This has been an unusual year. At present, there are no pending bankruptcy cases before the United States Supreme Court. I was hoping that the Court would grant *certiorari* in the *Tribune* case, but the Court denied *certiorari* on April 20, 2021. Therefore, I shall spend some time covering the only recent U.S. Supreme Court bankruptcy case, *City of Chicago, Illinois v. Fulton*.

Is Holding the Debtor's Car Hostage an Exercise of Control?

***City of Chicago, Illinois v. Fulton*, 208 L. Ed. 2d 384 (2021)**

So far in this term, the U.S. Supreme Court has not granted a petition for writ of *certiorari* in any bankruptcy case. The only bankruptcy case decided this term was a case that should have had oral argument last March but, because of the COVID pandemic, was not argued until last November. In *Fulton*, the issue before the Court was who has the burden of going forward when the creditor has possession but not title to its collateral– 1) the debtor or trustee or (2) the secured or unsecured creditor. If the automatic stay applies to mere possession, the creditor must immediately turn over the collateral or seek relief from the bankruptcy court. If the stay does not apply, the debtor or trustee must file an adversary complaint and seek turnover pursuant to 11 U.S.C. § 542. On January 14, 2021, the Court ruled that mere possession of the debtor's property by the creditor who does not take any other action was not a stay violation. Thus it is the Debtor's or Trustee's burden to bring an adversary complaint to enforce its rights.

Justice Sotomayor provided an excellent summary of the facts in her concurring opinion. One of the appellees was George Peake. Mr. Peake relied on his 200,000-mile 2007 Lincoln MKZ to travel 45 miles each day from his home on Chicago's South Side to his job in Joliet. In June 2018, the City of Chicago impounded Peake's car for unpaid parking and red light tickets. While the vehicle was worth just around $4,300, the vehicle was subject to a $7,430 consensual first priority security interest. For its part, the City was owed $5,393.27 and asserted a junior lien.

Without his car, Mr. Peake had to pay for rides to Joliet, which were not inconsequential. Mr. Peake filed a Chapter 13 case hoping to recover his car and confirm a chapter 13 plan that would repay his creditors, including the City. The City, however, demanded that he pay $1,250.00 on its unsecured claim or Mr. Peake would have to wait until the court confirmed his plan. Under 11 U.S.C. § 1326, Mr. Peake, with or without his car, was required to commence payments under his plan within thirty days of filing of the plan. Justice Sotomayor observed that the average adversary proceeding takes 100 days.

The other two appellees' stories are not much different. In Ms. Fulton's case, she was a single mother with a preschooler. She used the car for work, to care for her elderly parents and to take her child to day care. The City seized her car on Christmas Eve. Ms. Fulton filed a Chapter 13 case and filed a motion for a turnover order. The City claimed that she should have filed an adversary complaint and refused to return the car to her despite a bankruptcy court order and the passage of eight months' time.

The issue facing the Court was whether the City's actions violated the automatic stay. Was the City required to surrender the cars upon demand pursuant to 11 U.S.C. § 542 or were the debtors required to file an adversary proceeding for a turnover.

The starting point is 11 U.S.C. § 362(a). Section 362(a)(3) stays "any act to obtain possession of property of the estate or of property from the estate *or to exercise control over property of the estate."* The italicized language was added in the 1984 amendments to the Bankruptcy Code. Some commentators argue that this language was only designed to deal with intangible personal property as to which no one could obtain physical possession.[i] That is a minority view. Thus, the question is whether mere possession, without doing more, constitutes exercising control. Justice Alito, in writing for the Court, focused on the phrase "any act" in the

prefatory language of section 362. 141 S. Ct. at 590. He reasoned that, since only conduct that disturbs the status quo is an act, passive possession is not an act. *Id*. The automatic stay simply freezes on a temporary basis the parties' positions. *Id.; see also In re Denby-Peterson*, 941 F.3d 115, 125 (3d Cir. 2019); *In re Cowen*, 849 F.3d 943, 949-50 (10th Cir. 2017); ACT, Black's Law Dictionary (11th ed. 2019) (defining "act" as "something done or performed, esp. voluntarily; a deed."). In reality, the City had locked up the car in a pound and hired guards and perhaps vicious guard dogs to keep the cars' owners away. The debtors' cars were not simply parked on the street. Nevertheless, the Court held that a stay constitutes only a temporary freeze to preserve the status quo as long as the creditor takes no affirmative action. 141 S. Ct. at 590.

The Court supported its conclusion by referring to 11 U.S.C. § 542, which with limited exceptions provides:

> Any entity, other than a custodian, in possession, custody or control, during the case, of property that the trustee may use, sell or lease under section 3632 of this title, or that the debtor may exempt under section 522 of this title shall deliver to the trustee, and account for, such property or the value of such property unless such property is of inconsequential vale or benefit to the estate.

The Court concluded that if 11 U.S.C. § 362 (a)(3) was self-executing, then 11 U.S.C. § 542 would be superfluous. 141 S.Ct. at 591. If the City had to immediately surrender the cars, what additional purpose would section 542 provide? In addition, the respondents' interpretation would render the two sections contradictory. If 11 U.S.C. § 362(a)(3) were self-executing, the exceptions for turnover of property of inconsequential value listed in section 542 would be trumped by section 362(a)(3).

The Court left open two issues. First, respondent Shannon argued in the bankruptcy court that the City's actions violated both 11 U.S.C. § 362(a)(4) and (6). Subsection (a)(4) covers any action to create, perfect or enforce against any property of the debtor any lien to the extent that

such lien secures a claim that arose before the commencement of the case. Subsection (a)(6) may be more applicable; it stays any act to collect, assess, or recover a claim against the debtor that arose before the commencement of the case. Does holding the debtor's car hostage for $1,200 ransom constitute a violation of subsection (a)(6)? While Shannon made this argument successfully to the trial court, the Court of Appeals for the Seventh Circuit did not address it. While at least one of the *amici* raised it, and it was raised in oral argument, the Court declined to comment on subsection (a)(6).

Finally, even though the Court queried the lawyers for a solution, the Court refused to come up with a method for aiding debtors whose cars are held hostage. *In Citizens Bank of Maryland v. Strumpf*, 516 U.S. 16 (1995), the Court held that where there were clashing rights, it would permit the Bank, in an account setoff case, to institute an administrative freeze and immediately seek stay relief from the court. Such a remedy in this case could resolve the conundrum identified by Justice Sotomayor. However, the Court declined to provide any procedural guidance other than Judge Sotomayor's plea that the Rules Committee address the problem.

While this case dealt with a Chapter 13 case, the same problem confronts Chapter 7 trustees. Chapter 7 trustees simply cannot demand a secured creditor (or as in this case an unsecured creditor), to turn over property under pain of contempt. Under Federal Rule of Bankruptcy Procedure 7001, if the creditor refuses to voluntarily turn over the collateral, the debtor or the trustee must file an adversary complaint.

Nothing in this case disturbs the U.S. Supreme Court's holding in *United States v. Whiting Pools, Inc.*, 462 U.S. 198 (1983), mandating that secured creditors turn over property of the estate to the trustee subject to receiving adequate protection of their interest in the collateral. Thus, in

many respects, the *Fulton* case deals with procedure and not substance. But, it does create a hurdle for trustees and debtors, particularly when the creditor mounts a "Stalingrad Defense."

In re Tingling, 990 F.3d 304 (2d Cir. 2021)

In *Tingling*, a Chapter 7 debtor asked the Court of Appeals for the Second Circuit to revisit its famous decision in *Brunner v. N.Y. State Higher Educ. Service Corp.*, 831 F.2d 395 (2d Cir. 1987). The *Brunner* test requires the debtor to (1) prove that she cannot maintain, based on current income and expenses, a "minimal" standard of living for herself and her dependents, if she is forced to repay the loans (2) that additional circumstances exist indicating that the state of affairs is likely to persist for that significant portion of the repayment period of the student loans, and 3) that the debtor has made good faith efforts to repay the loans. Over 1,000 cases have cited the *Brunner* test. All of the circuits save two have agreed with the holding. However the Court of Appeals for the Eighth Circuit adopted a totality of the circumstances test in *Educ. Credit Mgmt. Corp. v. Jesperson*, 571 F.3d 775 (8th Cir. 2009). The First Circuit has declined to take a position on the *Brunner* Test. *See Nash v. Connecticut Student Loan Found.*, 446 F.3d 188 (1st Cir. 2006). Attached as Exhibit A is my essay on student loans.

Tingling asked the Court of Appeals take a fresh look at the student loan discharge rule. The Court reaffirmed the *Brunner* test. The court noted that Tingling's income was above the poverty line and that Tingling failed to show that she could reduce her discretionary expenses in order to maintain a minimal standard of living and still make loan payments. In terms of the second prong, the Court found that Tingling was of a young age (52), lacked dependents, and had two degrees in healthcare administration. She was in good health and had failed to introduce any evidence that a recently diagnosed tumor would impair her earnings. Finally, Tingling failed to

show that she had availed herself of any of the various federal programs which allow repayment on an income basis, and she pocketed her annual $4,000 tax refund.

In summary, the Court made it very clear that it felt discharges of student loans should be granted only in extraordinary circumstances.

One case is worth watching, *In re Acosta-Conniff*, 686 Fed. Appx. 647 (11th Cir. 2017). In that case, the trial court not only applied the *Brunner* test, but held that anyone borrowing money to be a school teacher in Alabama must realize that a teacher's pay in Alabama is so parsimonious that the debtor should have known that she would never be able to repay the loans. Fortunately, the Court of Appeals reversed and held that an income expectation component should not be added to the *Brunner* test. The case has been on remand for three years.

The case is important when I see as a trustee debtors borrowing $646,000 for a Ph.D in music or $250,000 for a master's degree in social work. How could these debtors or the schools that processed these loans ever expect that the debtor could ever retire these debts.

What is clear from these cases is that Congressional action is need. Both the Commercial Law League and the American Bankruptcy Institute have presented proposed changes to the *Brunner* test and the statute, while politicians argue for simple forgiveness at the expense of the taxpayers. Stay tuned.

***In re Nuverra Environmental Solutions, Inc.*, 834 Fed. Appx. 729 (3d Cir. 2021)**

Once again, the loser's right to appeal may be an illusionary one. The Court of Appeals for the Third Circuit recently reaffirmed its precedent with respect to the doctrine of "equitable mootness." In *Nuverra*, a creditor held $450,000.00 in unsecured bonds issued by the debtor. The debtor filed a Chapter 11 petition and a plan which provided for a 54% recovery for secured creditors plus equity (*i.e.,* hope certificates). The unsecured creditors would receive 6% on their

claims. In addition, the debtor proposed to pay 100% to a privileged group of trade creditors whose support the debtor felt was needed for a successful post-confirmation operation. This bonus was advertised as a gift from the secured creditors. Absent the secured creditors' consent, this was a zero-cent case for unsecured creditors, including the trade creditors.

The bankruptcy court confirmed the plan and an unsecured creditor appealed. The district court and the bankruptcy court refused to stay the confirmation order pending appeal. The creditor appealed to the Court of Appeals for the Third Circuit. The creditor demanded that either the class be paid in full or its claim be paid in full and the rest of the creditors receive their 6% recovery. While the appeal was pending, the debtor substantially consummated its plan. The Court held that unless there is a way to prevent fatally scrambling the plan or harming third parties who relied on the confirmation order, the doctrine of equitable mootness mandated dismissal of the appeal.

The Court of Appeals concluded that section 1123(a)(4) of the Bankruptcy Code precluded the creditor from receiving more on its claim than other members of its class. The Court then concluded that it could not grant relief to the unsecured creditor class as a whole without fatally scrambling the plan.

Judge Krause, a member of the panel, criticized the Court's reliance on the doctrine of equitable mootness because there is nothing in the Bankruptcy Code that permits it. She viewed the doctrine of equitable mootness as an abdication of the Court's appellate jurisdiction to correct any wrongs in a confirmed plan.

As a final note, if you are litigating in the Seventh Circuit, the term "equitable mootness" is banned by order of former Judge Posner from the appellate lexicon and is replaced by the doctrine of impossibility to grant relief.

In re Wilton Armetal, Inc., 968 F.3d 273 (3d Cir. 2020)

Are We in Canada?

In *In re Wilton Armetal, Inc.*, the Court of Appeals for the Third Circuit held that Chapter 7 Trustees have authority to abandon estate causes of action to individual creditors. In that case, Creditor A had sold goods to the debtor. The debtor's artful management failed to pay for the goods, but instead started transferring assets to other entities controlled by that management and favored creditors. The angry creditor sued the favored creditor, the debtor's lawyer, to avoid all transfers to them and for aiding and abetting a breach of fiduciary duty. The defendants all filed motions to dismiss. The defendants argued that avoidance actions and actions where the injury is to the debtor and creditors' injuries are derivative of that injury constitute property of the estate and therefore cannot be brought by individual creditors.

The Court of Appeals agreed with the defendants that such actions were property of the estate. But, the court noted that the trustee had procured an order abandoning all property not listed in the order. Creditor A's causes of action were not listed. The Court of Appeals concluded that the causes of Action described in Creditor A's suit were not property of the estate. However, it is not clear whether an order of abandonment must state to whom the cause of action is abandoned? The default seems to be the pre-petition debtor. Second, what if Creditor A had offered to pay the trustee money for abandoning the cause of action. Would that be permitted? Finally, what would happen if the trustee simply filed a motion pursuant to 11 U.S.C. § 363 to sell causes of action? Some courts do permit the debtor to pledge avoidance actions to the secured creditor either by granting a security interest or a super priority claim with recourse to avoidance action proceeds.

In Canada, under the Company's Creditors' Arrangement Act or the Bankruptcy Insolvency Act, a trustee can simply sell the causes of action to a stranger. Toronto, here we come.

Creditors' counsel must also look at the three degrees of separation:

First Degree: Avoidance, indirect and derivative. If the action is an avoidance action or an action where the creditor's injury is derivative of an injury to the debtor, this is estate property and the Court of Appeals so held.

Second Degree: Direct or non-derivative, but related: What if the cause of action is direct or non-derivative. For example, the debtor's accountant made direct fraudulent misrepresentations to the creditor and also committed fraud or malpractice against the debtor. This is not property of the estate, but the Trustee may seek an injunction to enjoin such suits. *See, e.g., Fisher v. Apostolou*, 155 F.3d 876 (7th Cir. 1998). To win, the trustee must establish that the creditor's cause of action and the trustee's cause of action arise out of the same set of operative core facts and that permitting the creditor's action to proceed would provoke a race to the courthouse and defeat the principle of equality of distribution.

Third Degree: direct or non-derivative, but unrelated. For example, a debtor's employee has an automobile accident with a customer of the debtor in the debtor's parking lot. The injured customer should be allowed to proceed with its suit notwithstanding the fact that the debtor may have a separate claim against the customer arising from the debtor's sale of goods to the customer. An injunction will fail.

***Tufts v. Hay*, 977 F.3d 1204 (11th Cir. 2020)**

If you are called upon to represent a trustee, debtor in possession or creditors' committee, in the Eleventh Circuit, be sure to know your rights. In *Tufts v. Hay*, a chapter 11 debtor asked plaintiff Thomas Tufts and his law firm to act as special counsel. Unfortunately, the debtor's lead bankruptcy counsel forgot to have Tufts' retention approved by the bankruptcy court, despite assuring Tufts that they had done so. Ultimately, the bankruptcy court found out about this oversight and ordered Tufts' firm to return all of it post-petition fees. Tufts then sued the debtor's lead bankruptcy counsel for negligent and intentional misrepresentation and indemnification. The trial court dismissed the case on the basis of the *Barton* doctrine, which requires a party who wishes to sue a bankruptcy estate fiduciary or their counsel to get the bankruptcy court's permission first. The Court of Appeals reversed

Because the bankruptcy court had dismissed the bankruptcy case, the Eleventh Circuit held that the *Barton* doctrine did not apply, and that Tufts' lawsuit against the lead bankruptcy counsel could proceed. However, the Court of Appeals was careful to acknowledge the merits of the *Barton* doctrine, and suggested that there were reasons to apply the doctrine after the case was dismissed, but unfortunately the defendant law firm did not raise them.

***Hobbs v. Buffets LLC*, 979 F.3d 366 (5th Cir. 2020)**

The U.S. Trustee program had a shortfall in 2017, so Congress increased the quarterly fees that fund the program for the period 2018 through 2022. Prior to 2017, the U.S. Trustee fees and the fees paid to bankruptcy administrators in North Carolina and Alabama were the same. However, the new fee increase did not apply to those two states.

In *Hobbs v. Buffets LLC*, the Court of Appeals for the Fifth Circuit addressed this discrepancy. In that case, the debtor filed a chapter 11 case in 2016 and confirmed its plan in 2017. The debtor continued to make payments to its creditors well into 2018, a year in which the fee

increase applied. The debtor objected to the increased fees because, in the debtor's opinion, the increase was retroactive and violated the bankruptcy uniformity clause of the Constitution, as the fee increase only affected states subject to the U.S. Trustee system. North Carolina and Alabama do not have U.S. Trustees, but instead have administrators from the Clerk's office. Thus, the debtors in those two states therefore pay less fees than the debtors in U.S. States.

The Court of Appeals rejected both arguments. First, the Court concluded that the fees would be paid after enactment and not before. Therefore, it was not retroactive. Second, the panel ruled two-to-one that the uniformity clause was not offended. The issue before the Court was whether the increase was arbitrary based upon geography. The majority held that it was not arbitrary to charge a fee to those states where the debtors enjoyed the benefits of the U.S. Trustee program while not imposing the fees on states where there were no similar benefits. There was a strong dissent.

***Kelly v. Boosalis*, 974 F.3d 884 (8th Cir. 2020)**

This case arises out of the Petters ponzi scheme. The Trustee sued Boosalis to clawback fraudulent transfers made to Boosalis during the course of the scheme. The jury brought in a verdict for over $7 million dollars. The Judge applied Minnesota state law to the interest rate and imposed an additional million dollars in damages.

The issue in the case was whether the trustee had to prove that each payment was avoidable or could the trustee succeed in simply stating the there was a common scheme. Second, could the trustee avoid the payments of interest by the Ponzi scheme operator to the defendant? Finally, did the trial court err in awarding the state interest rate rather than the federal interest rate?

***Matter of Ward*, 978 F.3d 298 (5th Cir. 2020)**

How does a transfer of the venue of a Chapter 7 case (and the resultant issuance of a new § 341 meeting date) affect the timing of the deadline to object to a debtor's discharge? The Fifth Circuit recently addressed this question in *Matter of Ward*. In that case, the debtor originally filed in the U.S. Bankruptcy Court for the Eastern District of Texas, but the case was later transferred to the Northern District of Texas. The first court had set a date for the 11 U.S.C. § 341 meeting of creditors for May 30, 2014. Under the Federal Rules of Bankruptcy Procedure, the debtor's creditors therefore had until July 29, 2014 (i.e. sixty days after the § 341 meeting) to file a complaint objecting to discharge or dischargeability.

Before May 30, 2014, the debtor filed an agreed motion to transfer the case to the Northern District of Texas. The Clerk for the Northern District of Texas set a new section 341 meeting for July 22, 2014. The last day for objection to discharge in the N.D. Texas was September 20, 2014. On August 27, 2014, after the discharge objection deadline had passed when calculated from the § 341 meeting date set by the original court but not when calculated from the meeting date set by the transferee court, a creditor moved to extend the deadline to object. The Debtor objected to the extension on the grounds that the deadline had already passed because it had been more than 60 days since the section 341 meeting set by the clerk of the Eastern District of Texas. The Bankruptcy Court for the Northern District of Texas disagreed and granted the extension motion.

The Court of Appeals affirmed. While conceding that the deadline set forth in Bankruptcy Rule 4004 is to be strictly construed, it held that the parties were entitled to rely on the Clerk of the Northern District of Texas resetting the first meeting. In other words, everybody was guilty. Somebody should have told the transferee court about this problem and that court could have extended the deadline. However, since this anomaly was created by the court's clerk in the

Northern District of Texas and the parties were entitled to rely on the Court's clerk. This is precisely the sort of anomaly 11 U.S.C. § 105 was designed to remedy.

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[i] See Brubaker Ralph ,
Turnover, Adequate Protection and the Automatic stay Part 1 Origins and Evolution of the Turnover Power 33 Bankr. L. Letter No. 8 (Aug. 2013)
"Who is exercising Control Over What 33 Bankr. L. Letter No. 9 (September 2013) and
Adequate Protection and the Automatic Stay: A Reply to Judge Wedoff, 38 Bankr. L Letter No 11 (Nov 2018).