

Supplement to

Problems and Materials
on Bankruptcy Law and Practice

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Chapter Two

Page 22:

In *Stern v. Marshall*, [131 S. Ct. 2594](#) (2011), the Supreme Court addressed the bankruptcy court's power to adjudicate a "core proceeding" under 28 U.S.C. § 157(b)(2), a tortious interference counterclaim asserted in response to a claim filed against the bankruptcy estate. The Court held that even though § 157(b)(2) authorized the court to enter final judgment on the counterclaim, Article III of the U.S. Constitution did not. Such state law claims that are not necessarily resolved as part of a allowance or disallowance of a claim against the bankruptcy estate may not be finally adjudicated by a non-Article III judge.

Page 23, add to n.21:

See *In re Villarreal*, [413 B.R. 633](#) (Bankr. S.D. Tex. 2009), *appeal certified*, [2009 WL 2601298](#) (Bankr. S.D. Tex. 2009) (bankruptcy courts are not bound by decisions of district courts in multi-judge districts).

Page 24, add to n.23:

According to one court, by authorizing the direct appeal of a bankruptcy court order to the court of appeals on certification from a BAP, *see* 28 U.S.C. § 158(d)(2), the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109–8, 119 Stat. 23, impliedly indicates that Congress regarded BAP decisions as non-binding on bankruptcy courts. Otherwise, the BAP could simply take the appeal, forget certification, and provide an authoritative pronouncement itself. See *In re Rinard*, [451 B.R. 12](#) (Bankr. C.D. Cal. 2011).

Page 45:

The last paragraph indicates that all the courts to face the issue have ruled that § 526(a)(4) is unconstitutional. However, in *Hersh v. U.S. ex rel. Mukasey*, [553](#)

[F.3d 743](#) (5th Cir. 2008), *cert. denied*, 130 S. Ct. 1878 (2010), the Fifth Circuit Court of Appeals narrowed the scope of § 526(a)(4) to avoid potential constitutional questions. In so doing, the court held that the provision prohibits bankruptcy counsel from advising their clients to incur debt in contemplation of bankruptcy when doing so would be an abuse or improper manipulation of bankruptcy system. As so limited, the court also ruled it was neither overbroad or facially violative of counsel's free speech rights. The Eighth Circuit Court of Appeals refused to so limit § 526(a)(4) when it affirmed a lower court ruling that the provision is unconstitutional. *Milavetz, Gallop & Milavetz, P.A. v. United States*, [541 F.3d 785](#) (8th Cir. 2008).

In March of 2010, the Supreme Court reversed the court's decision in *Milavetz*. [130 S. Ct. 1324](#). In doing so it agreed to limit the scope of § 526(a)(4), but not in the way the Fifth Circuit Court of Appeals had done. Instead of restricting it to advice that would be an abuse of the bankruptcy system, the Court concluded that § 526(a)(4) "prohibits a debt relief agency only from advising a debtor to incur more debt because the debtor is filing for bankruptcy, rather than for a valid purpose." Although the precise reach of this narrowed scope remains unclear, the Court discussed a variety of concerns that underlie the prohibition: (i) that the newly incurred debt might be dischargeable, and therefore incurred without the intent to repay; (ii) that the new debt might dilute the bankruptcy estate; (iii) that the new debt might affect the debtor's eligibility under one or more chapters of the Code; or (iv) that the new debt, particularly if it is secured, might affect how the means test is applied. The Court treated § 526(a)(4) as responding to all of these concerns, and thus, the prohibition appears to remain fairly broad. However, § 526(a)(4) does not encompass advice unrelated to bankruptcy, such as a recommendation to incur debt to buy needed food, shelter, or medical care.

The Court did offer one bone to debtors and their attorneys. The Court expressly noted that the statute prohibits merely *advising* the debtor to incur debt, noting that "[c]overed professionals remain free to 'tal[k] fully and candidly about the incurrence of debt in contemplation of filing a bankruptcy case.'" Therefore, attorneys who simply explain options and their consequences will apparently not violate § 526(a)(4). For the moment, however, it is unclear whether bankruptcy attorneys will feel comfortable relying on the distinction between information and advice.

Chapter Three

Page 55:

Another example of an expectancy that may not rise to the level of a property right is a tribal member's interest in future per capita distributions from the tribe. See *In re Fess*, 408 B.R. 793 (Bankr. W.D. Wis. 2009) (ruling that because the tribal member had no right to the distribution under tribal law prior to payment, the future distributions were not property of the estate). But see *In re Howley*, 446 B.R. 506 (Bankr. D. Kan. 2011), appeal dismissed, 2011 WL 4440070 (D. Kan. 2011) (declining to follow *In re Fess*).

Page 57, add to n.10:

See also *In re Cutter*, 398 B.R. 6 (9th Cir. BAP 2008) (property contributed to self-settled Californian spendthrift trust was property of the debtor's estate).

Page 57:

In a very interesting opinion, one bankruptcy court ruled recently that a deposit account containing prepetition contributions to the debtor's campaign for reelection as a state representative was property of the estate. *In re Chambers*, 451 B.R. 621 (Bankr. N.D. Ga. 2011). The court concluded that a state statute restricting how the funds could be used did not determine ownership of the funds.

Page 58:

The language of § 541(a)(5) is apparently not adequate to bring into the estate all property that the debtor becomes entitled to receive by virtue of someone's death within the 180-day period following the petition. In *In re Hall*, 441 B.R. 680 (10th Cir. BAP 2009), the debtor's father passed away 18 days after the petition was filed. As a result, the debtor became entitled to receive: (a) certificates of deposit; (b) a one-fifth interest in certain real property; (c) United States bonds; and (d) an

individual retirement account, all as a payable-on-death beneficiary or similar beneficiary designation. The court ruled that although “payable on death” designations for financial assets and transfer on death deeds are often used as will substitutes, the beneficiary does not acquire the property by “bequest, devise, or inheritance,” the phrased used in § 541(a)(5). Accordingly, none of the property was included in the debtor’s bankruptcy estate.

Page 66, add to n. 22:

See also In re Meyers, [616 F.3d 626](#) (7th Cir. 2010) (allocating a tax refund based on the portions of the taxable year falling pre- and post-petition is appropriate for debtors whose income and withholdings were fairly stable).

Page 66:

A completely different allocation problem may arise over the right to a tax refund if a married couple files a joint tax return but only one of them files for bankruptcy protection. In such a case, the court must ascertain the portion of the couple’s total tax liability attributable to each – based on their individual incomes – and compare that to the tax payments that each of them made. *See In re Crowson*, [431 B.R. 484](#) (10th Cir. BAP 2010) (treating tax credits as payments for this purpose); *In re Palmer*, [449 B.R. 621](#) (Bankr. D. Mont. 2011); *In re Evans*, [449 B.R. 827](#) (Bankr. N.D. Ga. 2010). *Contra In re Smith*, [2011 WL 345865](#) (Bankr. S.D. Ind. 2011) (spouses presumptively share equal ownership of a right to a tax refund, which may be rebutted only by evidence of a domestic relations court order or an enforceable, written, prepetition contract).

Page 82, add to n. 32:

While the earmarking doctrine may survive, courts strictly enforce the requirement that the debtor have no access to or control over the newly loaned funds. *See, e.g., In re Marshall*, [550 F.3d 1251](#) (10th Cir. 2008), *cert. denied*, 129 S. Ct. 2871 (2009) (balance transfer from one credit card issuer to another was a transfer of an interest in the debtor’s property during the preference period; the

earmarking, even if it extends beyond the co-debtor context, protects the preferred creditor only if the new lender requires the funds be used to pay a specific debt, which was not the case here); *In re Entringer Bakeries, Inc.*, 548 F.3d 344 (5th Cir. 2008) (earmarking doctrine did not insulate from avoidance as a preferential transfer a pay off of bank with funds provided by refinancing lender because the debtor had control of the funds before making the payment and because the debtor had never stipulated to the refinancing lender that it would use the funds to pay off the bank).

Page 119, add to the Notes after the BFP case:

4. One bankruptcy court has applied *BFP*'s presumption of reasonable equivalence to a transfer made pursuant to court-ordered payment in connection with a criminal case. According to the court, absent extrinsic evidence of fraud or collusion between the sovereign and the criminal defendant, any payment the defendant makes pursuant to a plea agreement approved by a court will be in exchange for reasonably equivalent value (*e.g.*, longer jail terms, more substantial fines, and the costs of trial). *In re Citron*, 428 B.R. 562 (Bankr. E.D.N.Y. 2010), *reconsideration denied*, 433 B.R. 62 (Bankr. E.D.N.Y. 2010). *See also In re Zerbo*, 397 B.R. 642 (Bankr. E.D.N.Y. 2008) (division of assets incident to divorce is conclusively deemed to be for reasonably equivalent value if the division of assets was approved by a matrimonial court and if there is no evidence of extrinsic fraud or collusion among the divorcing parties).

5. In a very interesting and somewhat controversial decision, one bankruptcy court has ruled that *BFP* does not apply to preference actions under § 547. *See In re Villarreal*, 413 B.R. 633 (Bankr. S.D. Tex. 2009), *appeal certified*, 2009 WL 2601298 (Bankr. S.D. Tex. 2009). In that case, a creditor with a lien securing a \$70,000 debt foreclosed prepetition and bought the property at the foreclosure sale for the amount of the debt. The property was worth in excess of \$3 million. The court ruled that the foreclosure sale was an avoidable preference, noting that the issue in § 547(b)(5) is not whether it provided reasonably equivalent value, merely whether it received “more” than what it would have received in a Chapter 7 liquidation. The decision raises the specter of using § 547 to unwind properly conducted foreclosure sales.

Chapter Four

Page 127:

The following table updates the table of homestead exemptions that appears in the book.

State	Statute	Homestead Exemption Amount	Opt-Out of Bankruptcy Exemptions
Florida	Florida Constitution Article X § 4; Fla. Stat. Ann. § 222.01	Unlimited in value (limited by area)	✓
Iowa	§§ 561.1, 561.2	Unlimited in amount (limited by area)	✓
Kansas	§ 60-2301	Unlimited in amount (limited by area)	✓
South Dakota	§ 43-31-2	Unlimited in amount (limited by area)	✓
Texas	Prop. §§ 41.001, 41.002	Unlimited in amount (limited by area)	
Oklahoma	tit. 31, § 2	Unlimited in amount (limited by area) unless more than 25% is used for business, then limited to \$5,000	✓
Nevada	§ 115.010	\$550,000	✓
Massachusetts	ch. 188, § 1	\$500,000	
Minnesota	§ 510.02 , as adjusted by State Department of Commerce notice on April 26, 2010	\$360,000 (\$900,000 if used primarily for agriculture)	
Rhode Island	§ 9-26-4.1	\$300,000	

State	Statute	Homestead Exemption Amount	Opt-Out of Bankruptcy Exemptions
Montana	§ 70-32-104	\$250,000	✓
Arizona	§ 33-1101	\$150,000	✓
New York	Civ. Prac. § 5206	\$150,000 for some counties, \$125,000 and \$75,000 for other counties	
Vermont	tit. 27, § 101	\$125,000	
Washington	§ 6.13.030	\$125,000	
New Hampshire	§ 480:1	\$100,000	
North Dakota	§ 47-18-01	\$100,000	✓
Idaho	§ 55-1003	\$100,000	✓
South Carolina	§ 15-41-30	\$100,000 (\$50,000 per co-owner)	✓
Maine	tit. 14, § 4422	\$95,000 (\$47,500 per debtor) (may be increased to \$190,000 aggregate and \$95,000 per debtor if meet criteria regarding age or disability)	✓
California	Civ. Pro. Code § 704.730	\$75,000 (variable amounts up to \$175,000 if meet criteria regarding age and income level)	✓
Connecticut	§ 52-352b	\$75,000 (\$125,000 if judgment is for hospital services)	
Mississippi	§ 85-3-21	\$75,000	✓
Wisconsin	§ 815.20	\$75,000	
Nebraska	§ 40-101	\$60,000	✓
New Mexico	§ 42-10-9	\$60,000	
Colorado	§ 38-41-201	\$60,000 (\$90,000 if elderly or disabled)	✓
Alaska	§ 09.38.010	\$54,000	✓
Utah	§ 78B-5-503	\$40,000 (\$20,000 per debtor)	✓

State	Statute	Homestead Exemption Amount	Opt-Out of Bankruptcy Exemptions
Oregon	§ 18.395	\$40,000 (\$50,000 for joint debtors)	✓
Louisiana	§ 20:1	\$35,000	✓
North Carolina	§ 1C-1601	\$35,000 (\$60,000 if over 65 and spouse is deceased)	✓
Illinois	735 5/12-901	\$30,000 (\$15,000 per debtor)	✓
Ohio	§ 2329.66	\$20,200	✓
Hawaii	§ 651-92	\$20,000 (\$30,000 for head of household or if over 65)	
Maryland	Cts. and Judicial Proc. § 11-504 as amended by Md. Legis 32 (2011)	The periodically adjusted amount for homestead under 11 U.S.C. § 522(d)(1); \$ 21,625 in 2010.	✓
Indiana	§ 34-55-10-2	\$15,000	✓
Missouri	§ 513.475	\$15,000	✓
Alabama	§ 6-10-2	\$10,000 if jointly owned by husband and wife otherwise \$5,000 per debtor	✓
Wyoming	§§ 1-20-101, 1-20-102	\$10,000 per “occupant”	✓
Tennessee	§ 26-2-301	\$7,500 (\$5,000 for one owner) (if minor children or an elderly couple, allowed up to \$25,000)	✓
Virginia	§ 34-4	\$5,000 (\$10,000 if 65 or older) (plus \$500 for each dependent)	✓
Kentucky	§ 427.060	\$5,000	
West Virginia	§ 38-9-1 § 38-10-4	In general, \$5,000; in bankruptcy, \$25,000	✓
Georgia	§ 44-13-1 § 44-13-100	In general, \$5,000; in bankruptcy, \$20,000 (\$10,000 per debtor)	✓

State	Statute	Homestead Exemption Amount	Opt-Out of Bankruptcy Exemptions
Michigan	§ 600.6023 § 600.5451	In general, \$3,500; in bankruptcy, \$35,300 (\$52,925 if elderly or disabled) (indexed)	✓
Arkansas	§ 16-66-210	\$2,500 (but not less than 80 acres outside of a town, not less than 1/4 acre within town)	
Pennsylvania	tit. 42 § 8123	\$300 (any type of property)	
Delaware	tit. 10 § 4901 tit. 10 § 4914	In general, none (but personal property has to be executed against first); in bankruptcy, \$75,000 in 2010, \$100,000 in 2011, \$125,000 in 2012	✓
New Jersey	2A:17-17	None	

Page 127, add to n.3:

Several states have enacted bankruptcy-only exemptions statutes: statutes that provide exemptions only to debtors in bankruptcy and different from the exemptions available to judgment debtors generally. Several courts have held that these statutes survive constitutional attack. *See, e.g., Sheehan v. Peveich*, [574 F.3d 248](#) (4th Cir. 2009), *cert. denied*, [130 S. Ct. 1066](#) (2010); *In re Kulp*, [949 F.2d 1106](#) (10th Cir. 1991); *In re Applebaum*, [422 B.R. 684](#) (9th Cir. BAP 2009); *In re Brown*, [2007 WL 2120380](#) (Bankr. N.D.N.Y. 2007), *aff'd* [2007 WL 4560671](#) (N.D. N.Y. 2007); *In re Shumaker*, [124 B.R. 820](#) (Bankr. D. Mont. 1991); *In re Vasko*, [6 B.R. 317](#) (Bankr. N.D. Ohio 1980). Other courts have held these statutes to be unconstitutional. *See In re Schafer*, [455 B.R. 590](#) (6th Cir. BAP 2011); *In re Pontius*, [421 B.R. 814](#) (Bankr. W.D. Mich. 2009); *In re Regevig*, [389 B.R. 736](#) (Bankr. D. Ariz. 2008), *on reconsideration*, [389 B.R. 736](#) (Bankr. D. Ariz. 2008); *In re Wallace*, [347 B.R. 626](#) (Bankr. W.D. Mich. 2006); *In re Cross*, [255 B.R. 25](#) (Bankr. N.D. Ind. 2000); *In re Lennen*, [71 B.R. 80](#) (Bankr. N.D. Cal. 1987); *In re Reynolds*, [24 B.R. 344](#) (Bankr. S.D. Ohio 1982).

See also *In re Urban*, 375 B.R. 882 (9th Cir. BAP 2007) (the residency requirement in § 522(b)(3) is not unconstitutional even though it requires debtors to use the exemption of laws of a state other than the forum state).

Page 130:

Pursuant to § 104 of the Bankruptcy Code, the dollar amount of the exemptions listed in § 522(d) were adjusted, effective in cases filed after April 1, 2010. The following chart revises the chart that appears in the book and compares the current exemption limits under federal and Washington law.

	Washington Exemption Amount	Federal Exemption Amount
Homestead	\$125,000	\$21,625
Jewelry	\$3,500	\$1,450
Clothing	No limit	\$11,525 aggregate limit; \$550 per item limit
Books & Mementoes	\$3,500	
Household Goods	\$6,500 (\$750 per item limit)	
Other Property	\$3,000 aggregate limit (\$1,500 max. in cash)	\$1,150 + \$10,825 (of unused homestead)
Motor Vehicle	\$3,200	\$3,450
Tools of Trade	\$10,000	\$2,175
Life Insurance Contract	N/A	\$11,525
Prescribed Health Aids	No limit	No limit

Page 132, add after Problem 4-2, at the top of the page:

Because the Bankruptcy Code looks to the local law of the debtor’s residence for the applicable exemptions, an enrolled member of a Native American tribe who lives off the reservation cannot rely on tribal law to exempt the right to receive a per capita distribution. See, e.g., *In re Howley*, [439 B.R. 535](#) (Bankr. D. Kan. 2010), *on motion to amend*, [446 B.R. 506](#) (Bankr. D. Kan), *appeal dismissed*, [2011 WL 440070](#) (D. Kan. 2011). It remains unclear whether a member of a tribe who resides on the reservation can use tribal law to supplement the exemption provided by state law.

Page 133, add to n.7:

See also *In re Reardon*, [403 B.R. 822](#) (Bankr. D. Mont. 2009) (\$35,000 van equipped for wheel chair access and purchased with government funds was a “professionally prescribed health aid” under state law for debtor who was paralyzed from the waist down).

Page 138, add to n.11 after the citation to In re Green:

In re Anderson, [377 B.R. 865](#) (6th Cir. BAP 2007), *abrogated by Schwab v. Reilly*, [130 S. Ct. 2652](#) (2010).

Page 141:

In *In re Reilly*, [534 F.3d 173](#) (3rd Cir. 2008), the Third Circuit Court of Appeals followed decisions by the Eleventh Circuit Court of Appeals and Sixth Circuit BAP and ruled that if the debtor claims an exemption amount equal to the scheduled value of an asset, the debtor is claiming the entire asset as exempt and the trustee may not sell the asset for more unless the trustee objected to the exemption. In June 2010, the Supreme Court reversed.

SCHWAB V. REILLY
130 S. Ct. 2652 (S. Ct. 2010)

Justice THOMAS delivered the opinion of the Court.

When a debtor files a Chapter 7 bankruptcy petition, all of the debtor’s assets become property of the bankruptcy estate subject to the debtor’s right to reclaim certain property as “exempt.” The Bankruptcy Code specifies the types of property debtors may exempt, § 522(b), as well as the maximum value of the exemptions a debtor may claim in certain assets, § 522(d). Property a debtor claims as exempt will be excluded from the bankruptcy estate “[u]nless a party in interest” objects. § 522(l).

This case presents an opportunity for us to resolve a disagreement among the Courts of Appeals about what constitutes a claim of exemption to which an interested party must object under § 522(l). The issue is whether an interested party must object to a claimed exemption where, as here, the Code defines the property the debtor is authorized to exempt as an interest, the value of which may not exceed a certain dollar amount, in a particular type of asset, and the debtor’s schedule of exempt property accurately describes the asset and declares the “value of [the] claimed exemption” in that asset to be an amount within the limits that the Code prescribes. Fed. Rule Bkrty. Proc. Official Form 6, Schedule C (1991) (hereinafter Schedule C). We hold that, in cases such as this, an interested party need not object to an exemption claimed in this manner in order to preserve the estate’s ability to recover value in the asset beyond the dollar value the debtor expressly declared exempt.

I

Respondent Nadejda Reilly filed for Chapter 7 bankruptcy when her catering business failed. She supported her petition with various schedules and statements, two of which are relevant here: Schedule B, on which the Bankruptcy Rules require debtors to list their assets (most of which become property of the estate), and Schedule C, on which the Rules require debtors to list the property they wish to reclaim as exempt. The assets Reilly listed on Schedule B included an itemized list of cooking and other kitchen equipment that she described as “business equipment,” and to which she assigned an estimated market value of \$10,718.

On Schedule C, Reilly claimed two exempt interests in this equipment pursuant to different sections of the Code. Reilly claimed a “tool[s] of the trade” exemption of \$1,850 in the equipment under § 522(d)(6), which permits a debtor to exempt his “aggregate interest, not to exceed \$1,850 in value, in any implements, professional

books, or tools, of [his] trade.” And she claimed a miscellaneous exemption of \$8,868 in the equipment under § 522(d)(5), which, at the time she filed for bankruptcy, permitted a debtor to take a “wildcard” exemption equal to the “debtor’s aggregate interest in any property, not to exceed” \$10,225 “in value.” The total value of these claimed exemptions (\$10,718) equaled the value Reilly separately listed on Schedules B and C as the equipment’s estimated market value.

Subject to exceptions not relevant here, the Federal Rules of Bankruptcy Procedure require interested parties to object to a debtor’s claimed exemptions within 30 days after the conclusion of the creditors’ meeting held pursuant to Rule 2003(a). *See* Fed. Rule Bankr. Proc. 4003(b). If an interested party fails to object within the time allowed, a claimed exemption will exclude the subject property from the estate even if the exemption’s value exceeds what the Code permits. *See, e.g.,* § 522(l); *Taylor v. Freeland & Kronz*, 503 U.S. 638, 642-643 (1992).

Petitioner William G. Schwab, the trustee of Reilly’s bankruptcy estate, did not object to Reilly’s claimed exemptions in her business equipment because the dollar value Reilly assigned each exemption fell within the limits that §§ 522(d)(5) and (6) prescribe. But because an appraisal revealed that the total market value of Reilly’s business equipment could be as much as \$17,200, Schwab moved the Bankruptcy Court for permission to auction the equipment so Reilly could receive the \$10,718 she claimed as exempt, and the estate could distribute the equipment’s remaining value (approximately \$6,500) to Reilly’s creditors.

Reilly opposed Schwab’s motion. She argued that by equating on Schedule C the total value of the exemptions she claimed in the equipment with the equipment’s estimated market value, she had put Schwab and her creditors on notice that she intended to exempt the equipment’s full value, even if that amount turned out to be more than the dollar amount she declared, and more than the Code allowed. Citing § 522(l), Reilly asserted that because her Schedule C notified Schwab of her intent to exempt the full value of her business equipment, he was obliged to object if he wished to preserve the estate’s right to retain any value in the equipment in excess of the \$10,718 she estimated. Because Schwab did not object within the time prescribed by Rule 4003(b), Reilly asserted that the estate forfeited its claim to such value. * * *

The Bankruptcy Court denied * * * Schwab’s motion to auction the equipment * * *. Schwab sought relief from the District Court, arguing that neither the Code nor Rule 4003(b) requires a trustee to object to a claimed exemption where the amount the debtor declares as the “value of [the debtor’s] claimed exemption” in

certain property is an amount within the limits the Code prescribes. The District Court rejected Schwab's argument, and the Court of Appeals affirmed.

The Court of Appeals agreed with the Bankruptcy Court that by equating on Schedule C the total value of her exemptions in her business equipment with the equipment's market value, Reilly "indicate[d] the intent" to exempt the equipment's full value. In reaching this conclusion, the Court of Appeals relied on our decision in *Taylor*:

We believe this case to be controlled by *Taylor*. Just as we perceive it was important to the *Taylor* Court that the debtor meant to exempt the full amount of the property by listing "unknown" as both the value of the property and the value of the exemption, it is important to us that Reilly valued the business equipment at \$10,718 and claimed an exemption in the same amount. Such an identical listing put Schwab on notice that Reilly intended to exempt the property fully.

"[A]n unstated premise" of *Taylor* was "that a debtor who exempts the entire reported value of an asset is claiming the 'full amount,' whatever it turns out to be."

Relying on this "unstated premise," the Court of Appeals held that Schwab's failure to object to Reilly's claimed exemptions entitled Reilly to the equivalent of an in-kind interest in her business equipment, even though the value of that exemption exceeded the amount that Reilly declared on Schedule C and the amount that the Code allowed her to withdraw from the bankruptcy estate.

As noted, the Court of Appeals' decision adds to disagreement among the Circuits about what constitutes a claim of exemption to which an interested party must object under § 522(I). We granted certiorari to resolve this conflict. We conclude that the Court of Appeals' approach fails to account for the text of the relevant Code provisions and misinterprets our decision in *Taylor*. Accordingly, we reverse.

II

The starting point for our analysis is the proper interpretation of Reilly's Schedule C. If we read the Schedule Reilly's way, she claimed exemptions in her business equipment that could exceed statutory limits, and thus claimed exemptions to which Schwab should have objected if he wished to enforce those limits for the benefit of the estate. If we read Schedule C Schwab's way, Reilly claimed valid exemptions to which Schwab had no duty to object. The Court of Appeals construed Schedule C Reilly's way and interpreted her claimed exemptions as

improper, and therefore objectionable, even though their declared value was facially within the applicable Code limits. In so doing, the Court of Appeals held that trustees evaluating the validity of exemptions in cases like this cannot take a debtor’s claim at face value, and specifically cannot rely on the fact that the amount the debtor declares as the “value of [the] claimed exemption” is within statutory limits. Instead, the trustee’s duty to object turns on whether the interplay of various schedule entries supports an inference that the debtor “intended” to exempt a dollar value different than the one she wrote on the form. This complicated view of the trustee’s statutory obligation, and the strained reading of Schedule C on which it rests, is inconsistent with the Code.

The parties agree that this case is governed by § 522(*l*), which states that a Chapter 7 debtor must “file a list of property that the debtor claims as exempt under subsection (b) of this section,” and further states that “[u]nless a party in interest objects, the property claimed as exempt on such list is exempt.” The parties further agree that the “list” to which § 522(*l*) refers is the “list of property . . . claim[ed] as exempt” currently known as “Schedule C.” The parties, like the Courts of Appeals, disagree about what information on Schedule C defines the “property claimed as exempt” for purposes of evaluating an exemption’s propriety under § 522(*l*). Reilly asserts that the “property claimed as exempt” is defined by reference to all the information on Schedule C, including the estimated market value of each asset in which the debtor claims an exempt interest. Schwab and the United States as *amicus curiae* argue that the Code specifically defines the “property claimed as exempt” as an interest, the value of which may not exceed a certain dollar amount, in a particular asset, *not* as the asset itself. Accordingly, they argue that the value of the property claimed exempt, *i.e.*, the value of the debtor’s exempt interest in the asset, should be judged on the value the debtor assigns the interest, *not* on the value the debtor assigns the asset. The point of disagreement is best illustrated by the relevant portion of Reilly’s Schedule C:

Schedule C-Property Claimed as Exempt

Description of Property	Specify Law Providing Each Exemption	Value of Claimed Exemption	Current Market Value of Property Without Deducting Exemptions

* * *	11 U.S.C. § 522(d)(6)		
See attached list of business equipment	11 U.S.C. § 522(d)(5)	1,850 8,868	10,718

According to Reilly, Schwab was required to treat the estimate of market value she entered in column four as part of her claimed exemption in identifying the “property claimed as exempt” under § 522(*I*). Relying on this premise, Reilly argues that where, as here, a debtor equates the total value of her claimed exemptions in a certain asset (column three) with her estimate of the asset’s market value (column four), she establishes the “property claimed as exempt” as the full value of the asset, whatever that turns out to be. Accordingly, Reilly argues that her Schedule C clearly put Schwab on notice that she “intended” to claim an exemption for the full value of her business equipment, and that Schwab’s failure to oppose the exemption in a timely manner placed the full value of the equipment outside the estate’s reach.

Schwab does not dispute that columns three and four apprised him that Reilly equated the total value of her claimed exemptions in the equipment (\$1,850 plus \$8,868) with the equipment’s market value (\$10,718). He simply disagrees with Reilly that this “identical listing put [him] on notice that Reilly intended to exempt the property fully,” regardless whether its value exceeded the exemption limits the Code prescribes. Schwab and *amicus* United States instead contend that the Code defines the “property” Reilly claimed as exempt under § 522(*I*) as an “interest” whose value cannot exceed a certain dollar amount. Construing Reilly’s Schedule C in light of this statutory definition, they contend that Reilly’s claimed exemption was facially unobjectionable because the “property claimed as exempt” (*i.e.*, two interests in her business equipment worth \$8,868 and \$1,850, respectively) is property Reilly was clearly entitled to exclude from her estate under the Code provisions she referenced in column 2. Accordingly, Schwab and the United States conclude that Schwab had no obligation to object to the exemption in order to preserve for the estate any value in Reilly’s business equipment beyond the total amount (\$10,718) Reilly properly claimed as exempt.

We agree. The portion of § 522(*I*) that resolves this case is not, as Reilly asserts, the provision stating that the “property claimed as exempt on [Schedule C] is exempt” unless an interested party objects. Rather, it is the portion of § 522(*I*) that defines the target of the objection, namely, the portion that says Schwab has a duty to object to the “list of property that the debtor claims as exempt *under subsection (b)*.” (Emphasis added.) That subsection, § 522(*b*), does *not* define the

“property claimed as exempt” by reference to the estimated market value on which Reilly and the Court of Appeals rely. Section 522(b) refers only to property defined in § 522(d), which in turn lists 12 categories of property that a debtor may claim as exempt. As we have recognized, most of these categories (and all of the categories applicable to Reilly’s exemptions) define the “property” a debtor may “clai[m] as exempt” as the debtor’s “interest” – up to a specified dollar amount – in the assets described in the category, *not* as the assets themselves. Viewing Reilly’s form entries in light of this definition, we agree with Schwab and the United States that Schwab had no duty to object to the property Reilly claimed as exempt (two interests in her business equipment worth \$1,850 and \$8,868) because the stated value of each interest, and thus of the “property claimed as exempt,” was within the limits the Code allows.

Reilly’s contrary view of Schwab’s obligations under § 522(l) does not withstand scrutiny because it defines the target of a trustee’s objection – the “property claimed as exempt” – based on language in Schedule C and dictionary definitions of “property” that the definition in the Code itself overrides. Although we may look to dictionaries and the Bankruptcy Rules to determine the meaning of words the Code does not define, the Code’s definition of the “property claimed as exempt” in this case is clear. As noted above, §§ 522(d)(5) and (6) define the “property claimed as exempt” as an “interest” in Reilly’s business equipment, *not* as the equipment *per se*. Sections 522(d)(5) and (6) further and plainly state that claims to exempt such interests are statutorily permissible, and thus unobjectionable, if the value of the claimed interest is below a particular dollar amount. That is the case here, and Schwab was entitled to rely upon these provisions in evaluating whether Reilly’s exemptions were objectionable under the Code. * * *

For all of these reasons, we conclude that Schwab was entitled to evaluate the propriety of the claimed exemptions based on three, and only three, entries on Reilly’s Schedule C: the description of the business equipment in which Reilly claimed the exempt interests; the Code provisions governing the claimed exemptions; and the amounts Reilly listed in the column titled “value of claimed exemption.” In reaching this conclusion, we do not render the market value estimate on Reilly’s Schedule C superfluous. We simply confine the estimate to its proper role: aiding the trustee in administering the estate by helping him identify assets that may have value beyond the dollar amount the debtor claims as exempt, or whose full value may not be available for exemption because a portion of the interest is, for example, encumbered by an unavoidable lien. * * *

Our interpretation of Schwab's statutory obligations is not only consistent with the governing Code provisions; it is also consistent with the historical treatment of bankruptcy exemptions. Congress has permitted debtors to exempt certain property from their bankruptcy estates for more than two centuries. Throughout these periods, debtors have validly exempted property based on forms that required the debtor to list the value of a claimed exemption without also estimating the market value of the asset in which the debtor claimed the exempt interest. Indeed, it was not until 1991 that Schedule B-4 was redesignated as Schedule C and amended to require the estimate of market value on which Reilly so heavily relies. This amendment was not occasioned by legislative changes that altered the Code's definition of "the property claimed as exempt" in this case as an "interest," not to exceed a certain dollar amount, in Reilly's business equipment. Accordingly, we agree with Schwab and the United States that this recent amendment to the exemption form does not compel Reilly's view of Schwab's statutory obligations, or render the claimed exemptions in this case objectionable under the Code.

III

The Court of Appeals erred in holding that our decision in *Taylor* dictates a contrary conclusion. *Taylor* does not rest on what the debtor "meant" to exempt. Rather, *Taylor* applies to the face of a debtor's claimed exemption the Code provisions that compel reversal here.

The debtor in *Taylor*, like the debtor here, filed a schedule of exemptions with the Bankruptcy Court on which the debtor described the property subject to the claimed exemption, identified the Code provision supporting the exemption, and listed the dollar value of the exemption. Critically, however, the debtor in *Taylor* did *not*, like the debtor here, state the value of the claimed exemption as a specific dollar amount at or below the limits the Code allows. Instead, the debtor in *Taylor* listed the value of the exemption itself as "\$ *unknown*":

The interested parties in *Taylor* agreed that this entry rendered the debtor's claimed exemption objectionable on its face because the exemption concerned an asset (lawsuit proceeds) that the Code did not permit the debtor to exempt beyond a specific dollar amount. Accordingly, although this case and *Taylor* both concern the consequences of a trustee's failure to object to a claimed exemption within the time specified by Rule 4003, the question arose in *Taylor* on starkly different facts. In *Taylor*, the question concerned a trustee's obligation to object to the debtor's entry of a "value claimed exempt" that was *not* plainly within the limits the Code allows. In this case, the opposite is true. The amounts Reilly listed in the Schedule

C column titled “Value of Claimed Exemption” are facially within the limits the Code prescribes and raise no warning flags that warranted an objection.

Taylor * * * establishes and applies the straightforward proposition that an interested party must object to a claimed exemption if the amount the debtor lists as the “value claimed exempt” is not within statutory limits, a test the value (\$ *unknown*) in *Taylor* failed, and the values (\$8,868 and \$1,850) in this case pass. * * *

We adhere to this test. * * * [W]e take Reilly’s exemptions at face value and find them unobjectionable under the Code, so the objection deadline we enforced in *Taylor* is inapplicable here. * * *

IV

* * * Where, as here, a debtor accurately describes an asset subject to an exempt interest and on Schedule C declares the “value of [the] claimed exemption” as a dollar amount within the range the Code allows, interested parties are entitled to rely upon that value as evidence of the claim’s validity. Accordingly, we hold that Schwab was not required to object to Reilly’s claimed exemptions in her business equipment in order to preserve the estate’s right to retain any value in the equipment beyond the value of the exempt interest. In reaching this conclusion, we express no judgment on the merits of, and do not foreclose the courts from entertaining on remand, procedural or other measures that may allow Reilly to avoid auction of her business equipment.

We reverse the judgment of the Court of Appeals for the Third Circuit and remand this case for further proceedings consistent with this opinion.

It is so ordered.

Justice Ginsburg dissented, joined by the Chief Justice and Justice Breyer. [Omitted]

NOTE

In response to the Court’s decision in *Schwab*, some debtors have declared as exempt “100% of the fair market value of the property.” Several trustees have objected that such a claim is improper under the applicable state exemption law, and generally the trustees have been successful. *See, e.g., In re Stoney*, 445 B.R. 543 (Bankr. E.D. Va. 2011); *In re Winchell*, 2010 WL 5338054 (Bankr. E.D. Wash. 2010). *But cf. In re*

Moore, [442 B.R. 865](#) (Bankr. N.D. Tex. 2010) (indicating such a claimed exemption is proper but that, upon the trustee's objection, an evidentiary hearing will be held on whether the value of the property exceeds the available exemption amount).

QUESTION

Does the Court's decision resolve the question of who is entitled to postpetition appreciation? *See In re Gebhart*, [621 F.3d 1206](#) (9th Cir. 2010).

Chapter Five

Page 168:

The book is arguably inaccurate when it indicates at the end of the first full paragraph that allowable claims are generally restricted to the amount due as of the petition date. Following the Supreme Court's decision in *Travelers Casualty & Surety Co. of America v. Pacific Gas & Elec. Co.*, [549 U.S. 443](#) (2007), many courts are allowing claims for post-petition attorneys' fees if the debtor is responsible for them pursuant to a prepetition contract. See *Ogle v. Fidelity & Deposit Co. of Maryland*, [586 F.3d 143](#) (2d Cir. 2009), *cert. denied*, 130 S. Ct. 2373 (2010).

Page 169, add at the end of the carryover paragraph at the top:

Because a proof of claim is a public document, a creditor should be careful to redact confidential information when submitting documentation to support its claim. For example, a provider of medical or psychiatric services should not indicate the precise services provided to the debtor. Failure to redact such confidential information may subject the creditor to liability. See *In re Ortiz*, [430 B.R. 523](#) (Bankr. E.D. Wis. 2010).

Page 172, add after the end of the indented paragraph at the top of the page:

If the deadline for filing proofs of claims has passed before a final judgment is rendered against a creditor in an avoidance action, the creditor will have 30 days from entry of the judgment to file a proof of claim with respect to the revived claim. Bankr. R. [3002\(c\)\(3\)](#). See also *In re Nowak*, [586 F.3d 450](#) (6th Cir. 2009) (upholding decision not to treat the creditor's other filings as an informal proof of claim).

Page 172, add at the end of the first paragraph after the indented paragraph:

While § 502(d) can be used to disallow a claim of a creditor who fails to repay an avoidable preference, it apparently cannot be used to disallow payment of a postpetition administrative expense to such a creditor. *In re Ames Department Stores, Inc.*, 582 F.3d 422 (2d Cir. 2009), cert. denied, 130 S. Ct. 1527 (2010). *Contra In re MicroAge, Inc.*, 291 B.R. 503 (9th Cir. BAP 2002).

Page 183, add at the end of the carryover paragraph at the top of the page:

The Third Circuit Court of Appeals in an en banc decision overruled *Frenville* in 2010. The case in which it did so, *In re Grossman's Inc.*, 607 F.3d 114 (3d Cir. 2010), involved a woman who had purchased home remodeling materials that contained asbestos. When the seller filed for bankruptcy protection twenty years later, the buyer as yet manifested no symptoms related to asbestos exposure. It was only ten years after that, long after the debtor's plan had been confirmed, that the buyer began to experience symptoms of mesothelioma, a cancer linked to asbestos exposure. She was diagnosed with the disease shortly thereafter. The buyer moved to reopen the bankruptcy for a determination that her claim was not discharged. After she passed away, her estate continued the litigation.

The lower courts ruled that the claim was not discharged because under state law, the claim did not accrue until injury manifests itself. The Third Circuit Court of Appeals acknowledged the universal criticism of *Frenville* and ruled that “a ‘claim’ arises when an individual is exposed pre-petition to a product or other conduct giving rise to an injury.” The court remanded for consideration of whether discharge of the buyer's claim would comport with due process.

Chapter Six

Page 203:

The brackets in the blocked quotation from *In re Bumper Sales* are incorrect. The quoted paragraph should read as follows:

In order to determine the applicability of the exception in Section 552(b), we must undertake a [three]-part inquiry. First, is there a prepetition security agreement that by its terms extends to [the debtor's] prepetition inventory, accounts and proceeds? Second, did [the debtor] receive the proceeds of the prepetition inventory and accounts after the filing of the petition? Third, is [the debtor's] postpetition inventory second generation proceeds of prepetition inventory and accounts, and are [the debtor's] postpetition accounts proceeds of postpetition inventory?

Page 205, problem 6-1(A):

The citation to § 522 should be to § 552.

Page 206:

The Supreme Court's decision in *Ron Pair Enterprises* was based on the comma before "interest," not the comma after "costs."

Page 216, add to n.32:

See also *In re McCaskill*, 434 B.R. 875 (Bankr. W.D. Mo. 2010) (security interest in an automobile that attached when the creditor contemporaneously released its lien on a different motor vehicle and which was perfected 34 days later was nevertheless substantially contemporaneous, in part because the creditor believed its lien release was valid when filed rather than when executed).

Page 217, Problem 6-10:

The decision in *Lee* was reversed on appeal. See *In re Lee*, [530 F.3d 458](#) (6th Cir. 2008).

Page 217, Problem 6-11(B):

Rephrase the question as follows:

- B. How, if at all, would the analysis in Part A change if both parties intended that Doctor would use the loaned funds to buy some new equipment that would serve as collateral for the loan, Doctor did so use the funds, and Doctor received the new equipment on April 10? See § 547(c)(1),(3), (e)(2), (3).

Chapter Seven

Page 266, add to n.12:

Cf. In re Holcomb, [380 B.R. 813](#) (10th Cir. BAP 2008) (§ 362(c)(3)(A) terminates the stay only with respect to actions against the debtor, not actions as against property of the estate).

Page 270, add to n.21:

See also In re Rafter Seven Ranches L.P., [414 B.R. 722](#) (10th Cir. BAP 2009) (a limited partnership is not an “individual” entitled to damages for willful violations of automatic stay).

Page 270, add to the end of the first full paragraph on the page:

It is worth noting that § 362(k) does not on its face make damages available only to the debtor. Accordingly, if a creditor can show damage to itself as a result of a stay violation – damage not merely to the estate, but to itself directly – then the creditor may be entitled to an award. *See St. Paul Fire & Marine Ins. Co. v. Labuzan*, [579 F.3d 533](#) (5th Cir. 2009).

Page 279, add to n.43:

See also Myers v. TooJay’s Management Corp., [640 F.3d 1278](#) (11th Cir. 2011); *In re Burnett*, [635 F.3d 169](#) (5th Cir. 2011); *Rea v. Federal Investors*, [627 F.3d 937](#) (3d Cir. 2010).

Page 280, add to the first full paragraph on the page:

Note, cable television is apparently not a utility service. *See in re Darby*, [470 F.3d 573](#) (5th Cir. 2006); *In re Moorefield*, [218 B.R. 795](#) (Bankr. M.D.N.C. 1997).

Chapter Eight

Page 297, add to n.16:

See also *Thompson v. General Motors Acceptance Corp., LLC*, 566 F.3d 699 (7th Cir. 2009) (upon debtor’s request, secured creditor must first return the seized asset and then, if necessary, seek adequate protection of its interests); *In re Johnson*, 501 F.3d 1163 (10th Cir. 2007) (treating a refusal to return property repossessed prepetition as a stay violation but focusing on the willfulness of the violation).

Page 308, revise n.32 to read as follows:

See *Coastal Fed. Credit Union v. Hardiman*, 398 B.R. 161 (E.D.N.C. 2008); *In re Blakeley*, 363 B.R. 225 (Bankr. D. Utah 2007); *In re Anderson*, 384 B.R. 652 (Bankr. D. Del. 2006); *In re Donald*, 343 B.R. 524 (Bankr. E.D.N.C. 2006). *Contra In re Steinhaus*, 349 B.R. 694 (Bankr. D. Id. 2006); *In re Rowe*, 342 B.R. 341 (Bankr. D. Kan. 2006) (both ruling that the “allowed” requirement should be ignored in this context because it makes no sense). See also *In re Miller*, 443 B.R. 54 (Bankr. D. Del. 2011) (although § 521(a)(6) does not apply if creditor has not filed a proof of claim, § 362(h) is not so limited).

Page 308, revise n.33 to read as follows:

See *In re Visnicky*, 401 B.R. 61 (Bankr. D.R.I. 2009) (indicating that Rhode Island’s recent enactment of the Uniform Consumer Credit Code, specifically R.I. Code. § 6-51-3(a), made a default-on-filing clause unenforceable); *In re Rowe*, 342 B.R. 341 (Bankr. D. Kan. 2006) (ruling that a default-on-bankruptcy clause was unenforceable under the Kansas version of the Uniform Consumer Credit Code and that the 2005 revisions to § 521 merely relegated secured creditor to nonbankruptcy rights). See also *In re Steinhaus*, 349 B.R. 694 (Bankr. D. Id. 2006) (suggesting that a default-on-filing clause is unenforceable under Id. Stat. § 28-45-107); *In re Riggs*, 2006 WL 2990218 (Bankr. W.D. Mo. 2006) (suggesting that a default-on-filing clause may not be enforceable in Missouri under Mo. Stat. § 408.552). *But see In re Jones*, 591 F.3d 308 (4th Cir. 2010) (default-on-filing clause is enforceable under

West Virginia law and state statute requiring creditor to give notice of the right to cure before repossessing collateral was inapplicable because the default – filing for bankruptcy protection – could not be cured). Compare *In re Anderson*, 384 B.R. 652 (Bankr. D. Del. 2006) (ruling that a default on bankruptcy clause is valid in Delaware), with *In re Baker*, 390 B.R. 524 (Bankr. D. Del. 2008) (disagreeing with *Anderson*), *aff'd*, 400 B.R. 136 (D. Del. 2009).

Connecticut's statute regulating retail installment sales provides that filing a Chapter 7 petition or being a debtor in bankruptcy cannot be the basis for a default that gives rise to a right to repossess the collateral. See Conn. Gen. Stat. § 36a-785(a).

If repossession occurs after the debtor has received a discharge and the case is closed, the bankruptcy court has no jurisdiction to determine whether state law invalidates a default-on-bankruptcy clause, and thus renders the repossession improper. *In re Dumont*, 383 B.R. 481 (9th Cir. BAP 2008), *aff'd* 581 F.3d 1104 (9th Cir. 2009).

Page 308, add a new footnote after the first sentence to the first full paragraph:

That said, the Ninth Circuit has ruled that other changes made by BAPCPA – to § 521(a)(2)(C) and § 362(h) – eliminated retention as an option, without regard to whatever § 521(a)(6) may have done. See *In re Dumont*, 581 F.3d 1104 (9th Cir. 2009).

Chapter Nine

Page 314:

The chart is revised on the next page to show the adjusted dollar limitations for the priorities that have a dollar limitation.

DISTRIBUTION OF THE ESTATE UNDER § 726(a)

1a	Trustee expenses incurred in administering the estate to pay support obligations	Administrative expenses
1b	Spousal & child support claims	
2	Costs & expenses of preserving the estate	Administrative expenses § 503(b)
	Compensation to professionals: trustees, attorneys, accountants, <i>etc.</i> – § 330(a)	
	Reimbursement of certain creditor expenses	
	Compensation for certain creditor services	
3	Certain expenses arising from involuntary filings	Priorities § 507(a)
4	Certain employee wage claims (up to \$11,725)	
5	Certain employee benefit claims (up to \$11,725 per employee)	
6	Certain agricultural and aquicultural bailment claims (up to \$5,775)	
7	Certain consumer deposits (up to \$2,600)	
8	Certain tax claims	
9	Claims owed by depository institutions to maintain capital levels	
10	Personal injury claims resulting from drunk driving	
11	Timely unsecured claims	
12	Untimely unsecured claims	
13	Prepetition claims for fines & penalties	
14	Interest on any of the claims listed above	
15	To debtor	

Page 345, add after the first full paragraph on the page:

Severance pay for employees terminated prepetition apparently requires a different analysis than vacation pay. While wages, salaries, commissions, and even vacation pay are “earned” by the performance of services, severance pay is “earned” on the date the employee becomes entitled to receive such compensation, which is usually the date of termination, even if the amount of the pay is based on length of service. See *Matson v. Alarcon*, 651 F.3d 404 (4th Cir. 2011). As the bankruptcy court in that case wrote,

severance pay is not accrued as an alternative form of compensation in any meaningful fashion. If an employee chooses to quit of his or her own volition, he or she would not have “earned” and certainly would not be entitled to any severance pay. Rather, severance pay is “earned” on the day that an employee shows up to work and is terminated by the company without cause.

In re LandAmerica Financial Group, Inc., 435 B.R. 343, 351 (Bankr. E.D. Va. 2010).

For employees terminated post-petition, most courts regard their claims for severance pay to be an administrative expense in full under § 503(b)(1) if the severance pay is *in lieu of notice*. However, because administrative expense treatment is based on service to the *estate*, not to *the debtor*, they allocate the claim to pre- and post-bankruptcy periods if the severance pay is based on length of employment. See, e.g., *In re Roth American, Inc.*, 975 F.2d 949 (3d Cir. 1992).

Chapter Ten

Page 361, add to n.8:

See also In re Settembre, [425 B.R. 423](#) (Bankr. W.D. Ky. 2010) (debtor’s testimony that financial records were lost during a move was a sufficient defense to an action under § 727(a)(6) for failure to comply with the order to produce the records, but it was not a defense to an action under to deny the discharge under § 727(a)(3) for failure to maintain records).

Page 370, add to the end of the carryover paragraph at the top of the page:

Willful inactivity by the executor of an estate – evidenced by a failure for three years to file tax returns on behalf of an estate or to take steps necessary to close the estate – can result in a willful and malicious injury. *In re DiGiovanni*, [446 B.R. 709](#) (Bankr. E.D. Pa. 2011).

Page 370, add to n.22:

See also In re Barboza, [545 F.3d 702](#) (9th Cir. 2008) (an infringement can be “willful” for the purposes of copyright law if it is reckless, but recklessness does not make conduct “willful” for purposes of § 523(a)(6)).

Page 370, add to n.24:

Compare In re Sandoval, [341 B.R. 282](#) (Bankr. C.D. Cal. 2006) (statutory damages for unauthorized reception of cable television service not excepted from discharge under § 523(a)(2), (4), or (6)), *with In re Figler*, [407 B.R. 181](#) (Bankr. W.D. Pa. 2009) (prepetition judgment for misappropriation of satellite television service not excepted from discharge under § 523(a)(2) but is excepted under § 523(a)(4) as larceny).

Page 370, add to n.26:

See also *In re Khafaga*, [419 B.R. 539](#) (Bankr. E.D.N.Y. 2009) (franchisor stated a claim under § 523(a)(6) by alleging that debtor-franchisee secretly opened a competing business in the name of his wife and diverted business thereto in violation of the non-compete obligations under the franchise agreement).

Page 370, add to n.29:

See also *Lockerby v. Sierra*, [535 F.3d 1038](#) (9th Cir. 2008) (intentional breach of contract is not a willful and malicious injury unless it constitutes an independent tort; under Arizona law, an intentional refusal to pay pursuant to settlement agreement was not an independent tort).

Page 371, add to n.36:

But cf. *In re McGuckin*, [418 B.R. 251](#) (Bankr. N.D. Ohio 2009) (judgment debt arising out of debtor's failure for years to clean bathroom or kitchen of leased residence could not be excepted from discharge as a "willful and malicious injury").

Page 381, add after the last paragraph on the page:

Recently, the Fourth Circuit Court of Appeals took *Ellison* a step further. In *In re Strack*, [524 F.3d 493](#) (4th Cir. 2008), the debtor was the CEO and majority shareholder of a corporation that had borrowed money on a secured basis. The security agreement required the corporation to segregate proceeds of collateral and "hold them in trust" for the secured party, but the debtor failed to comply. The Fourth Circuit Court of Appeals, reversing lower court rulings, held that the debtor had breached a fiduciary obligation to the secured party, thereby making his obligation on a guaranty nondischargeable under § 523(a)(4) as a defalcation while acting in a fiduciary capacity. The case is particularly interesting for two reasons. First, most nondischargeability complaints dealing with sales out of trust are brought under § 523(a)(6) and generally fail, but the court expressly declined to reach that issue, choosing instead to base its analysis on § 523(a)(4). Perhaps,

therefore, creditors should re-evaluate their strategy. Second, the court emphasized the language in the security agreement and the fact that it was the failure to remit the proceeds, not the unauthorized sale of the collateral, that constituted the breach of a fiduciary duty. Accordingly, secured parties may wish to make sure their security agreements have similar language.

Should parties be able to make the relationship a “fiduciary” relationship merely by having “trust” language in the contract documents? Why are some contractual relationships deemed to be fiduciary in nature and not others?

Page 386, add after the third note:

4. A recent bankruptcy decision reveals a potential trap for a Chapter 7 debtor whose circumstances during the case do not qualify as undue hardship. If circumstances later arise that would make repayment of the debtor’s student loans an undue hardship, it will not be possible to discharge the debt. Not only do § 727(a)(8) and § 1328(f) bar a new discharge for several years, but the debtor will apparently not be entitled to re-open the Chapter 7 case to seek to expand the scope of the discharge. *In re Zygarewicz*, 423 B.R. 909 (Bankr. E.D. Cal. 2010). The court ruled that while the adversary proceeding may be raised at any time, including after the case is closed, the circumstances giving rise to the undue hardship must exist when the discharge is first granted. Accordingly, a debtor who was seriously injured in an automobile accident one year after the discharge and whose ability to work was impaired, could not use that fact as a basis for discharging her educational loan debt. If the court’s analysis is correct, an individual debtor’s attorney should perhaps advise the client that if subsequent events – such as an accident – make repayment of student loans an undue hardship, it may not be possible to discharge the debt for several years.

Page 387, add to n. 75:

While the educational loan debt owed by the parent of the student can be nondischargeable, a parent/guarantor's claim against the student for reimbursement is apparently not covered by § 523(a)(8) and is therefore dischargeable. *See In re Posner*, [434 B.R. 800](#) (Bankr. E.D. Mich. 2010).

Page 388, add to n. 79:

Cf. McKay v. Ingleson, [558 F.3d 888](#) (9th Cir. 2009) (allowing student to attend classes without prepayment was an advance that qualifies as a "loan").

Page 391:

Delete the reference to § 523(a)(15) in the first sentence of the first full paragraph. The 2005 amendments to the Bankruptcy Code deleted the reference to § 523(a)(15) in § 523(c)(1).

Page 398, add before the problem:

The term "current monthly income" is defined in § 101(10A). It refers to income "that the debtor receives" and which is "derived" during the 6-month period ending before the petition. This phrasing raises allocation questions similar to those confronted in Chapter Three: what about: (i) income received during the 6-month period but attributable to work performed outside the 6-month period; and, conversely, (ii) income earned during the 6-month period but received afterwards? One recent and thoughtful decision has concluded that "receives" and "derived" are different concepts and that both must be satisfied for the income to be counted. Accordingly, the debtor must both receive and earn the income during the relevant 6-month period. *See In re Arnoux*, [442 B.R. 769](#) (Bankr. E.D. Wash. 2010).

Page 398, Problem 10-15:

Replace the problem in the book with the following:

Problem 10-15

Dennis and Deirdre were married six years ago, shortly after they completed college. They currently live in Spokane, Washington, where Dennis is employed as an architect. Deirdre was employed as a claims specialist with an insurance company until the birth of their daughter Evangeline three years ago. Since then, she has elected to stay home and care for the baby, in part because Evangeline has had a series of minor but recurring illnesses. With the loss of Deirdre's income, the couple has had a difficult time making ends meet.

They left school with a combined \$80,000 in student loan debt, which they elected to pay over 15 years at \$630 per month. They pay monthly rent of \$1,250 for a two-bedroom apartment. They each have a car. Dennis purchased his car three years ago. It is currently worth about \$8,000 and he pays \$340/month on what was originally a four-year, \$15,000 loan. Two years ago Deirdre entered into a four-year lease of a new car. The lease calls for \$225 in monthly payments.

Dennis earns \$6,200 per month. From that, the following deductions are taken:

Income Taxes	\$520
Social Security	\$430
401k Plan Contribution	\$300
Health Insurance	<u>\$200</u>
	\$1,450

With their rent, car payments, student loans, medical co-pays, not to mention food, clothing, utilities, gasoline, insurance, and other living expenses, they find themselves falling further behind each month. To cover their expenses they have done what so many do: taken cash advances on their various credit cards. As a result, they have built up a substantial credit card debt and can no longer make even the minimum monthly payments. They currently owe the following:

Student Loans	\$65,000
Car Loan	\$3,800
Credit Cards	<u>\$16,200</u>
	\$85,000

- A. Are Dennis and Deirdre eligible for Chapter 7 bankruptcy relief? *See* Selected Means Test Data, which appear at the end of this supplement.
- B. How, if at all, would the result be different if Dennis earned \$6,000 per month, with no change in the deductions identified above? *See* § 707(b)(7).
- C. How, if at all, would the results in Part A be different if the debtors indicated on their Statement of Intention that they planned to surrender Deirdre's car to the lessor? What if they had in fact surrendered the car prior to the trustee's motion to dismiss the case? *See In re Singletary*, 354 B.R. 455 (Bankr. S.D. Tex. 2006).
- D. In reviewing the formula in § 707(b)(2), what might debtors do to satisfy the means test? In other words, what, if any, prepetition transactions could debtors enter into to make it more likely they will satisfy the means test?

Page 406, add after the carryover paragraph from Problem 10-17:

A bankruptcy discharge operates on the debtor's personal liability; it does not eliminate the debt itself. Thus, for example, a guarantor will remain liable despite the debtor's discharge and, absent lien avoidance, any collateral will retain *in rem* liability. Much the same principle applies to the terms of contracts that the debtor entered into prepetition. The debtor will have no remaining payment obligation but the contract itself survives. This can be important if other aspects of the contract fall into dispute.

Thus, for example, if a mortgage loan contract provides for arbitration, and the debtor wishes to bring a claim against the lender post-discharge, the arbitration provision remains enforceable. The debtor's agreement to arbitrate has not been discharged. *Green Tree Servicing, LLC v. Brough*, 930 N.E.2d 1238 (Ind. Ct. App. 2010); *In re Wells Fargo Bank*, 300 S.W.3d 818 (Tex. Ct. App. 2009). *See also MBNA American Bank v. Hill*, 436 F.3d 104 (2d Cir. 2006). Similarly, a clause in a prepetition contract entitling a lender to attorney's fees can be enforced with respect to the fees arising during post-discharge litigation. *Siegel v. Federal Home*

Loan Mortgage Corp., [143 F.3d 525](#) (9th Cir.1998). As the court noted, the attorney's fees provision "may have fallen dormant, but it was reviviscible." *Id.* at 531.

Because liens are generally not affected by the discharge, the creditor retains the right to enforce the lien but not the right to pursue the debtor for a deficiency or any other portion of the discharged obligation. This dichotomy is easy to state but occasionally difficult to apply. For example, in one recent case the creditor got into trouble after it continued to pursue a detinue action after the debtor received a Chapter 7 discharge. The court ruled that the creditor did not violate discharge injunction by the detinue action or even by seeking a contempt citation for the debtor's failure to comply with a court order to turn over the collateral, but that it did violate the discharge injunction by accepting payments to allow the debtor to avoid contempt after learning that the debtor no longer had the collateral. *In re Butler*, [2011 WL 806078](#) (Bankr. C.D. Ill. 2011).

Chapter Eleven

Page 417, add to the end of the first paragraph:

Several courts have interpreted § 1307(b) as giving a Chapter 13 debtor the absolute right to dismiss the case. *See, e.g., In re Barbieri*, 199 F.3d 616 (2d Cir. 1999). However, following the Supreme Court’s decision in *Marrama v. Citizens Bank of Massachusetts*, 549 U.S. 365 (2007) (a debtor who has acted in bad faith does not have the right under § 706(a) to convert to Chapter 13), a growing number have ruled that a bankruptcy court may, due to the debtor’s bad faith, refuse to dismiss and instead convert the case to Chapter 7. *See In re Jacobsen*, 609 F.3d 647 (5th Cir. 2010); *In re Rosson*, 545 F.3d 764 (9th Cir. 2008). *See also In re Molitor*, 76 F.3d 218 (8th Cir. 1996).

Page 421:

Refer to the revised chart on page 28 of this Supplement for the revised distribution amounts on priority claims in a Chapter 7 case.

Page 429:

Although one circuit court ruled that the income portion of the debtor’s “protected disposable income” should be computed mechanically, by multiplying the debtor’s current monthly income by the number of months in the plan, *In re Kagenveama*, 541 F.3d 868 (9th Cir. 2008) (requiring a simple, mechanical calculation), three other circuit courts ruled to the contrary. *See In re Lasowski*, 575 F.3d 815 (8th Cir. 2009) (distinguishing “disposable income” from “projected disposable income” and requiring bankruptcy courts to include in the latter amounts freed up when a loan is paid off during the plan); *In re Nowlin*, 576 F.3d 258 (5th Cir. 2009) (permitting bankruptcy courts to consider events reasonable certain future events – such as the limited duration of a plan payment – when calculating projected disposable income); *In re Lanning*, 545 F.3d 1269 (10th Cir. 2008), *aff’d*, 130 S. Ct. 2464 (2010) (while “projected disposable income” is presumed to be the debtor’s “current monthly income,” that can be rebutted by a showing of a

substantial change in circumstances). *See also In re Petro*, 395 B.R. 369 (6th Cir. BAP 2008) (“projected disposable income” is forward-looking concept which requires courts to consider both future and historical finances of debtor, and bankruptcy court erred in not considering how the debtor’s period of unemployment during the six months before bankruptcy would affect future disposable income); *In re Kibbe*, 361 B.R. 302 (1st Cir. BAP 2007) (projected disposable income should not be calculated solely from debtor’s income for the prior six months, but should take into account fact that debtor recently accepted a higher paying job).

In June of 2010, the Supreme Court resolved the conflict by adopting the more flexible approach affirming the Tenth Circuit Court of Appeals decision in *In re Lanning*.

HAMILTON V. LANNING
130 S. Ct. 2464 (S. Ct. 2010)

Justice ALITO delivered the opinion of the Court.

Chapter 13 of the Bankruptcy Code provides bankruptcy protection to “individual[s] with regular income” whose debts fall within statutory limits. Unlike debtors who file under Chapter 7 and must liquidate their nonexempt assets in order to pay creditors, Chapter 13 debtors are permitted to keep their property, but they must agree to a court-approved plan under which they pay creditors out of their future income. A bankruptcy trustee oversees the filing and execution of a Chapter 13 debtor’s plan.

Section 1325 of Title 11 specifies circumstances under which a bankruptcy court “shall” and “may not” confirm a plan. If an unsecured creditor or the bankruptcy trustee objects to confirmation, § 1325(b)(1) requires the debtor either to pay unsecured creditors in full or to pay all “projected disposable income” to be received by the debtor over the duration of the plan.

We granted certiorari to decide how a bankruptcy court should calculate a debtor’s “projected disposable income.” Some lower courts have taken what the parties term the “mechanical approach,” while most have adopted what has been called the “forward-looking approach.” We hold that the “forward-looking approach” is correct.

I

As previously noted, § 1325 provides that if a trustee or an unsecured creditor objects to a Chapter 13 debtor’s plan, a bankruptcy court may not approve the plan unless it provides for the full repayment of unsecured claims or “provides that all

of the debtor's projected disposable income to be received" over the duration of the plan "will be applied to make payments" in accordance with the terms of the plan. 11 U.S.C. § 1325(b)(1). Before the enactment of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA), the Bankruptcy Code (Code) loosely defined "disposable income" as "income which is received by the debtor and which is not reasonably necessary to be expended" for the "maintenance or support of the debtor," for qualifying charitable contributions, or for business expenditures.

The Code did not define the term "projected disposable income," and in most cases, bankruptcy courts used a mechanical approach in calculating projected disposable income. That is, they first multiplied monthly income by the number of months in the plan and then determined what portion of the result was "excess" or "disposable."

In exceptional cases, however, bankruptcy courts took into account foreseeable changes in a debtor's income or expenses.

BAPCPA left the term "projected disposable income" undefined but specified in some detail how "disposable income" is to be calculated. "Disposable income" is now defined as "current monthly income received by the debtor" less "amounts reasonably necessary to be expended" for the debtor's maintenance and support, for qualifying charitable contributions, and for business expenditures. § 1325(b)(2)(A)(i) and (ii). "Current monthly income," in turn, is calculated by averaging the debtor's monthly income during what the parties refer to as the 6-month look-back period, which generally consists of the six full months preceding the filing of the bankruptcy petition. See § 101(10A)(A)(I). The phrase "amounts reasonably necessary to be expended" in § 1325(b)(2) is also newly defined. For a debtor whose income is below the median for his or her State, the phrase includes the full amount needed for "maintenance or support," see § 1325(b)(2)(A)(i), but for a debtor with income that exceeds the state median, only certain specified expenses are included, see §§ 707(b)(2), 1325(b)(3)(A).

II

A

Respondent had \$36,793.36 in unsecured debt when she filed for Chapter 13 bankruptcy protection in October 2006. In the six months before her filing, she received a one-time buyout from her former employer, and this payment greatly inflated her gross income for April 2006 (to \$11,990.03) and for May 2006 (to \$15,356.42). As a result of these payments, respondent's current monthly income,

as averaged from April through October 2006, was \$5,343.70 – a figure that exceeds the median income for a family of one in Kansas. Respondent’s monthly expenses, calculated pursuant to § 707(b)(2), were \$4,228.71. She reported a monthly “disposable income” of \$1,114.98 on Form 22C.

On the form used for reporting monthly income (Schedule I), she reported income from her new job of \$1,922 per month – which is below the state median. On the form used for reporting monthly expenses (Schedule J), she reported actual monthly expenses of \$1,772.97. Subtracting the Schedule J figure from the Schedule I figure resulted in monthly disposable income of \$149.03.

Respondent filed a plan that would have required her to pay \$144 per month for 36 months. Petitioner, a private Chapter 13 trustee, objected to confirmation of the plan because the amount respondent proposed to pay was less than the full amount of the claims against her, see § 1325(b)(1)(A), and because, in petitioner’s view, respondent was not committing all of her “projected disposable income” to the repayment of creditors, see § 1325(b)(1)(B). According to petitioner, the proper way to calculate projected disposable income was simply to multiply disposable income, as calculated on Form 22C, by the number of months in the commitment period. Employing this mechanical approach, petitioner calculated that creditors would be paid in full if respondent made monthly payments of \$756 for a period of 60 months. There is no dispute that respondent’s actual income was insufficient to make payments in that amount.

B

The Bankruptcy Court endorsed respondent’s proposed monthly payment of \$144 but required a 60-month plan period. The court agreed with the majority view that the word “projected” in § 1325(b)(1)(B) requires courts “to consider at confirmation the debtor’s *actual* income as it was reported on Schedule I” (emphasis added). This conclusion was warranted by the text of § 1325(b)(1), the Bankruptcy Court reasoned, and was necessary to avoid the absurd result of denying bankruptcy protection to individuals with deteriorating finances in the six months before filing.

Petitioner appealed to the Tenth Circuit Bankruptcy Appellate Panel, which affirmed. The Panel noted that, although Congress redefined “disposable income” in 2005, it chose not to alter the pre-existing term “projected disposable income.” Thus, the Panel concluded, there was no reason to believe that Congress intended to alter the pre-BAPCPA practice under which bankruptcy courts determined projected disposable income by reference to Schedules I and J but considered other

evidence when there was reason to believe that the schedules did not reflect a debtor's actual ability to pay.

The Tenth Circuit affirmed. According to the Tenth Circuit, a court, in calculating "projected disposable income," should begin with the "presumption" that the figure yielded by the mechanical approach is correct, but the Court concluded that this figure may be rebutted by evidence of a substantial change in the debtor's circumstances.

This petition followed, and we granted certiorari.

III

A

The parties differ sharply in their interpretation of § 1325's reference to "projected disposable income." Petitioner, advocating the mechanical approach, contends that "projected disposable income" means past average monthly disposable income multiplied by the number of months in a debtor's plan. Respondent, who favors the forward-looking approach, agrees that the method outlined by petitioner should be determinative in most cases, but she argues that in exceptional cases, where significant changes in a debtor's financial circumstances are known or virtually certain, a bankruptcy court has discretion to make an appropriate adjustment. Respondent has the stronger argument.

First, respondent's argument is supported by the ordinary meaning of the term "projected." "When terms used in a statute are undefined, we give them their ordinary meaning." *Asgrow Seed Co. v. Winterboer*, 513 U.S. 179, 187 (1995). Here, the term "projected" is not defined, and in ordinary usage future occurrences are not "projected" based on the assumption that the past will necessarily repeat itself. For example, projections concerning a company's future sales or the future cash flow from a license take into account anticipated events that may change past trends. On the night of an election, experts do not "project" the percentage of the votes that a candidate will receive by simply assuming that the candidate will get the same percentage as he or she won in the first few reporting precincts. And sports analysts do not project that a team's winning percentage at the end of a new season will be the same as the team's winning percentage last year or the team's winning percentage at the end of the first month of competition. While a projection takes past events into account, adjustments are often made based on other factors that may affect the final outcome.

Second, the word "projected" appears in many federal statutes, yet Congress rarely has used it to mean simple multiplication. * * *

By contrast, we need look no further than the Bankruptcy Code to see that when Congress wishes to mandate simple multiplication, it does so unambiguously – most commonly by using the term “multiplied.” *See, e.g.*, 11 U.S.C. § 1325(b)(3) (“current monthly income, when multiplied by 12”); §§ 704(b)(2), 707(b)(6), (7)(A) (same); § 707(b)(2)(A)(i), (B)(iv) (“multiplied by 60”).

Third, pre-BAPCPA case law points in favor of the “forward-looking” approach. Prior to BAPCPA, the general rule was that courts would multiply a debtor’s current monthly income by the number of months in the commitment period as the first step in determining projected disposable income. But courts also had discretion to account for known or virtually certain changes in the debtor’s income. This judicial discretion was well documented in contemporary bankruptcy treatises.

Pre-BAPCPA bankruptcy practice is telling because we “will not read the Bankruptcy Code to erode past bankruptcy practice absent a clear indication that Congress intended such a departure.” *Travelers Casualty & Surety Co. of America v. Pacific Gas & Elec. Co.*, 549 U.S. 443, 454, (2007). Congress did not amend the term “projected disposable income” in 2005, and pre-BAPCPA bankruptcy practice reflected a widely acknowledged and well-documented view that courts may take into account known or virtually certain changes to debtors’ income or expenses when projecting disposable income. In light of this historical practice, we would expect that, had Congress intended for “projected” to carry a specialized-and indeed, unusual-meaning in Chapter 13, Congress would have said so expressly.

B

The mechanical approach also clashes repeatedly with the terms of 11 U.S.C. § 1325.

First, § 1325(b)(1)(B)’s reference to projected disposable income “to be received in the applicable commitment period” strongly favors the forward-looking approach. There is no dispute that respondent would in fact receive far less than \$756 per month in disposable income during the plan period, so petitioner’s projection does not accurately reflect “income to be received” during that period. The mechanical approach effectively reads this phrase out of the statute when a debtor’s current disposable income is substantially higher than the income that the debtor predictably will receive during the plan period.

Second, § 1325(b)(1) directs courts to determine projected disposable income “as of the effective date of the plan,” which is the date on which the plan is confirmed and becomes binding. Had Congress intended for projected disposable

income to be nothing more than a multiple of disposable income in all cases, we see no reason why Congress would not have required courts to determine that value as of the *filing* date of the plan. In the very next section of the Code, for example, Congress specified that a debtor shall commence payments “not later than 30 days after the *date of the filing of the plan.*” § 1326(a)(1) (emphasis added). Congress’ decision to require courts to measure projected disposable income “as of the *effective* date of the plan” is more consistent with the view that Congress expected courts to consider postfiling information about the debtor’s financial circumstances.

Third, the requirement that projected disposable income “will be applied to make payments” is most naturally read to contemplate that the debtor will actually pay creditors in the calculated monthly amounts. § 1325(b)(1)(B). But when, as of the effective date of a plan, the debtor lacks the means to do so, this language is rendered a hollow command.

C

The arguments advanced in favor of the mechanical approach are unpersuasive. Noting that the Code now provides a detailed and precise definition of “disposable income,” proponents of the mechanical approach maintain that any departure from this method leaves that definition “with no apparent purpose.” This argument overlooks the important role that the statutory formula for calculating “disposable income” plays under the forward-looking approach. As the Tenth Circuit recognized in this case, a court taking the forward-looking approach should begin by calculating disposable income, and in most cases, nothing more is required. It is only in unusual cases that a court may go further and take into account other known or virtually certain information about the debtor’s future income or expenses.

Petitioner faults the Tenth Circuit for referring to a rebuttable “presumption” that the figure produced by the mechanical approach accurately represents a debtor’s “projected disposable income.” Petitioner notes that the Code makes no reference to any such presumption but that related Code provisions expressly create other rebuttable presumptions. *See* § 707(b)(2)(A)(i) and (B)(i). He thus suggests that the Tenth Circuit improperly supplemented the text of the Code.

The Tenth Circuit’s analysis, however, simply heeds the ordinary meaning of the term “projected.” As noted, a person making a projection uses past occurrences as a starting point, and that is precisely what the Tenth Circuit prescribed. * * *

Petitioner also notes that § 707 allows courts to take “special circumstances” into consideration, but that § 1325(b)(3) incorporates § 707 only with respect to

calculating expenses. Thus, he argues, a “special circumstances” exception should not be inferred with respect to the debtor’s income. We decline to infer from § 1325’s incorporation of § 707 that Congress intended to eliminate, *sub silentio*, the discretion that courts previously exercised when projecting disposable income to account for known or virtually certain changes.

D

In cases in which a debtor’s disposable income during the 6-month look-back period is either substantially lower or higher than the debtor’s disposable income during the plan period, the mechanical approach would produce senseless results that we do not think Congress intended. In cases in which the debtor’s disposable income is higher during the plan period, the mechanical approach would deny creditors payments that the debtor could easily make. And where, as in the present case, the debtor’s disposable income during the plan period is substantially lower, the mechanical approach would deny the protection of Chapter 13 to debtors who meet the chapter’s main eligibility requirements. Here, for example, respondent is an “individual whose income is sufficiently stable and regular” to allow her “to make payments under a plan,” § 101(30), and her debts fall below the limits set out in § 109(e). But if the mechanical approach were used, she could not file a confirmable plan. Under § 1325(a)(6), a plan cannot be confirmed unless “the debtor will be able to make all payments under the plan and comply with the plan.” And as petitioner concedes, respondent could not possibly make the payments that the mechanical approach prescribes.

In order to avoid or at least to mitigate the harsh results that the mechanical approach may produce for debtors, petitioner advances several possible escape strategies. He proposes no comparable strategies for creditors harmed by the mechanical approach, and in any event none of the maneuvers that he proposes for debtors is satisfactory.

1

Petitioner first suggests that a debtor may delay filing a petition so as to place any extraordinary income outside the 6-month look-back period. We see at least two problems with this proposal.

First, delay is often not a viable option for a debtor sliding into bankruptcy. Potential Chapter 13 debtors typically find a lawyer’s office when they are one step from financial Armageddon: There is a foreclosure sale of the debtor’s home the next day; the debtor’s only car was mysteriously

repossessed in the dark of last night; a garnishment has reduced the debtor's take-home pay below the ordinary requirements of food and rent. Instantaneous relief is expected, if not necessary.

K. Lundin & W. Brown, Chapter 13 Bankruptcy § 3.1[2] (4th ed. rev.2009).

Second, even when a debtor is able to delay filing a petition, such delay could be risky if it gives the appearance of bad faith. *See* 11 U.S.C. § 1325(a)(7) (requiring, as a condition of confirmation, that “the action of the debtor in filing the petition was in good faith”); *In re Myers*, 491 F.3d 120, 125 (3d Cir. 2007) (citing “the timing of the petition” as a factor to be considered in assessing a debtor's compliance with the good-faith requirement).

2

Petitioner next argues that a debtor with unusually high income during the 6 months prior to the filing of a petition, could seek leave to delay filing a schedule of current income (Schedule I) and then ask the bankruptcy court to exercise its authority under § 101(10A)(A)(ii) to select a 6-month period that is more representative of the debtor's future disposable income. We see little merit in this convoluted strategy. If the Code required the use of the mechanical approach in all cases, this strategy would improperly undermine what the Code demands. And if, as we believe, the Code does not insist upon rigid adherence to the mechanical approach in all cases, this strategy is not needed. In any event, even if this strategy were allowed, it would not help all debtors whose disposable income during the plan period is sharply lower than their previous disposable income.

3

Petitioner suggests that a debtor can dismiss the petition and refile at a later, more favorable date. But petitioner offers only the tepid assurance that courts “generally” do not find this practice to be abusive. This questionable stratagem plainly circumvents the statutory limits on a court's ability to shift the look-back period, and should give debtors pause.

4

Petitioner argues that respondent might have been able to obtain relief by filing under Chapter 7 or by converting her Chapter 13 petition to one under Chapter 7. The availability of Chapter 7 to debtors like respondent who have above-median incomes is limited. In respondent's case, a presumption of abuse would attach under § 707(b)(2)(A)(i) because her disposable income, “multiplied by 60,” exceeds

the amounts specified in subclauses (I) and (II). Nevertheless, petitioner argues, respondent might have been able to overcome this presumption by claiming that her case involves “special circumstances” within the meaning of § 707(b)(2)(B)(i). Section 707 identifies as examples of “special circumstances” a “serious medical condition or a call or order to active duty in the Armed Forces,” and petitioner directs us to no authority for the proposition that a prepetition decline in income would qualify as a “special circumstance.” In any event, the “special circumstances” exception is available only to the extent that “there is no reasonable alternative,” a proposition we reject with our interpretation of § 1325(b)(1) today.

In sum, each of the strategies that petitioner identifies for mitigating the anomalous effects of the mechanical approach is flawed. There is no reason to think that Congress meant for any of these strategies to operate as a safety valve for the mechanical approach.

IV

We find petitioner’s remaining arguments unpersuasive. Consistent with the text of § 1325 and pre-BAPCPA practice, we hold that when a bankruptcy court calculates a debtor’s projected disposable income, the court may account for changes in the debtor’s income or expenses that are known or virtually certain at the time of confirmation. We therefore affirm the decision of the Court of Appeals.

It is so ordered.

Justice Scalia dissented. [Omitted.]

Note

The Sixth Circuit has interpreted the Supreme Court’s opinion in *Hamilton v. Lanning* as applying to the expense side of the computation as well as to the income side. Specifically, the debtor must be denied a deduction for a home mortgage expense if the debtor has indicated an intention to surrender the property. *In re Darrohn*, [615 F.3d 470](#) (6th Cir. 2010).

Courts were also divided on another issue involved in computing “projected disposable income” for debtors with income above the state median. Recall that the IRS Local Standards permit a debtor to deduct

vehicle “ownership costs.” Courts disagreed on whether such a deduction is available – in other words, whether it is “applicable” under § 702(b)(2)(A)(ii)(I) – if the debtor owns the vehicle free and clear (*i.e.*, does not lease or have a car loan). Compare *In re Washburn*, 579 F.3d 934 (8th Cir. 2009), *In re Tate*, 571 F.3d 423 (5th Cir. 2009); *In re Ross-Tousey*, 549 F.3d 1148 (7th Cir. 2008); *In re Pearson*, 390 B.R. 706 (10th Cir. BAP 2008), *vacated as moot*, 309 Fed. Appx. 216 (10th Cir. 2009), *In re Kimbro*, 389 B.R. 518 (6th Cir. BAP 2008), *reversed and remanded*, 409 Fed. Appx. 930 (6th Cir. 2011) (all allowing the deduction).

The United States Supreme Court settled the question in *Ransom v. FIA Card Services*, 131 S. Ct. 716 (2011), by holding that a debtor who does not have a car loan or a lease payment may not take the car-ownership deduction in calculating disposable income under the means test.

Page 430, add at the end of the page prior to Problem 11-4:

Courts are finding it extremely difficult to harmonize the rules that require:

- (i) adequate protection payments to begin within 30 days of the petition, § 1326(a)(1)(C), and to continue after confirmation, § 1325(a)(5)(B)(iii)(II);
- (ii) payments to be made in equal monthly amounts, § 1325(a)(5)(B)(iii)(I); and
- (iii) administrative expenses to be paid in full, with priority over other claims, § 1326(b)(1).

Consider the following recent case.

IN RE BUTLER

403 B.R. 5 (Bankr. W.D. Ark. 2009)

BEN T. BARRY, Bankruptcy Judge.

Before the Court is the Objection to Confirmation filed by Ford Motor Credit Company LLC [FMC] on October 1, 2008. The gravamen of the creditor’s objection is that upon confirmation, the payments to FMC would cease for approximately seven months while the trustee is paying the administrative costs and attorney fees under the plan. * * *

Background

The debtors filed their Chapter 13 Narrative Statement of Plan on August 22, 2008, in which they proposed to pay \$185 per month to the trustee for 60 months. The plan proposed to pay FMC \$116 per month for a vehicle with a listed value of \$5700, but did not provide for any adequate protection payments to be paid to FMC. The proposed plan also included administrative costs for an attorney fee “to be paid \$1,000 from funds paid in by the debtor.” * * * The initial \$1,000 payment to the attorney is referred to as a “kicker fee.” FMC objected to the proposed plan. Prior to the hearing, on December 30, 2008, the debtors filed a Modification of Chapter 13 Plan, in which the debtors proposed to pay FMC adequate protection payments in the amount of \$116 per month beginning 30 days after the date of filing and continuing until confirmation of the debtors’ plan. The next day, the Court entered its Agreed Order Granting Adequate Protection Payment reflecting the terms provided for in the modified plan. The remaining unresolved objection for hearing was that,

[t]he plan is not feasible, in that the proposed plan payments to the trustee are insufficient to allow the trustee to make distributions to Creditor in equal monthly installments sufficient to provide Creditor adequate protection during the plan. The initial payment (kicker fee) paid to debtors’ attorney at confirmation may cause an interruption in Creditor’s disbursements.

Stipulations

* * *

9. Solely for the purposes of pre-confirmation adequate protection monthly payment determination, the parties agree that \$116 is acceptable. * * *

10. Upon confirmation of the plan, Debtors and Ford Credit project that the Chapter 13 Trustee intends to make the following disbursements, assuming there are sufficient funds on hand to do so: first, administrative costs for Trustee’s fees and expenses; second, Debtors’ attorney will receive \$1,050, (commonly referred to as the “kicker fee”). * * * Finally, after Debtor’s attorney receives \$1,050 for his kicker fee, Ford Credit will begin receiving its specified monthly payment in the amount of \$116.00 per month (again, assuming there are sufficient funds on hand to do so).

* * *

Discussion

The issue before the Court concerns the conflict between the code requirement of equal monthly payments to secured creditors under the plan pursuant to § 1325(a)(5)(B)(iii) and the plan provision that allows the trustee to pay a “kicker fee” to the attorney before making any payments to the secured creditor. According to the stipulations of the parties, this practice of paying the kicker fee first would result in FMC not receiving *any* payments for approximately seven months once the plan is confirmed. Although it seems a simple issue to state, resolution requires a close look at four code provisions.

Section 309 of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 [BAPCPA] amended the key code provisions related to the issue before the Court. Specifically, § 1325(a)(5)(B) was amended to provide equal monthly payments to secured creditors under a plan, and § 1326(a) was amended to provide adequate protection directly to a secured creditor not later than 30 days after the order for relief. These code sections, which are relevant to this Court’s decision, must be read together * * *.

Adequate Protection

A debtor is required to make payments beginning not later than 30 days after the order for relief in an amount proposed by the debtor’s plan. 11 U.S.C. § 1326(a)(1). Included in this amount are payments that provide adequate protection to creditors holding allowed claims secured by personal property. Adequate protection is compensation paid to the creditor for the depreciation of its collateral. According to the code, unless otherwise ordered by the court, payments related to the lease of personal property and that provide adequate protection to a secured creditor are to be made directly to the holder of such claims. 11 U.S.C. § 1326(a)(1)(B), (C). The balance of the required payment is to be paid to the trustee. However, in Arkansas, in accordance with General Order 32, all payments under this section are required to be made directly to the trustee prior to confirmation. The trustee then makes the adequate protection payments to secured creditors that have filed a proof of claim.

Congress added § 1326(a)(1)(C) to the code under BAPCPA. Before the enactment of BAPCPA, some courts held that adequate protection payments ended upon confirmation of a plan, presumably because a confirmed plan would satisfy any requirement of adequate protection to the creditor. If the creditor was not adequately protected, it could object to confirmation of the plan or obtain relief from stay and acquire its collateral. Now, because there is a specific code provision

requiring a debtor to pay adequate protection payments beginning within 30 days after the order for relief, creditors holding allowed claims secured by personal property are protected if their collateral is depreciating, regardless of any proposed plan provision or payment scheme. In other words, adequate protection is required before *and* after confirmation of the debtor's plan.

Even after the enactment of BAPCPA, under § 1325(a)(1) a plan must still comply with the provisions of chapter 13 in order to be confirmed. As stated, one of the "new" requirements under chapter 13 is the specific requirement that a debtor pay to a secured creditor adequate protection beginning not later than 30 days after the order for relief. 11 U.S.C. § 1326(a)(1)(C). To meet this requirement, some courts allow a debtor's plan to provide for the payment of adequate protection after confirmation until the payments provided for in the plan begin. *See, e.g., In re Hill*, 397 B.R. 259 (Bankr. M.D.N.C. 2007); *In re DeSardi*, 340 B.R. 790 (Bankr. S.D. Tex. 2006). Other courts look to another "new" requirement—equal monthly amounts for periodic payments—to ensure that payments in an amount sufficient to provide adequate protection are made beginning with the debtor's first payment after confirmation. *See, e.g., In re Sanchez*, 384 B.R. 574, 579 (Bankr. D. Or. 2008) (stating that "during the period of the plan" under § 1325(a)(5)(B)(iii)(II) means that equal monthly payments to secured creditors must start with first payment after confirmation); *In re Denton*, 370 B.R. 441, 446 (Bankr. S.D. Ga. 2007). It is this requirement of equal monthly payments that causes the most disagreement between courts, and upon which FMC's objection is based.

Equal Monthly Payments

* * * When read together, § 1325(a)(5)(B)(iii)(I) and (II) merely requires the debtor to propose a plan that provides for payments to secured creditors to be made monthly, in equal amounts. Further, if the creditor's claim is secured by personal property, the proposed payment to the creditor cannot be less than the amount required to provide adequate protection to that creditor. The purpose of the second part of this provision is to make sure that creditors whose claims are secured by personal property remain adequately protected during the period of the plan or until the creditor's claim is paid in full. For example, if adequate protection is determined to be \$200 per month and the balance of the debt is \$2000, the debtor cannot confirm a plan unless he proposes to pay that creditor at least \$200 per

month. The debtor is precluded from proposing a payment of less than \$200 per month over a longer period of time.¹

The purpose of the new provisions of BAPCPA relating to equal monthly payments was to restrict the types of payments that debtors had previously proposed to secured creditors with depreciating collateral. For instance, some debtors attempted to “backload” plans by proposing plans that call for a secured creditor to receive a large balloon payment at the end of the plan, or that provided for graduated or step-up payments during the life of the plan. Other examples include debtors not providing for equal monthly payments, such as reduced payments during certain months of the year, or payments that are made quarterly or semi-annually. The requirement of equal monthly payments whenever periodic payments are due eliminates this concern.

Although courts may agree about the general purpose behind § 1325(a)(5)(B)(iii)(I) and (II), the concept of periodic payments in relation to equal monthly amounts has resulted, basically, in two lines of cases. The first line of cases find that “periodic payments . . . in equal monthly amounts” refer to *all* payments made on allowed secured claims after confirmation, and those payments must begin with the trustee’s first distribution under a confirmed plan. *See, e.g., Denton*, 370 B.R. at 446; *Sanchez*, 384 B.R. at 578. These courts conclude that equal monthly payments must begin with confirmation and continue until the secured claim is paid in full. *Denton*, 370 B.R. at 443. According to these courts, the periodic payments contemplated under the code refer to all “regularly-recurring post-confirmation payments on an allowed secured claim.” *Id.* at 446. Because the code states that the periodic payments shall be in equal monthly amounts, the courts conclude that all periodic payments after confirmation must be in equal monthly amounts. *Id.*

The second line of cases find the equal monthly payment provision requires payments to be equal *once they begin* and to continue to be equal until the claim is paid in full. There is no requirement in the code that the payments begin with the first payment after confirmation. *See, e.g., DeSardi*, 340 B.R. at 805; *Hill*, 397 B.R. at 268-69. This provision was explained by the *DeSardi* court:

The equal payment provision does not state that its requirements must be met beginning in month one of the plan. Nor does the section state that payments must be equal “as of the effective date of the plan.” In contrast, the immediately preceding section of § 1325(a)(5)(B)(ii) does use such

¹ Unless, of course, the creditor otherwise accepts the plan under § 1325(a)(5)(A).

language. That section states that “Except as provided in subsection (b) the court shall confirm a plan if . . . with respect to each allowed secured claim provided for by the plan . . . the plan provides that . . . the value, as of the effective date of the plan, of property to be distributed under the plan on account of such claim is not less than the allowed amount of such claim.” 11 U.S.C. § 1325(a)(5)(B)(ii). While perfectly aware of its drafting options, Congress wrote “[I]f . . . property to be distributed pursuant to this subsection is in the form of periodic payments, such payments shall be in equal monthly amounts.” 11 U.S.C. § 1325(a)(5)(B)(iii)(I). Most importantly, subsection 1325(a)(5)(B)(iii)(II) explicitly requires that payments be not less than the amount to provide adequate protection “during the period of the plan.” No similar language exists in subsection (I). The Court understands this clause to require payments to be equal once they begin, and to continue to be equal until they cease.

DeSardi, 340 B.R. at 805. This Court believes that the reasoning behind the second line of cases as stated by the *DeSardi* court more accurately describes the proper interpretation of this code provision, especially considering the requirement of adequate protection and the trustee’s duties described below.

Confirmation

According to the code, after a plan is confirmed, the trustee shall distribute *as soon as practicable* the payments made by the debtor to the trustee pursuant to § 1326(a)(1). 11 U.S.C. § 1326(a)(2). The timing and the amount of payments to specific creditors is determined by the trustee in accordance with the bankruptcy code. However, the trustee is not bound by the equal payment provision of § 1325(a)(5)(B)(iii). Sections 1322 and 1325 concern the contents of a plan and what a *debtor* must do to have a plan confirmed. The debtor is required to propose a plan that provides for equal monthly payments to secured creditors. The directives relating to the trustee’s administration of the debtor’s confirmed plan are contained in § 1326 and are few, indicating “an intent to repose broad discretion in trustees for the administration of plans.” *In re Erwin*, 376 B.R. 897, 902 (Bankr. C.D. Ill. 2007). Part of this code driven discretion concerns the timing of when the equal monthly payments to secured creditors would begin. And that determination must take into account another trustee requirement under § 1326:

Before or at the time of each payment to creditors under the plan, there shall be paid –

- (1) any unpaid claim of the kind specified in section 507(a)(2) of this title;
- (2) if a standing trustee appointed under section 586(b) of title 28 is serving in the case, the percentage fee fixed for such standing trustee under section 586(e)(1)(B) of title 28.

11 U.S.C. § 1326(b). The trustee must make payments as soon as practicable after confirmation, but either before or at the same time of each payment, the trustee must pay certain administrative claims.

Payments of Administrative Claims

Upon confirmation, the code requires the trustee to pay unpaid claims for administrative expenses allowed under § 507(a)(2), which refers to § 503(b), and the trustee's percentage fee. 11 U.S.C. § 1326(b). Section 503(b) includes compensation awarded under § 330(a), which includes allowed attorney fees in a chapter 13 case. These payments must be made either before or at the same time as payments to creditors under the plan. Some courts, and a leading bankruptcy treatise, hold that the requirement to pay any unpaid claim means that the administrative claims must be paid in full before any creditors receive payment. *See, e.g., In re Bishop*, 101 B.R. 185, 186 (B.A.P. 9th Cir.1989). Presumably, for these courts, the use of the word "or" in the phrase "before *or* at the time of each payment to creditors under the plan" does not allow flexibility in the payment of administrative claims at confirmation. Rather, it is to allow the payment of administrative claims that arise after confirmation and *ongoing* trustee percentage fees concurrent with the ongoing distributions to creditors.

Other courts find that the statute permits a court the option of "ordering complete payment of allowed administrative expense claims in front of other creditors, or ordering their payment 'at the time of' payment to other creditors." *In re Balderas*, 328 B.R. 707, 717 (Bankr. W.D. Tex. 2005). These courts recognize that while administrative fees cannot be deferred, they do not have to be paid in full prior to the distributions to creditors under the plan. This would allow a plan to be confirmed, for instance, that proposes to pay the attorney fee over a one year period, rather than having to pay the fee in full prior to the payment of other creditors. This interpretation of § 1326(b) would allow attorneys to continue to offer their services to debtors with the debtors continuing to pay little or no money to the attorneys prior to filing, while still allowing creditors to begin receiving payments concurrent with the payment of attorney fees over time. * * *

The requirement to pay administrative fees – either in full before or concurrent with payments to creditors – when read in conjunction with the requirement to make adequate protection payments within 30 days of filing, dictate that equal monthly payments may not necessarily occur until some time after confirmation. For instance, in the case before the Court, the debtors have proposed a monthly payment of \$185. If the adequate protection payment after confirmation remains \$116, the same amount as preconfirmation adequate protection payments, then after the adequate protection payment is made, \$69 would remain. If the adequate protection payment continues to be made through the trustee’s office (as is required for preconfirmation payments under General Order 32), the current trustee fee of 5% would have to be deducted (\$5.80), leaving \$63.20 to pay the remaining administrative fees, which include the attorney “kicker fee.” In this case, the kicker fee is \$1,000. This is the amount that would need to be paid before any payments were made to creditors under the plan. At \$63.20 per month, the kicker fee would be paid in approximately 18 months, at which time the regular monthly payments to the creditors could begin. In the mean time, payment for the depreciation of the creditor’s property is provided by the adequate protection payments that are required by the code. The Court finds that this is the proper application of § 1326(b) with regard to the timing of the trustee’s requirement to pay certain administrative claims before or at the time of payments to creditors.

* * *

Conclusion

Reading the sections together, the Court finds that in order for a plan to be confirmed, the plan must include certain provisions and adhere to the strictures of the code. First, pursuant to § 1326(a)(1)(C), the debtor must pay adequate protection to a creditor holding an allowed secured claim secured by personal property beginning 30 days from the order for relief. Second, the debtor must propose a plan that provides for equal monthly payments to that secured creditor. Those proposed plan payments cannot be less than an amount sufficient to provide adequate protection to the creditor during the period of the plan. Third, pursuant to § 1326(b), upon confirmation of the plan the trustee must pay administrative claims and the trustee’s percentage fee before or at the same time as each payment to creditors under the plan. However, confirmation of a plan does not obviate the requirement for adequate protection. If adequate protection payments are made through the trustee’s office, the adequate protection payments must be paid prior to any unpaid claim of the kind specified in § 507(a)(2) and the percentage fee fixed

for the chapter 13 trustee. As soon as the administrative fees are paid (including the “kicker” fee), the trustee shall begin paying the equal monthly payments proposed in plan.

NOTE

The court in *Butler* was willing to allow the debtor’s plan to provide for monthly adequate protection payments of one amount followed later by payments of the debt in a different (and presumably higher), monthly amount. While several other courts agree, *see e.g., In re Marks*, 394 B.R. 198 (Bankr. N.D. Ill. 2008); *In re DiSardi*, 340 B.R. 790 (Bankr. S.D. Tex. 2006), others do not, *see, e.g., In re Sanchez*, 384 B.R. 574 (Bankr. D. Or. 2008); *In re Denton*, 370 B.R. 441 (Bankr. S.D. Ga. 2007).

Page 435, add to the end of the first paragraph on the page:

The debtor may be able to modify a home-mortgage claim with the creditor’s consent. *See In re Wilcox*, 438 B.R. 428 (Bankr. D. Colo. 2010).

Page 435, add to n.46:

But see In re Cook, 432 B.R. 519 (D.N.J. 2010) (*Dewsnup* prohibits stripping off home mortgage).

Courts disagree about whether the debtor may strip off a wholly under water home mortgage lien if the debtor is not entitled to a Chapter 13 discharge. *Compare In re Sadowski*, 2011 WL 4572005 (Bankr. D. Conn. 2011); *In re Victorio*, 454 B.R. 759 (Bankr. S.D. Cal. 2011); *In re Gerardin*, 447 B.R. 342 (Bankr. S.D. Fla. 2011); *In re Fenn*, 428 B.R. 494 (Bankr. N.D. Ill. 2010); *In re Mendoza*, 2010 WL 736834 (Bankr. D. Colo. 2010); *In re Blosser*, 2009 WL 1064455 (Bankr. E.D. Wis. 2009); *In re Jarvis*, 390 B.R. 600 (Bankr. C.D. Ill. 2008) (all prohibiting strip off), *with In re Fisette*, 455 B.R. 177 (8th Cir. BAP 2011); *In re Jennings*, 454 B.R. 252 (Bankr. N.D. Ga. 2011); *In re Okosisi*, 451 B.R. 90 (Bankr. D. Nev. 2011); *In re Fair*, 450 B.R. 853 (E.D. Wis. 2011); *In re Davis*, 447 B.R. 738 (Bankr. D. Md. 2011); *In re Waterman*, 447 B.R. 324 (Bankr. D. Colo. 2011); *In re Hill*, 440 B.R. 176 (Bankr.

S.D. Cal. 2010); *In re Tran*, [431 B.R. 230](#) (Bankr. N.D. Cal. 2010) (all permitting strip off).

Page 436, add to n.47:

See also In re Moore, [441 B.R. 732](#) (Bankr. N.D.N.Y. 2010) (debtors may modify a mortgage that encumbers a single parcel of real property that consists of debtors' personal residence and a stand-alone apartment building); *In re Reyes*, [2009 WL 4825200](#) (Bankr. W.D. Wash. 2009) (debtor who rented rooms in her residence to boarders and who informed lender of that fact at the time the mortgage loan was made could modify the lender's claim).

Page 436, add to the end of the paragraph:

Courts disagree about whether the anti-modification rule of § 1322(b)(2) requires that the debtor use the property as a principal residence on the date of the bankruptcy petition or merely when the mortgage loan was made. *See, e.g., In re Benafel*, [2010 WL 5373127](#) (Bankr. D. Or. 2010) (discussing cases and ruling that relevant time is when loan was made).

Page 438, add to the last paragraph before Problem 11-7:

The 910-day period in the hanging paragraph is apparently not tolled by a prior bankruptcy case. *See Hingiss v. MMCC Financial Corp.*, [2011 WL 2455323](#) (E.D. Wis. 2011); *In re Maas*, [416 B.R. 767](#) (Bankr. D. Kan. 2009).

Page 447, add to n.69:

See also In re Truss, [404 B.R. 329](#) (Bankr. E.D. Wis. 2009) (allowing the debtors to continue making their regular payments on their student loan indebtedness even though those claimants would receive a dividend during the life of the plan of 60-79%, whereas other claimants would received less than 3%). *Contra In re Martellaro*, [404 B.R. 548](#) (Bankr. D. Mont. 2008) (proposed plan

under which debtor would continue making \$150/month payment on student loans pursuant to § 1322(b)(5) unfairly discriminated against other claims).

Page 454, add to n.78:

See *In re Dickson*, [427 B.R. 399](#) (6th Cir. BAP 2010) (debtor has derivative standing to pursue avoidance claims under §§ 544 and 547 when the trustee declines to do so).

Page 455, add to n.84:

In re Mersmann, [505 F.3d 1033](#) (10th Cir. 2007) (overruling *Anderson* and abrogated by *Espinosa*). The Supreme Court decided in *United Student Aid Funds, Inc. v. Espinosa*, [130 S. Ct. 1367](#) (2010) that the bankruptcy courts have an obligation to make a finding of undue hardship before confirming a plan proposing to discharge student loans, even if there is objection or adversary proceeding, and failure of the bankruptcy court to do so is an appealable error but does not prevent the confirmation order from being binding on creditors.

Page 481, add after Note 3:

Note 3 indicates that § 546(c) authorizes vendors who sold goods to the debtor in the ordinary course of business to reclaim the goods if they were delivered within 45 days before the petition. While the provision certainly does *permit* creditors to reclaim goods under such circumstances, it remains unclear whether the provision is an independent source of such a reclamation right or whether it merely allows the vendor to exercise such a right that exists under nonbankruptcy law. Prior to the 2005 amendments, the provision expressly referenced reclamation rights under nonbankruptcy law and was generally not regarded as creating a right to reclaim. The 2005 amendments may have been an attempt to change that, but if so, early cases indicate it may have failed. See *In re Magwood*, [2008 WL 509635](#) (Bankr. M.D. Ala. 2008) (§ 546(c) does not create a reclamation right, it merely imposes a limit on the trustee's avoiding powers); *In re Dana Corp.*, [367 B.R. 409](#) (Bankr. S.D.N.Y. 2007) (§ 546(c) does not create a federal reclamation right, it merely

permits enforcement of some reclamation rights available under nonbankruptcy law). The issue is important because the most common nonbankruptcy source of a right to reclaim – U.C.C. § 2-702 – generally requires that the seller exercise the right within ten days, not 45 days.

Chapter Twelve

Page 489, add to the text before Problem 12-1:

If the debtor engages in unauthorized postpetition transactions – such as by using cash collateral without court or creditor permission or by selling assets outside the ordinary course of business without prior court approval – any transfer of estate property in connection with that transaction can be avoided. *See* § 549. There is protection for a good faith transferee of real estate, § 549(c), but no protection for transferees of any other type of property. Moreover, the transferee has no defense for the value of what it provided in exchange. Thus, a person who postpetition buys the debtor’s accounts in a transaction outside the ordinary course of business and who fails to make sure that the bankruptcy court has authorized the sale, risks having to return the accounts without any setoff, recoupment, or defense for the amount it paid. *In re Straightline Investments, Inc.*, 525 F.3d 870 (9th Cir. 2008). Similarly, a person who postpetition sells goods to the debtor and who is paid with cash collateral will have to return the payment if the debtor was not authorized to use the cash collateral for this purpose, even if the transaction was in the ordinary course of the debtor’s business. *In re Delco Oil, Inc.*, 599 F.3d 1255 (11th Cir. 2010). Because of this, parties who conduct business with bankruptcy debtors must be extremely careful.

Page 520, add after the third paragraph:

It is not always easy to know when a creditor’s vote is made in bad faith. Perhaps the most situation arises when a competitor buys up the controlling portion of a class of claims in the hope of forcing the debtor to sell coveted assets or enter into strategic joint venture. Consider the following recent decision by the Second Circuit.

*IN RE DBSD NORTH AMERICA, INC.***634 F.3d 79 (2d Cir. 2011)**

Gerald E. Lynch, Circuit Judge.

These consolidated appeals arise out of the bankruptcy of DBSD North America, Incorporated and its various subsidiaries (together, “DBSD”). The bankruptcy court confirmed a plan of reorganization for DBSD over the objections of the two appellants here, Sprint Nextel Corporation (“Sprint”) and DISH Network Corporation (“DISH”).

Before us, Sprint argues that the plan improperly gave shares and warrants to DBSD’s owner – whose interest lies below Sprint’s in priority – in violation of the absolute priority rule of § 1129(b)(2)(B). DISH, meanwhile, argues that the bankruptcy court erred when it found DISH did not vote “in good faith” under § 1126(e) and when, because of the § 1126(e) ruling, it disregarded DISH’s class for the purposes of counting votes under § 1129(a)(8). * * *

On Sprint’s appeal, we conclude * * * that the plan violated the absolute priority rule. On DISH’s appeal we find no error, and conclude (1) that the bankruptcy court did not err in designating DISH’s vote, [and] (2) that, after designating DISH’s vote, the bankruptcy court properly disregarded DISH’s class for voting purposes * * *. We therefore affirm in part, reverse in part, and remand for further proceedings.

BACKGROUND

* * *

ICO Global Communications founded DBSD in 2004 to develop a mobile communications network that would use both satellites and land-based transmission towers. In its first five years, DBSD made progress toward this goal, successfully launching a satellite and obtaining certain spectrum licenses from the FCC, but it also accumulated a large amount of debt. Because its network remained in the developmental stage and had not become operational, DBSD had little if any revenue to offset its mounting obligations.

On May 15, 2009, DBSD (but not its parent ICO Global), filed a voluntary petition in the United States Bankruptcy Court for the Southern District of New York, listing liabilities of \$813 million against assets with a book value of \$627 million. Of the various claims against DBSD, three have particular relevance here:

The First Lien Debt: a \$40 million revolving credit facility that DBSD obtained in early 2008 to support its operations, with a first-priority security interest in substantially all of DBSD's assets. It bore an initial interest rate of 12.5%.

The Second Lien Debt: \$650 million in 7.5% convertible senior secured notes that DISH issued in August 2005, due August 2009. These notes hold a second-priority security interest in substantially all of DBSD's assets. At the time of filing, the Second Lien Debt had grown to approximately \$740 million. It constitutes the bulk of DBSD's indebtedness.

Sprint's Claim: an unliquidated, unsecured claim based on a lawsuit against a DBSD subsidiary. Sprint had sued seeking reimbursement for DBSD's share of certain spectrum relocation expenses under an FCC order. At the time of DBSD's filing, that litigation was pending in the United States District Court for the Eastern District of Virginia and before the FCC. In the bankruptcy case, Sprint filed a claim against each of the DBSD entities jointly and severally, seeking \$211 million. The bankruptcy court temporarily allowed Sprint's claim in the amount of \$2 million for voting purposes.

After negotiations with various parties, DBSD proposed a plan of reorganization which, as amended, provided for "substantial de-leveraging," a renewed focus on "core operations," and a "continued path as a development-stage enterprise." The plan provided that the holders of the First Lien Debt would receive new obligations with a four-year maturity date and the same 12.5% interest rate, but with interest to be paid in kind ("PIK"), meaning that for the first four years the owners of the new obligations would receive as interest more debt from DBSD rather than cash. The holders of the Second Lien Debt would receive the bulk of the shares of the reorganized entity, which the bankruptcy court estimated would be worth between 51% and 73% of their original claims. The holders of unsecured claims, such as Sprint, would receive shares estimated as worth between 4% and 46% of their original claims. Finally, the existing shareholder (effectively just ICO Global, which owned 99.8% of DBSD) would receive shares and warrants in the reorganized entity.

Sprint objected to the plan, arguing among other things that the plan violates the absolute priority rule of § 1129(b)(2)(B). That rule requires that, if a class of senior claim-holders will not receive the full value of their claims under the plan and the class does not accept the plan, no junior claim- or interest-holder may receive "any property" "under the plan on account of such junior claim or interest." In making its objection, Sprint noted that the plan provided for the existing shareholder, whose interest is junior to Sprint's class of general unsecured claims, to receive substantial

quantities of shares and warrants under the plan-in fact, much more than all the unsecured creditors received together. Sprint argued that “[b]ecause the Plan fails to satisfy” the absolute priority rule, “it cannot be confirmed.”

The bankruptcy court disagreed. It characterized the existing shareholder’s receipt of shares and warrants as a “gift” from the holders of the Second Lien Debt, who are senior to Sprint in priority yet who were themselves not receiving the full value of their claims, and who may therefore “voluntarily offer a portion of their recovered property to junior stakeholders” without violating the absolute priority rule. It held that it would permit such gifting “at least where, as here, the gift comes from secured creditors, there is no doubt as to their secured creditor status, where there are understandable reasons for the gift, where there are no ulterior, improper ends . . . and where the complaining creditor would get no more if the gift had not been made.”

Meanwhile, DISH, although not a creditor of DBSD before its filing, had purchased the claims of various creditors with an eye toward DBSD’s spectrum rights. As a provider of satellite television, DISH has launched a number of its own satellites, and it also has a significant investment in TerreStar Corporation, a direct competitor of DSDB’s in the developing field of hybrid satellite/terrestrial mobile communications. DISH desired to “reach some sort of transaction with [DBSD] in the future if [DBSD’s] spectrum could be useful in our business.”

Shortly after DBSD filed its plan disclosure, DISH purchased all of the First Lien Debt at its full face value of \$40 million, with an agreement that the sellers would make objections to the plan that DISH could adopt after the sale. As DISH admitted, it bought the First Lien Debt not just to acquire a “market piece of paper” but also to “be in a position to take advantage of [its claim] if things didn’t go well in a restructuring.”

Internal DISH communications also promoted an “opportunity to obtain a blocking position in the [Second Lien Debt] and control the bankruptcy process for this potentially strategic asset.” In the end, DISH (through a subsidiary) purchased only \$111 million of the Second Lien Debt – not nearly enough to control that class – with the small size of its stake due in part to DISH’s unwillingness to buy any claims whose prior owners had already entered into an agreement to support the plan.

In addition to voting its claims against confirmation, * * * DISH proposed to enter into a strategic transaction with DBSD, and requested permission to propose its own competing plan (a request it later withdrew).

DBSD responded by moving for the court to designate that DISH's "rejection of [the] plan was not in good faith." § 1126(e). The bankruptcy court agreed, finding that DISH, a competitor to DBSD, was voting against the plan "not as a traditional creditor seeking to maximize its return on the debt it holds, but . . . 'to establish control over this strategic asset.'" *DBSD II* (quoting DISH's own internal presentation slides). The bankruptcy court therefore designated DISH's vote and disregarded DISH's wholly-owned class of First Lien Debt for the purposes of determining plan acceptance under § 1129(a)(8). * * *

After designating DISH's vote and rejecting all objections, the bankruptcy court confirmed the plan. The district court affirmed, and DISH and Sprint appealed to this Court. * * *

DISCUSSION

II. *DISH's Appeal*

A. The Treatment of DISH's Vote

1. *Designating DISH's Vote as "Not in Good Faith"*

To confirm a plan of reorganization, Chapter 11 generally requires a vote of all holders of claims or interests impaired by that plan. *See* §§ 1126, 1129(a)(8). This voting requirement has exceptions, however, including one that allows a bankruptcy court to designate (in effect, to disregard) the votes of "any entity whose acceptance or rejection of such plan was not in good faith." § 1126(e).

The Code provides no guidance about what constitutes a bad faith vote to accept or reject a plan. Rather, § 1126(e)'s "good faith" test effectively delegates to the courts the task of deciding when a party steps over the boundary. Case by case, courts have taken up this responsibility. No circuit court has ever dealt with a case like this one, however, and neither we nor the Supreme Court have many precedents on the "good faith" voting requirement in any context; the most recent cases from both courts are now more than 65 years old and address § 1126(e)'s predecessor, § 203 of the Bankruptcy Act. Nevertheless, these cases, cases from other jurisdictions, legislative history, and the purposes of the good-faith requirement give us confidence in affirming the bankruptcy court's decision to designate DISH's vote in this case.

We start with general principles that neither side disputes. Bankruptcy courts should employ § 1126(e) designation sparingly, as "the exception, not the rule." *In re Adelpia Commc'ns Corp.*, 359 B.R. 54, 61 (Bankr. S.D.N.Y. 2006). For this reason, a party seeking to designate another's vote bears the burden of proving that it was not cast in good faith. Merely purchasing claims in bankruptcy "for the

purpose of securing the approval or rejection of a plan does not of itself amount to ‘bad faith.’ ” *In re P-R Holding*, 147 F.2d at 897. Nor will selfishness alone defeat a creditor’s good faith; the Code assumes that parties will act in their own self interest and allows them to do so.

Section 1126(e) comes into play when voters venture beyond mere self-interested promotion of their claims. “[T]he section was intended to apply to those who were not attempting to protect their own proper interests, but who were, instead, attempting to obtain some benefit to which they were not entitled.” *In re Figter*, 118 F.3d at 638. A bankruptcy court may, therefore, designate the vote of a party who votes “in the hope that someone would pay them more than the ratable equivalent of their proportionate part of the bankrupt assets,” *Young*, 324 U.S. at 211, or one who votes with an “ulterior motive,” that is, with “an interest other than an interest as a creditor,” *In re P-R Holding*, 147 F.2d at 897.

Here, the debate centers on what sort of “ulterior motives” may trigger designation under § 1126(e), and whether DISH voted with such an impermissible motive. The first question is a question of law that we review *de novo*, and the second a question of fact that we review for clear error, *see In re Baker*, 604 F.3d at 729, recognizing that “a decision that someone did or did not act in good faith” hinges on “an essentially factual inquiry and is driven by the data of practical human experience,” *In re Figter*, 118 F.3d at 638 (quotation marks omitted).

Clearly, not just any ulterior motive constitutes the sort of improper motive that will support a finding of bad faith. After all, most creditors have interests beyond their claim against a particular debtor, and those other interests will inevitably affect how they vote the claim. For instance, trade creditors who do regular business with a debtor may vote in the way most likely to allow them to continue to do business with the debtor after reorganization. And, as interest rates change, a fully secured creditor may seek liquidation to allow money once invested at unfavorable rates to be invested more favorably elsewhere. We do not purport to decide here the propriety of either of these motives, but they at least demonstrate that allowing the disqualification of votes on account of *any* ulterior motive could have far-reaching consequences and might leave few votes upheld.

The sort of ulterior motive that § 1126(e) targets is illustrated by the case that motivated the creation of the “good faith” rule in the first place, *Texas Hotel Securities Corp. v. Waco Development Co.*, 87 F.2d 395 (5th Cir. 1936). In that case, Conrad Hilton purchased claims of a debtor to block a plan of reorganization that would have given a lease on the debtor’s property – once held by Hilton’s company, later cancelled – to a third party. Hilton and his partners sought, by

buying and voting the claims, to “force [a plan] that would give them again the operation of the hotel or otherwise reestablish an interest that they felt they justly had in the property.” *Id.* at 398. The district court refused to count Hilton’s vote, but the court of appeals reversed, seeing no authority in the Bankruptcy Act for looking into the motives of creditors voting against a plan.

That case spurred Congress to require good faith in voting claims. As the Supreme Court has noted, the legislative history of the predecessor to § 1126(e) “make[s] clear the purpose of the [House] Committee [on the Judiciary] to pass legislation which would bar creditors from a vote who were prompted by such a purpose” as Hilton’s. *Young*, 324 U.S. at 211 n. 10. As then-SEC Commissioner Douglas explained to the House Committee:

We envisage that “good faith” clause to enable the courts to affirm a plan over the opposition of a minority attempting to block the adoption of a plan merely for selfish purposes. The *Waco* case ... was such a situation. If my memory does not serve me wrong it was a case where a minority group of security holders refused to vote in favor of the plan unless that group were given some particular preferential treatment, such as the management of the company. That is, there were ulterior reasons for their actions.

1937 Hearing, *supra*, at 181-82. One year after Commissioner Douglas’s testimony, and two years after the *Waco* case, Congress enacted the proposed good faith clause as part of the Chandler Act of 1938. The Bankruptcy Code of 1978 preserved this good faith requirement, with some rewording, as § 1126(e).

Modern cases have found “ulterior motives” in a variety of situations. In perhaps the most famous case, and one on which the bankruptcy court in our case relied heavily, a court found bad faith because a party bought a blocking position in several classes after the debtor proposed a plan of reorganization, and then sought to defeat that plan and to promote its own plan that would have given it control over the debtor. In another case, the court designated the votes of parties affiliated with a competitor who bought their claims in an attempt to obstruct the debtor’s reorganization and thereby to further the interests of their own business. In a third case, the court found bad faith where an affiliate of the debtor purchased claims not for the purpose of collecting on those claims but to prevent confirmation of a competing plan.

Although we express no view on the correctness of the specific findings of bad faith of the parties in those specific cases, we think that this case fits in the general constellation they form. As the bankruptcy court found, DISH, as an indirect competitor of DBSD and part-owner of a direct competitor, bought a blocking

position in (and in fact the entirety of) a class of claims, after a plan had been proposed, with the intention not to maximize its return on the debt but to enter a strategic transaction with DBSD and “to use status as a creditor to provide advantages over proposing a plan as an outsider, or making a traditional bid for the company or its assets.” In effect, DISH purchased the claims as votes it could use as levers to bend the bankruptcy process toward its own strategic objective of acquiring DBSD’s spectrum rights, not toward protecting its claim.

We conclude that the bankruptcy court permissibly designated DISH’s vote based on the facts above. This case echoes the *Waco* case that motivated Congress to impose the good faith requirement in the first place. In that case, a competitor bought claims with the intent of voting against any plan that did not give it a lease in or management of the debtor’s property. In this case, a competitor bought claims with the intent of voting against any plan that did not give it a strategic interest in the reorganized company. The purchasing party in both cases was less interested in maximizing the return on its claim than in diverting the progress of the proceedings to achieve an outside benefit. In 1936, no authority allowed disregarding votes in such a situation, but Congress created that authority two years later with cases like *Waco* in mind. We therefore hold that a court may designate a creditor’s vote in these circumstances.

We also find that, just as the law supports the bankruptcy court’s legal conclusion, so the evidence supports its relevant factual findings. DISH’s motive – the most controversial finding – is evinced by DISH’s own admissions in court, by its position as a competitor to DBSD, by its willingness to overpay for the claims it bought,² by its attempt to propose its own plan, and especially by its internal communications, which, although addressing the Second Lien Debt rather than the First Lien Debt at issue here, nevertheless showed a desire to “to obtain a blocking position” and “control the bankruptcy process for this potentially strategic asset.”

² The fact that DISH bought the First Lien Debt at par is circumstantial evidence of its intent, though we do not put as much weight on the price as the bankruptcy court did. It is certainly true, as the Loan Syndications and Trading Association points out in an amicus brief, that purchasers may have many good business reasons for buying debt at par, especially when, as in this case, the debt is well secured and interest rates dropped between the original issuance of the debt and its purchase. Buying claims at or above par therefore could not provide the sole basis for designating a creditor’s vote. Nevertheless, a willingness to pay high prices may tend to show that the purchaser is interested in more than the claim for its own sake. The weight to be given to such evidence is primarily an issue for the finder of fact, and we see no clear error in the bankruptcy court’s reliance on the factor in this case.

The Loan Syndications and Trading Association (LSTA), as *amicus curiae*, argues that courts should encourage acquisitions and other strategic transactions because such transactions can benefit all parties in bankruptcy. We agree. But our holding does not “shut[] the door to strategic transactions,” as the LSTA suggests. Rather, it simply limits the methods by which parties may pursue them. DISH had every right to propose for consideration whatever strategic transaction it wanted – a right it took advantage of here – and DISH still retained this right even after it purchased its claims. All that the bankruptcy court stopped DISH from doing here was using the votes it had bought to secure an advantage in pursuing that strategic transaction.

DISH argues that, if we uphold the decision below, “future creditors looking for potential strategic transactions with chapter 11 debtors will be deterred from exploring such deals for fear of forfeiting their rights as creditors.” But our ruling today should deter only attempts to “*obtain* a blocking position” and thereby “control the bankruptcy process for [a] potentially strategic asset” (as DISH’s own internal documents stated). We leave for another day the situation in which a *preexisting* creditor votes with strategic intentions. We emphasize, moreover, that our opinion imposes no categorical prohibition on purchasing claims with acquisitive or other strategic intentions. On other facts, such purchases may be appropriate. Whether a vote has been properly designated is a fact-intensive question that must be based on the totality of the circumstances, according considerable deference to the expertise of bankruptcy judges. Having reviewed the careful and fact-specific decision of the bankruptcy court here, we find no error in its decision to designate DISH’s vote as not having been cast in good faith.

Page 534, add after the LaSalle Street case:

One way debtors have attempted to circumvent the absolute priority rule is through having a senior class of creditors gift some of its recovery to the interest holders, bypassing a junior class. Sometimes the senior class of creditors is willing to do this in order to retain the expertise of the interest holders. However, the practice is rather controversial. Consider the additional excerpt from the Second Circuit’s opinions in *In re DSBS North America, Inc.*

IN RE DBSD NORTH AMERICA, INC.
634 F.3d 79 (2d Cir. 2011)

* * *

DISCUSSION

I. *Sprint's Appeal*

Sprint raises only one issue on appeal: it asserts that the plan improperly gives property to DBSD's shareholder without fully satisfying Sprint's senior claim, in violation of the absolute priority rule. *See* § 1129(b)(2)(B). That rule provides that a reorganization plan may not give "property" to the holders of any junior claims or interests "on account of" those claims or interests, unless all classes of senior claims either receive the full value of their claims or give their consent. Because the existing shareholder received shares and warrants on account of its junior interest, Sprint argues, Sprint's class of general unsecured creditors had a right to receive "full satisfaction of their claims" or at least "an amount sufficient to obtain approval from the class." But the plan provided neither, and so Sprint asks us to vacate the order confirming it or to provide other relief that would satisfy Sprint's claim.

* * *

B. Gifting and the Absolute Priority Rule

Sprint argues that the plan violated the absolute priority rule by giving shares and warrants to a junior class (the existing shareholder) although a more senior class (Sprint's class) neither approved the plan nor received the full value of its claims. *See* § 1129(b)(2)(B). The appellees respond, and the courts below held, that the holders of the Second Lien Debt, who are senior to Sprint and whom the bankruptcy court found to be undersecured, were entitled to the full residual value of the debtor and were therefore free to "gift" some of that value to the existing shareholder if they chose to. We recently avoided deciding the viability of this "gifting doctrine" in a similar context, *see In re Iridium Operating LLC*, 478 F.3d 452, 460-61 (2d Cir. 2007), but we now face the question squarely. We look through the district court to the bankruptcy court's decision, and review its analysis of law *de novo*.

Long before anyone had imagined such a thing as Chapter 11 bankruptcy, it was already "well settled that stockholders are not entitled to any share of the capital stock nor to any dividend of the profits until all the debts of the corporation are paid." *Chi., Rock Island & Pac. R.R. v. Howard*, 74 U.S. (7 Wall) 392, 409-10 (1868). In the days of the railroad barons, however, parties observed this rule in the

breach. Senior creditors and original shareholders often cooperated to control the reorganization of a failed company, sometimes to make the process go smoothly – to encourage the old shareholders to provide new capital for the reorganization or to keep them from engaging in costly and delaying litigation – or sometimes simply because the senior creditors and the old shareholders were the same parties. For their cooperation, the old owners would often receive or retain some stake in whatever entity arose from the reorganization. Junior creditors, however, often received little or nothing even though they technically stood above the old shareholders in priority.

In response to this practice, the Supreme Court developed a “fixed principle” for reorganizations: that all “creditors were entitled to be paid before the stockholders could retain [shares] for any purpose whatever.” *N. Pac. Ry. Co. v. Boyd*, 228 U.S. 482, 507-08 (1913). “[A] plan of reorganization,” the Court later stated, “would not be fair and equitable which . . . admitted the stockholders to participation, unless” at very least “the stockholders made a fresh contribution in money or in money’s worth in return for ‘a participation reasonably equivalent to their contribution.’” *Marine Harbor Props., Inc. v. Mfrs. Trust Co.*, 317 U.S. 78, 85 (1942). Courts came to call this the “absolute priority rule.”

The Bankruptcy Code incorporates a form of the absolute priority rule in its provisions for confirming a Chapter 11 plan of reorganization. For a district court to confirm a plan over the vote of a dissenting class of claims, the Code demands that the plan be “fair and equitable, with respect to each class of claims . . . that is impaired under, and has not accepted, the plan.” § 1129(b)(1). The Code does not define the full extent of “fair and equitable,” but it includes a form of the absolute priority rule as a prerequisite. * * * § 1129(b)(2)(B).

Absent the consent of all impaired classes of unsecured claimants, therefore, a confirmable plan must ensure either (i) that the dissenting class receives the full value of its claim, or (ii) that no classes junior to that class receive any property under the plan on account of their junior claims or interests.

Under the plan in this case, Sprint does not receive “property of a value . . . equal to the allowed amount” of its claim. Rather, Sprint gets less than half the value of its claim. The plan may be confirmed, therefore, only if the existing shareholder, whose interest is junior to Sprint’s, does “not receive or retain” “any property” “under the plan on account of such junior . . . interest.” We hold that the existing shareholder did receive property under the plan on account of its interest, and that the bankruptcy court therefore should not have confirmed the plan.

First, under the challenged plan, the existing shareholder receives “property” in the form of shares and warrants in the reorganized entity. The term “property” in § 1129(b)(2)(B) is meant to be interpreted broadly. But even if it were not, there is no doubt that “any property” includes shares and warrants like these.

Second, the existing shareholder receives that property “under the plan.” The disclosure statement for the second amended plan, under the heading “ARTICLE IV: THE JOINT PLAN,” states:

Class 9-Existing Stockholder Interests

In full and final satisfaction, settlement, release, and discharge of each Existing Stockholder Interest, and on account of all valuable consideration provided by the Existing Stockholder, including, without limitation, certain consideration provided in the Support Agreement, . . . *the Holder of such Class 9 Existing Stockholder Interest shall receive the Existing Stockholder Shares and the Warrants.*

(emphasis added). We need not decide whether the Code would allow the existing shareholder and Senior Noteholders to agree to transfer shares outside of the plan, for, on the present record, the existing shareholder clearly receives these shares and warrants “under the plan.”

Finally, the existing shareholder receives its shares and warrants “on account of” its junior interest. The Supreme Court has noted that “on account of” could take one of several interpretations. *See Bank of Am. Nat’l Trust & Sav. Ass’n v. 203 N. LaSalle St. Partnership*, 526 U.S. 434, 449 (1999). The interpretation most friendly to old equity – which the Supreme Court rejected as “beset with troubles . . . exceedingly odd . . . [and] unlikely” – reads “on account of” as “in exchange for.” Even under this generous test, the existing shareholder here receives property “on account of” its prior junior interest because it receives new shares and warrants at least partially “in exchange for” its old ones. The passage from the plan quoted above states as much: the existing shareholder receives shares and warrants “[i]n full and final satisfaction, settlement, release, and discharge of each Existing Stockholder Interest.”

The gift here even more easily satisfies the two less restrictive tests the Supreme Court examined (and viewed more favorably) in *203 North LaSalle*, both of which read “on account of” to mean some form of “because of.” The existing shareholder received its property “because of,” and thus “on account of,” its prior interest, for the same reasons set forth above.³

³ We note that not all distributions of property to a junior class are necessarily “on

This conclusion is not undermined by the fact that the disclosure statement recites, and the district court found, additional reasons why the existing shareholder merited receiving the shares and warrants. First, a transfer partly on account of factors other than the prior interest is still partly “on account of” that interest. Upholding this principle in *203 North LaSalle*, the Supreme Court refused to characterize a benefit given to existing shareholders “merely as a detail of the broader transaction” in which those shareholders also contributed new capital. Instead, receipt of property partly on account of the existing interest was enough for the absolute priority rule to bar confirmation of the plan.

Second, the other reasons that the appellees assert drove the award of warrants and shares to old equity here are themselves “on account of” the existing shareholder’s prior interest. The existing shareholder did not contribute additional capital to the reorganized entity; rather, as the bankruptcy court explained, the gift aimed to ensure the existing shareholder’s “continued cooperation and assistance” in the reorganization. The “continued cooperation” of the existing shareholder was useful only because of the shareholder’s position as equity holder * * *; an unrelated third party’s cooperation would not have been useful. And “assistance” sounds like the sort of “future labor, management, or expertise” that the Supreme Court has held insufficient to avoid falling under the prohibition of the absolute priority rule. Thus, notwithstanding the various economic reasons that may have contributed to the decision to award property to old equity here, it is clear that the existing shareholder could not have gained its new position but for its prior equity position.

In sum, we conclude that the existing shareholder received “property,” that it did so “under the plan,” and that it did so “on account of” its prior, junior interest.

The Supreme Court’s interpretations of § 1129(b)(2)(B) give us confidence in ours. Although that Court has not addressed the exact scenario presented here under the codified absolute priority rule, its two post-Code cases on the rule are

account of” the junior claims or interests. For example, the Supreme Court has left open the possibility that old equity could take under a plan if it invests new value in the reorganized entity, at least as long as a “market valuation” tests the adequacy of its contribution. *203 North LaSalle*, 526 U.S. at 458. In such a situation, the party receiving the property may argue – though we do not now decide the correctness of such an argument – that it does not receive anything “on account of” its interest but only on account of its new investment. For another example, our decision does not stop a senior claim-holder from receiving property on account of its senior claim just because the claim-holder also happens to hold a junior claim on account of which it receives nothing. There may well be other examples.

instructive. In both cases, the prior owners tried to avoid the absolute priority rule by arguing that they received distributions not on account of their prior interests but rather on account of the new value that they would contribute to the entity. *See 203 N. LaSalle*, 526 U.S. at 437; *Ahlers*, 485 U.S. at 199. In both cases, the Supreme Court rejected those arguments. Although dictum in an earlier case had suggested that contributing new value could allow prior shareholders to participate in the reorganized entity, *see Case*, 308 U.S. at 121, the Court refused to decide whether § 1129(b)(2)(B) permitted such new-value exchanges. Instead, the Court held that neither “future labor, experience and expertise,” *Ahlers*, 485 U.S. at 199, nor capital contributions “without benefit of market valuation,” *203 N. LaSalle*, 526 U.S. at 458, could suffice to escape the absolute priority rule, even assuming the ongoing validity of the *Case* dictum.

203 North LaSalle and *Ahlers* indicate a preference for reading the rule strictly. Given that the Supreme Court has hesitated to allow old owners to receive new ownership interests even when contributing new value, it is doubtful the Court would allow old owners to receive new ownership without contributing any new value, as in this case. As the Court explained in *Ahlers*, “the statutory language and the legislative history of § 1129(b) clearly bar any expansion of any exception to the absolute priority rule beyond that recognized in our cases at the time Congress enacted the 1978 Bankruptcy Code.” 485 U.S. at 206. The Supreme Court has never suggested any exception that would cover a case like this one.

The appellees, unsurprisingly, see the case in a different light. They contend that, under the “gifting doctrine,” the shares and warrants rightfully belonged to the secured creditors, who were entitled to share them with the existing shareholder as they saw fit. Citing *In re SPM Manufacturing Corp.*, 984 F.2d 1305 (1st Cir.1993), the appellees argue that, until the debts of the secured creditors “are paid in full, the Bankruptcy Code’s distributional priority scheme, as embodied in the absolute priority rule, is not implicated.” DBSD was not worth enough, according to the bankruptcy court’s valuation, to cover even the secured lenders’ claims, much less those of unsecured creditors like Sprint. Therefore, as the bankruptcy court stated in ruling for the appellees, “the ‘Gifting’ Doctrine – under which senior secured creditors voluntarily offer a portion of their recovered property to junior stakeholders (as the Senior Noteholders did here) – defeats Sprint’s Absolute Priority Rule objection.” We disagree.

Most fatally, this interpretation does not square with the text of the Bankruptcy Code. The Code extends the absolute priority rule to “any property,” § 1129(b)(2)(B)(ii), not “any property not covered by a senior creditor’s lien.” The

Code focuses entirely on who “receive[s]” or “retain[s]” the property “under the plan,” not on who *would* receive it under a liquidation plan. And it applies the rule to any distribution “under the plan on account of” a junior interest, regardless of whether the distribution could have been made outside the plan, and regardless of whether other reasons might support the distribution in addition to the junior interest.

* * *

Even if the text of § 1129(b)(2)(B) left any room for the appellees’ view of the case, we would hesitate to accept it in light of the Supreme Court’s long history of rejecting such views. That history begins at least as early as 1868, in *Howard*, 74 U.S. (7 Wall) 392. In that case, the stockholders and mortgagees of a failing railroad agreed to foreclose on the railroad and convey its property to a new corporation, with the old stockholders receiving some of the new shares. The agreement gave nothing, however, to certain intermediate creditors, who sought a share of the distribution in the courts.

The stockholders defended their agreement with nearly the exact logic the appellees employ here:

The road was mortgaged for near three times its value. . . . If, then, these stockholders have got anything, it must be because the bondholders have *surrendered* a part of *their* fund to them. If the fund belonged to the bondholders, they had a right so to surrender a part or a whole of it. And if the bondholders did so surrender their own property to the stockholders, it became the private property of these last; a gift, or, if you please, a transfer for consideration from the bondholders. . . . What right have these complainants to *such* property in the hands of the stockholders?

Even in 1868, however, the Supreme Court found that “[e]xtended discussion of that proposition is not necessary.” “Holders of bonds secured by mortgages as in this case,” the Court noted, “may exact the whole amount of the bonds, principal and interest, or they may, if they see fit, accept a percentage as a compromise in full discharge of their respective claims, but whenever their lien is legally discharged, the property embraced in the mortgage, or whatever remains of it, belongs to the corporation” for distribution to other creditors. Similarly, in this case, the secured creditors could have demanded a plan in which they received all of the reorganized corporation, but, having chosen not to, they may not “surrender” part of the value of the estate for distribution “to the stockholder[],” as “a gift.” Whatever the secured creditors here did not take remains in the estate for the benefit of other claim-holders.

* * *

We recognize the policy arguments against the absolute priority rule. Gifting may be a “powerful tool in accelerating an efficient and non-adversarial . . . chapter 11 proceeding,” Leah M. Eisenberg, *Gifting and Asset Reallocation in Chapter 11 Proceedings: A Synthesized Approach*, 29 AM. BANKR.INST. J. 50, 50 (2010), and no doubt the parties intended the gift to have such an effect here. As one witness testified below, “where . . . the equity sponsor is out of the money, . . . a tip is common to [e]nsure a consensual bankruptcy rather than a contested one.” Enforcing the absolute priority rule, by contrast, “may encourage hold-out behavior by objecting creditors . . . even though the transfer has no direct effect on the value to be received by the objecting creditors.” Harvey R. Miller & Ronit J. Berkovich, *The Implications of the Third Circuit’s Armstrong Decision on Creative Corporate Restructuring: Will Strict Construction of the Absolute Priority Rule Make Chapter 11 Consensus Less Likely?*, 55 AM. U.L. REV. 1345, 1349 (2006).

It deserves noting, however, that there are substantial policy arguments in favor of the rule. Shareholders retain substantial control over the Chapter 11 process, and with that control comes significant opportunity for self-enrichment at the expense of creditors. This case provides a nice example. Although no one alleges any untoward conduct here, it is noticeable how much larger a distribution the existing shareholder will receive under this plan (4.99% of all equity in the reorganized entity) than the general unsecured creditors put together (0.15% of all equity), despite the latter’s technical seniority. Indeed, based on the debtor’s estimate that the reorganized entity would be worth approximately \$572 million, the existing shareholder will receive approximately \$28.5 million worth of equity under the plan while the unsecured creditors must share only \$850,000. And if the parties here were less scrupulous or the bankruptcy court less vigilant, a weakened absolute priority rule could allow for serious mischief between senior creditors and existing shareholders.

Whatever the policy merits of the absolute priority rule, however, Congress was well aware of both its benefits and disadvantages when it codified the rule in the Bankruptcy Code. The policy objections to the rule are not new ones; the rule has attracted controversy from its early days. Four Justices dissented from the Supreme Court’s 1913 holding in *Boyd*, and that decision “was received by the reorganization bar and bankers with something akin to horror,” James N. Rosenberg, *Reorganization-The Next Step*, 22 COLUM. L. REV. 14, 14 (1922). The Commission charged with reviewing the bankruptcy laws in the lead-up to the enactment of the Bankruptcy Code suggested loosening the absolute priority rule to allow greater

participation by equity owners. Yet, although Congress did soften the absolute priority rule in some ways, it did not create any exception for “gifts” like the one at issue here. We therefore hold that the bankruptcy court erred in confirming the plan of reorganization.

Appendices

Pages 559-61:

The following revised data replaces the material in the book:

National Standards Based on Gross Monthly Income For Cases Filed on or After November 1, 2011

[amounts listed combine allowances for food, housing supplies,
apparel & services, personal care products and services, and miscellaneous]

One Person	\$534
Two People	\$985
Three People	\$1,171
Four People	\$1,377
Each Additional Person	\$262

Maximum Additional Amount Computed as 5% of Food and Clothing

One Person	\$19
Two People	\$35
Three People	\$42
Four People	\$50
Each Additional Person	\$10

**Local Housing and Utilities Standards
For Cases Filed on or After November 1, 2011**

**WASHINGTON
[Selected Counties]**

	Family Size and Expense Type									
	1 Person		2 People		3 People		4 People		5 or More People	
	Non-Mortgage	Mortgage Rent	Non-Mortgage	Mortgage /Rent	Non-Mortgage	Mortgage /Rent	Non-Mortgage	Mortgage /Rent	Non-Mortgage	Mortgage /Rent
Garfield County	\$392	\$517	\$460	\$607	\$484	\$640	\$540	\$714	\$549	\$725
King County	\$416	\$1,501	\$488	\$1,763	\$515	\$1,857	\$574	\$2,071	\$583	\$2,105
Kitsap County	\$369	\$1,157	\$434	\$1,359	\$457	\$1,432	\$510	\$1,596	\$518	\$1,622
San Juan County	\$371	\$1,235	\$436	\$1,450	\$459	\$1,528	\$512	\$1,704	\$520	\$1,731
Snohomish County	\$400	\$1,361	\$470	\$1,599	\$495	\$1,685	\$552	\$1,878	\$561	\$1,909
Spokane County	\$369	\$879	\$434	\$1,032	\$457	\$1,088	\$510	\$1,213	\$518	\$1,232
Walla Walla County	\$364	\$870	\$427	\$1,022	\$450	\$1,077	\$502	\$1,200	\$510	\$1,220
Yakima County	\$371	\$812	\$436	\$953	\$460	\$1,004	\$512	\$1,120	\$521	\$1,138

**Local Transportation Standards
For Cases Filed on or After November 1, 2011**

Operating Costs & Public Transportation Costs

	No Car	One Car	Two Cars
West Census Region	\$182	\$236	\$472

Ownership Costs

	First Car	Two Cars
National	\$496	\$992

**Schedule of Actual Administrative Expenses
of Administering a Chapter 13 Plan
For Cases Filed on or After November 1, 2011**

Eastern District of Washington	Western District of Washington
7.3%	5.9%

**Median Family Income by Family Size
For Cases Filed on or After November 1, 2011**

WASHINGTON

Family Size				
One Earner	Two People	Three People	Four People	More than Four People
\$51,671	\$61,919	\$69,195	\$80,404	\$7,500 more per person over 4

Page 561:

The latest version of the Chapter 13 Plan Form for the Eastern District of Washington can be obtained at www.waeb.uscourts.gov/LocalForms/. The latest version of the Chapter 13 Plan Form for the Western District of Washington can be obtained at www.wawb.uscourts.gov.