor plan, the shareholder new-value contribution consisted of \$37 million in funding, compared to \$505 million in general unsecured claims — about 7.3 percent of the unsecured claims pool.²⁶ The debtors asserted that the claims pool would be reduced through the claims-objection process. The court rejected this argument and pointed out that it had already granted the debtors’ claim objection, thus the amount of undisputed unsecured claims was about \$505 million.²⁷ The court concluded that a new value contribution of 7.3 percent of the unsecured creditors’ claims was not “substantial.”²⁸

Fourth, the court considered whether the proposed new-value contribution is “reasonably equivalent” to the reorganized debtor’s value. Both *Coltex* and *203 N. LaSalle* “mandate that a debtor market-test a proposed transaction in order to demonstrate that the purported new value was necessary

and reasonably equivalent, and was not merely an exclusive opportunity for old equity to gain advantages at the expense of creditors.”²⁹ Here, the debtors terminated exclusivity and exposed the case to the competing plan process.³⁰ The court acknowledged that this might be a proper method to potentially confirm a “new value” plan, but under the precedent set in *203 N. LaSalle*, competing plan processes might not be sufficient to satisfy this requirement.³¹

In any event, the court concluded that the debtor plan did not provide sufficient value because the petitioning creditors were offering more. Petitioning creditors valued the debtors’ enterprise at between \$103.9 million and \$116.4 million, with a midpoint of \$110.2 million. The debtors had proposed that their shareholders acquire 100 percent of the equity in the reorganized debtor in exchange for \$37 million.³²

In contrast, under the petitioning creditor’s plan, unsecured creditors had an option to purchase up to 75 percent of the equity; after a discount to the mid-point, the plan equity value would be up to \$62 million. The petitioning creditors asserted that they were paying “top dollar,” while no other plan set forth contribution capital at their valuation.³³ Essentially, the court concluded that the debtors’ proposed new value cannot constitute reasonably equivalent value when competing plans put forward greater contributions.³⁴

Fifth, the court analyzed whether the debtor’s contributions were “necessary.” The petitioning creditors contended that the new value is not *necessary* to fund the debtor plan because creditors are offering two competing plans that pro-

22 *Id.*

23 *Id.*

24 *Id.* at *33.

25 *Id.* at *34.

26 *Id.*

27 *Id.* at *36.

28 *Id.*

29 *Id.* at *37.

30 *Id.*

31 *Id.*

32 *Id.* at *35.

33 *Id.* at *36-37.

34 *Id.* at *37.

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vide more funding than the debtor plan and greater distributions.³⁵ The debtors asserted that the mere existence of a competing plan does not doom the debtors' plan; there are cases where a new-value plan is confirmed over a competing plan.³⁶ The court emphasized that the "necessary" prong of the new-value exception turns on the amount of money a party is willing to contribute. To satisfy the "necessary" requirement under *Coltex*, "old equity must be willing to contribute more money than any other source or it must be the lender of "last resort."³⁷

Further, "the market must be tested for other sources of funding and the debtor must be able to satisfy the bankruptcy court, with tangible proof, that the debtor would be unable to obtain funds from any other source or that no other source was willing to infuse the same amount of capital as old equity."³⁸ Again, for the purposes of the analysis, only the \$37 million cash contribution constitutes new value under the debtor plan.³⁹ The court simply concluded that the petitioning creditors' alternative plan would provide greater funding (\$41 million), plus better recoveries for creditors than the debtor plan.⁴⁰ The court agreed with the petitioning creditors contention that the shareholders' new value contribution was not "necessary."

Conclusion

The existence of a confirmable competing plan — one that had been accepted by an overwhelming majority of creditors entitled to vote — arguably doomed the debtor plan.

35 *Id.* at *36.

36 *Id.* at *38.

37 *Id.* (citing *In re Coltex Loop C. Three Partners LP*, 138 F.3d 39 (2d Cir. 1998)).

38 *Id.*

39 *Id.*

40 *Id.* at 37.

The *Eletson* court noted, "[t]he Court is unaware of any case post-*LaSalle* where the court has confirmed a new value plan despite a confirmable competing plan ... particularly where, as here, the creditors are willing to contribute more capital than the Debtors."⁴¹ Thus, the court determined that the debtor plan does not satisfy the new-value exception to the absolute-priority rule and cannot be confirmed.⁴²

The *Eletson* decision illustrates the power dynamic between equityholders and creditors — and, particular to this case, well-funded petitioning creditors who forced the debtor into an involuntary bankruptcy. *Eletson* demonstrates that insiders can provide a debtor with capital, but bankruptcy courts will favor a marketing process and alternative competing plans that provide greater distributions to creditors and a substantial ratio of cash relative to unsecured claims.

Eletson provides a pathway for equity owners to retain their interests in a reorganized entity through the new-value exception, albeit a narrow one. Through this thorough analysis, the *Eletson* court made clear that the proposed "new value" must be in readily available cash or cash equivalents, and the debtors must go through some market testing. However, the *Eletson* court left some questions unanswered.

For example, what constitutes a "substantial" contribution? Would 10 percent constitute "substantial"?⁴³ Also, does the competing plan process necessarily satisfy the requirement that new value can be market-tested? Ultimately, can a "new value" plan ever be approved over a competing plan filed by the debtors' creditors? Although theoretically possible, under instructions laid out by the Supreme Court and Second Circuit precedent, it appears unlikely. **abi**

41 *Id.* at *40.

42 *Id.*

43 *Eletson* cited *In re Abeinsa Holding Inc.*, B.R. 265, 275 (Bankr. D. Del. 2016), which found that 15.9 percent was substantial.

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to some degree works at cross-purposes to Congress's intent in enacting subchapter V, which gives small business debtors more control over the plan process than in other chapter 11 cases by eliminating the absolute-priority rule and granting the debtor the exclusive right to propose a plan.²⁵

However, subjecting corporate debtors to § 523(a)'s nondischargeability provisions greatly empowers creditors with such claims, enabling them to block consensual plan confirmation, then force litigation.²⁶ The attendant delay and increased fees would make the subchapter V case slower and more expensive.²⁷

Moreover, post-confirmation dischargeability litigation creates uncertainty around a debtor's ability to get a fresh start.²⁸ Namely, a creditor holding a nondischargeable judgment must be paid in full, unless the business stops operating. As a result, such a creditor can seize any remaining assets of the small business debtor following the completion of the three- or five-year plan term.²⁹

For these reasons, many bankruptcy commentators have urged a turning away from the *Cleary Packaging* rule. For

28 *Id.*

29 Richard P. Cook, "Discharges in Subchapter V: What Has Changed? What Remains the Same? Are Elephants Hiding in Mouseholes?," *XLI ABI Journal* 6, 24-25, 58, June 2022, abi.org/abi-journal/discharges-in-subchapter-v-what-has-changed-what-remains-the-same-are-elephants-hiding (unless otherwise specified, all links in this article were last visited on Nov. 22, 2024).

25 11 U.S.C. §§ 1181(a), 1191(b), 1189(a).

26 Robert J. Landry III, "Applicability of Discharge Exceptions to Corporate Debtors in Subchapter V: A 'Death Blow' to Rescuing Small Businesses," 17 *J. Bus., Entrepreneurship & L.* 1, 33 (2024).

27 *Id.*

continued on page 62

Exhibit 1



Total Subchapter V Cases

590

Last Updated Date

Filter By State

All

Filter By Circuit

4

Filter By District

All

Subchapter V Cases by MONTH

Year ● 2020 ● 2021 ● 2022 ● 2023 ● 2024

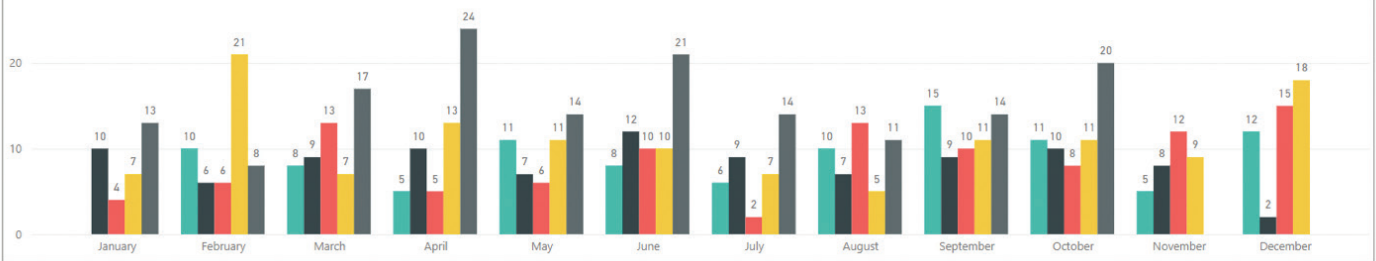


Exhibit 2



Total Subchapter V Cases

1215

Last Updated Date

10/31/2024

Filter By State

All

Filter By Circuit

5

Filter By District

All

Subchapter V Cases by MONTH

Year ● 2020 ● 2021 ● 2022 ● 2023 ● 2024

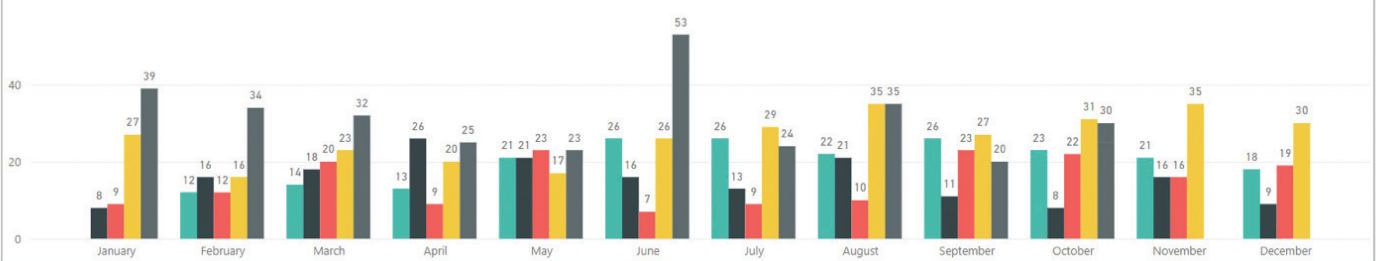
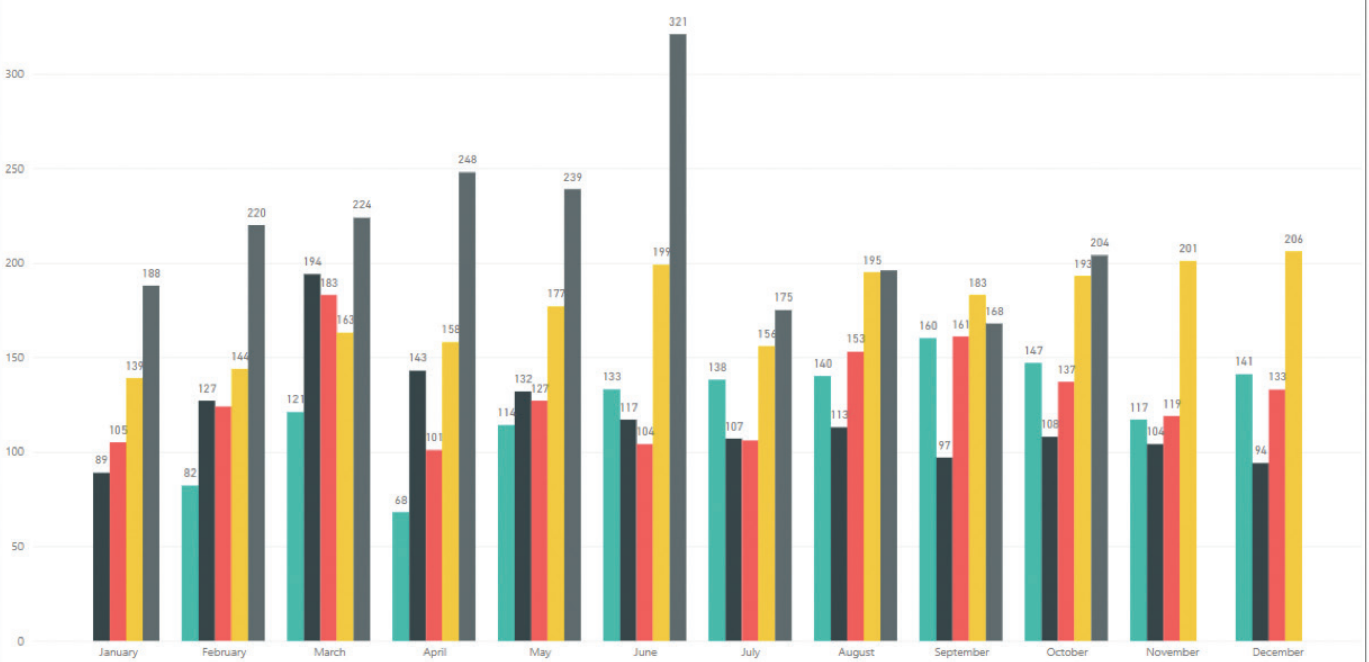


Exhibit 3

[Back to report](#)

SUBCHAPTER V CASES BY MONTH

Year ● 2020 ● 2021 ● 2022 ● 2023 ● 2024



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example, in the spring of 2024, ABI's Subchapter V Task Force stated that "a corporation's (or other entity's) discharge under a nonconsensual Subchapter V plan should not be subject to the section 523(a) exceptions and recommends a statutory amendment for clarification."³⁰ Similarly, the National Association of Bankruptcy Trustees has cautioned that applying § 523(a) to corporate debtors will lead them to "turn away from Subchapter V, the exact opposite outcome of what Congress intended."³¹

Small Business Debtors Still Choosing Subchapter V Despite Nondischargeability Risk

ABI collects data on subchapter V filings by month, year, state and circuit.³² These figures have shown no dip in subchapter V filings following the *Cleary Packaging* and *GFS Industries* decisions. *Cleary Packaging* was decided on June 7, 2022, and that month, 10 subchapter V cases were filed in the Fourth Circuit. The next month, only two³³ were filed, but for the remainder of 2022, filings remained at the same or higher levels.³⁴ Filings remained steady during all of 2023 (see Exhibit 1 on p. 61).

GFS Industries was decided on April 17, 2024. In April 2024, 25 subchapter V cases were filed in the Fifth

Circuit.³⁵ In May 2024, 23 were filed;³⁶ in June 2024, there was a spike given the sunset of the \$7.5 million debt limit on June 21, 2024. Filings remained fairly steady after the June spike, with 24, 35, 20 and 30 filings in July through October, respectively³⁷ (see Exhibit 2 on p. 61).

This trend held nationwide after the *GFS Industries* decision. In April 2024, there were 248 subchapter V filings nationwide, then 239 in May.³⁸ There was a national June spike in advance of the debt limit sunset, for 321 total filings.³⁹ There were 175 in July, 196 in August, 168 in September and 204 in October.⁴⁰ More generally, subchapter V small business elections increased 9 percent, to 167, in September 2024 from September 2023⁴¹ (see Exhibit 3 on p. 61). In other words, it appears that potential subchapter V debtors have not been deterred by the specter of post-confirmation litigation made more likely by the *Cleary Packaging* rule, and they still view the benefits of subchapter V as outweighing the potential drawbacks. **abi**

Editor's Note: *ABI's Subchapter V Task Force's Final Report and recommendations to Congress is posted at subvtaskforce.abi.org. All members are invited to submit their experiences with subchapter V at abi.org/subvstories.*

³⁰Hon. Paul W. Bonapfel, Hon. Michelle M. Harner, Robert J. Keach, Megan W. Murray, Prof. Alexandra Sickler, Donald L. Swanson, Lisa A. Tracy & Jolene E. Wee, Subchapter V Task Force Report and Recommendations, ABI Annual Spring Meeting 513, 520 (2024), abi-org-corp.s3.amazonaws.com/materials/SubchapterVTaskForceReport_0.pdf.

³¹ *Avion Funding v. GFS Indus.*, Case No. 23-50237, Docket No. 44 (5th Cir. Aug. 24, 2023).

³² See tinyurl.com/ABISubV-Month-Circuit-State.

³³*Id.*

³⁴*Id.*

³⁵*Id.*

³⁶*Id.*

³⁷*Id.*

³⁸*Id.*

³⁹*Id.*

⁴⁰*Id.*

⁴¹ "Bankruptcy Statistics," ABI, abi.org/newsroom/bankruptcy-statistics.

Benchnotes

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slant" on application of equitable tolling, and trustee's ability to bring avoidance actions in involuntary chapter 7 case is often subject to cooperation of debtor);

• *In re Jackson*, 663 B.R. 738 (B.A.P. 8th Cir. 2024) (dismissing as constitutionally moot debtor's appeal from bankruptcy court's order annulling and retroactively vacating automatic stay to give effect to U.S.'s post-petition eviction of debtor from four properties that he owned and seizure of personal property left at eviction sites, where debtor failed to obtain stay of order and properties were sold at auction during pendency of appeal; because properties had been sold to *bona fide* purchaser, "there is no effective relief that may be accorded Jackson regarding his requests for return of his property"; because order annulling automatic stay was moot, debtor's appeal of order denying contempt sanctions was also moot, as "[t]here can be no basis for contempt based on a violation of the stay once the stay is annulled");

• *In re Bohman*, 2024 WL 4564547 (Bankr. D. Utah 2024) (retired anesthesiologist was not "engaged in commer-

cial or business activities" at time he filed individual chapter 11 petition, and thus was ineligible to file under subchapter V; debtor's only source of income in two years prior to bankruptcy filing was from Social Security; volunteer work that debtor performed for family ranch was not commercial or business activity because work did not involve purchase or sale of commodities and was not means of livelihood or employment for gain; while debtor owned interest in defunct mining business, there was no credible evidence that debtor intended to recommence business operations as of petition date, and debtor's tangential involvement in business's appeal from adverse judgment was not significant enough to prove that debtor was engaged in commercial or business activities as of petition date);

• *In re Celsius Network LLC*, 2024 WL 4564200 (Bankr. S.D.N.Y. Oct. 24, 2024) (court would authorize service of process on defendants in fraudulent-transfer avoidance lawsuits "by airdropping a nonfungible token ... to their cryptocurrency wallet addresses," where plaintiff was unable

to locate or identify defendants; service in this manner was reasonably calculated to apprise defendants of pendency of action because “each wallet is a pseudonymous identifier of a single wallet-holder, and only that individual who owns a private key to a given wallet can access the wallet,” and it was unlikely that wallets had changed hands after alleged fraudulent transfers of cryptocurrency into wallets);

• *In re Freeman*, 2024 WL 4546980 (Bankr. N.D. Miss. Oct. 22, 2024) (chapter 7 trustee’s motion for summary judgment on adversary complaint to compel debtor’s nonfiling estranged spouse to turn over home in which she was living so that home could be sold and proceeds distributed to creditors would be granted in part and denied in part; trustee proved that home was estate property because it was acquired by debtor and spouse while they were married and was therefore community property under California law, and included in bankruptcy estate pursuant to 11 U.S.C. § 541(a)(2); court had already denied debtor’s claim of homestead exemption in home, and nondebtor spouse had no right to claim exemption in home on her own behalf; however, issue of fact existed as to whether home was “of inconsequential value or benefit to the estate”; although home had more than \$373,000 in nonexempt equity, there were only three claims filed against estate, and two of them appeared to be sole and separate debt of debtor rather than community claims, such that they could not be satisfied out of community property pursuant to 11 U.S.C. § 726(c); record was not sufficiently developed to determine whether third claim of \$7,140.38 was fully or par-

tially enforceable against community property, and court had to weigh amount of claims that could actually be paid out of proceeds from sale of home against administrative and other costs of sale to determine whether home was of inconsequential value or benefit); and

• *In re Fawcett*, 2024 WL 4553195 (Bankr. E.D. Mo. Oct. 22, 2024) (state of Missouri, which brought claim on behalf of class of consumers, was entitled to judgment against chapter 7 debtor who owned and controlled construction company that took down payments from customers without intent or ability to complete construction work; in addition to establishing right to judgment under state consumer fraud statute, state proved that claim satisfied elements of nondischargeability under 11 U.S.C. § 523(a)(2)(A) for false pretenses, false representations or actual fraud; debtor, by himself and acting through construction company’s sales representative, told customers that company would complete their construction projects; despite debtor’s testimony that he believed that company would finish work, evidence showed that debtor knew or should have known that representations were false given company’s insolvency and undercapitalization and debtor’s control over company’s financial accounts and records; debtor intended to deceive customers into paying substantial down payments without intention that company would complete work, and customers justifiably relied to their detriment on debtor’s misrepresentations; penalties and fine to which state was entitled under consumer fraud statute were nondischargeable under 11 U.S.C. § 523(a)(7)). **abi**

Legislative Highlights

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“Our bipartisan bill eliminates those loopholes that have allowed predatory practices to flourish by banning upfront fees, improving transparency, and enhancing consumer protections,” Rep. McBride said. She referenced a Consumer Financial Protection Bureau (CFPB) lawsuit last year against a conglomerate of the nation’s largest credit-repair organizations for illegally collecting fees, the result of which now has the CFPB distributing \$2.7 billion to more than 4 million affected consumers. “To prevent such abuses in the future, the [ES CRA] prevents credit-repair organizations from charging illegal upfront fees.”

“Fraudulent credit repair organizations, or CROs, should not get away with scamming hardworking Americans seeking to improve their scores and unlock their American dream,” Rep. Kim said. The ESCRA “helps consumers and hikes penalties for scammers.”

CFPB Finalizes Rule to Remove Medical Bills from Credit Reports

The CFPB on Jan. 7 finalized a rule⁴ that will remove an estimated \$49 billion in medical bills from the credit reports of about 15 million Americans. The CFPB’s action will ban

the inclusion of medical bills on credit reports used by lenders and will prohibit lenders from using medical information in their lending decisions. The rule will increase privacy protections and prevent debt collectors from using the credit-reporting system to coerce people into paying bills they do not owe.

The CFPB’s new rule amends Regulation V, which implements the Fair Credit Reporting Act (FCRA), to end this exception and establish guardrails for credit-reporting companies, prohibiting them from including medical bills on credit reports sent to lenders, who are banned from considering them. The final rule:

• *Prohibits lenders from considering medical information:* The rule ends the special regulatory carveout that previously allowed creditors to use certain medical information in making lending decisions. This means lenders also will be barred from using information about medical devices, such as prosthetic limbs, that could be used to require that the devices serve as collateral for a loan for the purposes of repossession.

• *Bans medical bills on credit reports:* The rule bans credit-reporting agencies from including medical debt information on credit reports and credit scores sent to lenders. Lenders will continue to be able to consider medical information to verify medical-based forbearances, verify medical expenses that a consumer needs a loan to pay, consider certain benefits as income when underwriting, and other legitimate uses. **abi**

⁴ “CFPB Finalizes Rule to Remove Medical Bills from Credit Reports,” Consumer Fin. Prot. Bureau (Jan. 7, 2025), consumerfinance.gov/about-us/newsroom/cfpb-finalizes-rule-to-remove-medical-bills-from-credit-reports.

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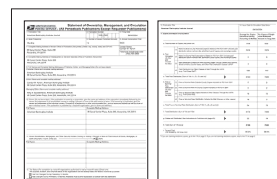
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The ABI Journal (ISSN: 1931-7522) is published 12 times per year for the price of membership by the American Bankruptcy Institute, 99 Canal Center Plaza, Suite 200, Alexandria, VA 22314-5511, (703) 739-0800, Fax (703) 739-1060, info@abimail.org, abi.org. Periodical postage paid at Alexandria, VA, and additional mailing offices. POSTMASTER: Send address changes to ABI, 99 Canal Center Plaza, Suite 200, Alexandria, VA 22314-5511.

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