UNITED STATES SUPREME COURT

2016 CASE REVIEW

LOU JONES BREAKFAST

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CASES DECIDED LAST TERM

I. *Husky Int'l Elecs., Inc v. Ritz,* 136 S. Ct. 1582 (2016).

A. Issue: Whether the term "actual fraud" in §523(a)(2)(A) encompasses forms of fraud, like fraudulent conveyance schemes, that can be effected without a false representation?

B. Facts.

1. Husky International Electronics, Inc. sold components used in electronic devices to Chrysalis Manufacturing Corp. for approximately $164,000.

2. Daniel Ritz was a director of Chrysalis and owned 30% of its common stock.

3. Between 2006 and 2007, Ritz drained the assets of Chrysalis, transferring its assets to other Ritz-controlled entities.

4. Husky sued Ritz asserting that Ritz's actions constituted actual fraud under Texas law.

5. Ritz filed a petition under Chapter 7 and Husky sought to have its debt declared non-dischargable under Code §523(a)(2)(A).

6. The District Court found Ritz personally liable for the debt under Texas law, but concluded that the debt was not "obtained by…actual fraud" under §523(a)(2)(A) and could be discharged.

7. The Fifth Circuit affirmed, holding that, while Ritz's actions may have hindered Husky's ability to recover its debt, Ritz did not make any false representations regarding the transfers and therefore did not commit "actual fraud."

C. Supreme Court Opinion.

1. Writing for the seven-member majority, Justice Sotomayor began by noting the 1978 Code added "actual fraud" to the prior Act provision which prohibited debtors from discharging debts obtained by "false pretenses or false representations." By doing so, Congress presumably intended "actual fraud" to mean something different from "false representation."

2. Actual fraud denotes any fraud that involves moral turpitude or intentional wrong.

3. From the time of the Statutes of Queen Elizabeth I, "fraud" has been used to describe transfers of assets like Ritz's scheme, and from the time of Elizabeth "actual fraud" has been broad enough to incorporate a fraudulent conveyance.

4. Fraudulent conveyances, although fraud, do not require a fraudulent misrepresentation, and are not an inducement-based fraud. A false representation has never been a required element of "actual fraud" and the Court declines to adopt one.

5. The Court dismissed Ritz's argument that holding that §523(a)(2)(A) encompasses fraudulent conveyances would render duplicative §523(a)(4) (fraud or defalcation while action in a fiduciary capacity) and §532(a)(6) (willful and malicious injury to … property of another).

6. While there is overlap in the sections, finding that fraudulent conveyances are encompassed in §523(a)(2)(A) preserves meaningful differences between the other two sections.

7. The Court also dismissed Ritz's argument that its holding would conflict with the provisions of §727(a)(2), which prevents a debtor's discharge if, within one year preceding the bankruptcy, it transfers, removes or conceals property with the intent of hindering, delaying or defrauding a creditor.

8. Section 727(a) is broader in scope than section 523 because it results in the denial of the debtor's discharge, punishing acts that hinder the entire bankruptcy filing, but is narrower in timing as it only applies to the year period prior to the bankruptcy. Section 523(a)(2)(A) is a tailored remedy for behavior connected with specific acts.

9. The Court refuted Ritz's assertion that §523(a)(2)(A) requires that the debt be "obtained by" actual fraud and that the fraud must exist at the inception of the transaction.

10. The Court's prior decision of *Field v. Mans,* 516 U.S. 59 (1995), which Ritz (and the dissent) relied on, dealt with a fraudulent misrepresentation, and the Court in that case did not intend to establish a reliance requirement for frauds not based upon a misrepresentation.

11. Finally, the Court dispatched Ritz's argument that Congress's decision to add "actual fraud" to what became §523(a)(2)(A) was done to restrict the exception's reach rather than expand it by making clear that "false pretenses" and "false representations" needed to be intentional. The Court notes that the statute is disjunctive and concludes that Ritz's reading would require substituting the word "by" for the word "or."

12. Reversed and remanded.

D. Dissent.

1. Justice Thomas, the sole dissenter, would find that §523(a)(2)(A) requires that the debt be "obtained by" actual fraud to be non-dischargable.

2. "Actual fraud" as used in the exception does not encompass fraudulent transfer schemes.

3. Section 523(a)(2)(A) covers only situations in which money property is *obtained by* actual fraud and results in a debt, and the section only applies where the fraudulent conduct occurs at the inception of the debt. A fraudulent transfer such as the one here does not fit that mold.

4. The plain meaning of "obtained by" has an "inherent" element of causation and refers to "resulting from" or "traceable to" fraud. There must be a causal nexus between the debt and the fraud, citing *Norton* and *Collier's*.

5. Husky can't show that Ritz made any oral or written representations to Husky to induce it to sell goods to Chrysalis or that Ritz transferred Chrysalis's assets to avoid its obligation to Husky.

6. The majority disregards *Field v. Mans* and that case's requirement that there be reliance on some sort of false statement, misrepresentation or omission to show "actual fraud."

7. The words "obtained by" modify false pretenses, false misrepresentations and actual fraud in §523(a)(2)(A). The Court has never before suggested that the section might apply to a situation in which there was no false statement, misrepresentation or omission when the debt was first obtained.

8. Actual fraud (as distinguished from false pretenses or false representation) would apply where someone incurred credit card debt with no intention to repay. This interpretation does not render "obtained by" a nullity, as the majority's holding does.

9. The majority decision impermissibly broadens §523(a)(2)(A) to cover fraudulent transfers second guessing Congress' choices. If Congress wanted the section to cover fraudulent transfer situations, it would have spoken more clearly.

II. *Puerto Rico v. Franklin Cal. Tax-Free Tr.*, 136 S. Ct. 1938 (2016).

A. Issue: Does the Bankruptcy Code prohibit Puerto Rico from enacting its own municipal bankruptcy scheme?

B. Facts.

1. Over $20 billion of Puerto Rico's increasing debt is held by three public utility companies, which were operating at a combined annual deficit of $800 million.

2. The Government Development Bank of Puerto Rico owned by the Commonwealth ("Bank") previously provided funding to the utilities to fund the operating deficits, having loaned over one-half of its assets to the utilities. The Bank faced its own fiscal crisis.

3. Puerto Rico's access to the capital markets became severely compromised after the rating agencies downgraded Puerto Rican bonds, including those issued by the utilities.

4. To respond to the crisis, Puerto Rico enacted the Puerto Rico Corporation Debt Enforcement and Recovery Act ("Recovery Act").

5. Chapter 2 of the Recovery Act created a "consensual" debt modification procedure that allowed the utilities to propose changes to the terms of their outstanding debt instruments, which had to be coupled with a Bank-approved recovery plan to bring the utility back to financial self-sufficiency.

6. Chapter 3 of the Recovery Act, which mirrored Chapters 9 and 11 of the Bankruptcy Code, created a court-supervised restructuring process in a local court to devise the best solution for the broadest group of creditors.

7. A group of investment funds ("Funds") holding over $2 billion in bonds issued by one of the utilities brought suit against Puerto Rico, various government officials and the Bank to enjoin enforcement of the Recovery Act, claiming that the Bankruptcy Code prohibited Puerto Rico from implementing its own municipal bankruptcy scheme.

8. The District Court ruled for the plaintiffs, and the First Circuit affirmed.

C. Supreme Court Opinion.

1. Writing for a six-member majority of the Court, Justice Thomas began by indicating that the case required the Court to parse three sections of the Bankruptcy Code: §§ 109(c), 903(1) and 101(52).

2. Section 109(c), addressing who may be a debtor, provides in relevant part that an entity may be a debtor under Chapter 9 if it is "specifically authorized …by State law…to be a debtor under [Chapter 9]."

3. The Court describes this as a "gateway" provision, which requires States to authorize municipalities to file a case under Chapter 9 in order to be an eligible debtor.

4. Section 903(1), the pre-emption provision provides:

   "Reservation of State power to control municipalities.
   This chapter does not limit or impair the power of a State to control, by legislation or otherwise, a municipality of or in such State in the exercise of the political or governmental powers of such municipality, including expenditures for such exercise, but---
   (1) a State law prescribing a method of composition of indebtedness of such municipality may not bind any creditor that does not consent to such composition; and
   (2) a judgment entered under such a law may not bind a creditor that does not consent to such composition."

5. This provision, said the Court, bars States from enacting their own municipal bankruptcy schemes.

6. Section 101(52), which defines "State" and which was added to the Bankruptcy Code in 1984, provides: "The term 'State' includes the District of Columbia and Puerto Rico, except for the purpose of defining who may be a debtor under chapter 9 of this title."

7. Justice Thomas defined the Court's task as determining the effect of the definition of "State" for the purposes of the gateway provision in § 109(c).

8. Prior to 1984, both parties agreed that Puerto Rico was treated as a State, and the Recovery Act, which sets forth a method of composition of indebtedness, would have been preempted.

9. In light of the amendment, however, Puerto Rico asserts that it was excluded from Chapter 9 altogether, and the preemption provision therefore does not apply to it.

10. The Funds argue that the § 101(52) definition precludes Puerto Rico from authorizing its municipalities to seek relief, but that Puerto Rico remains a "State" for the purposes of the preemption provision in § 903(1) and Puerto Rico is therefore barred from enacting the Recovery Act.

11. The Court begins by examining the plain meaning of the statutes at issue.

12. Congress's specific reference to who may be a debtor in the definitional section evidences its intent to exclude Puerto Rico as a "State" which could authorize its municipalities to seek Chapter 9 relief.

13. However, Puerto Rico is a "State" for the purposes of the preemption provision, just as it was prior to the 1984 amendments. If Congress had decided otherwise it would have said so, as Congress does not "…hide elephants in mouseholes."

14. Justice Thomas takes exception to the dissent's adoption of Puerto Rico's argument that the exclusion of Puerto Rico as a "State" for the purposes of the gateway provision effectively removes Puerto Rico from all of Chapter 9.

15. The gateway provision of § 109(c) is directed at the municipalities seeking relief. If a municipality does not have State authorization to file, it is excluded from Chapter 9 entirely. A State's role is only to provide authorization or not.

16. However, the preemption provision provides that States may not enact their own municipal debt relief schemes. Puerto Rico is bound by this provision even though Congress removed its authority to authorize its municipalities to seek relief under Chapter 9. It Congress had intended otherwise, it would have said so.

17. Justice Thomas finds misplaced the dissent's reliance on the introductory clause of §903 that Chapter 9 does not limit or impair the power of a State to control its municipalities. Because Puerto Rico's municipalities are ineligible for Chapter 9 relief, says the dissent, Chapter 9 cannot "affect Puerto Rico's control over its municipalities." Puerto Rico is therefore excluded from the ambit of Chapter 9 entirely.

18. Precluding Puerto Rico from authorizing its municipalities to seek Chapter 9 relief does not limit or impair Puerto Rico from controlling its municipalities.

19. Despite the clear fiscal crisis, our constitutional structure does not permit the Court to rewrite a statute that Congress enacted. The judgement is affirmed.

D. Dissent.

1. Justice Sotomayor, joined by Justice Ginsberg, begins by noting that because Puerto Rico's municipalities cannot access Chapter 9, a nonfederal bankruptcy solution is not merely a parallel option, it is the only option for Puerto Rico to deal with its crippling debt crisis.

2. The Bankruptcy Code must be read in context. Section 109 establishes gateways of eligibility for various debtors for relief under the various chapters, and § 109(c) requires that a municipality seeking relief must be authorized to do so by its State.

3. It is undisputed that the definitional section's reference to who may be a debtor under Chapter 9 precludes Puerto Rico from authorizing its municipalities to seek Chapter 9 relief.

4. However, the introductory clause of § 903 delineates the balance of power between the States that can authorize their municipalities to access Chapter 9 and the bankruptcy courts that would preside over cases filed under that chapter.

5. Because Puerto Rico's municipalities cannot pass through the § 109(c) gateway, nothing in Chapter 9 affects Puerto Rico's control over its municipalities.

6. The reservation preamble of § 903(1) is therefore meaningless to Puerto Rico--- there is no power to reserve from Chapter 9's operation.

7. The words of the statute, argues the dissent, must be read contextually in view of their place in the overall statutory scheme.

8. Because Chapter 9 can only affect municipalities and States eligible to pass through the gateway in §109(c), that must mean that none of Chapter 9's provisions, including the preemption provision, apply to Puerto Rico and its municipalities.

9. Nobody has presented a compelling case as to why Congress decided to bar Puerto Rico from authorizing its municipalities to access Chapter 9. In context, it is logical to find that Congress intended Puerto Rico to be removed from both the benefits and the burdens of the preemption clause in §903(1).

10. Finding otherwise has real world consequences for 3.5 million citizens facing a humanitarian crisis, who have no other remedy. Congress could step in and pass appropriate legislation, but until it does so, the dissent would find that §903(1) does not preempt the Recovery Act.

III. *Hawkins v. Cmty. Bank of Raymore*, 136 S. Ct. 1072 (2016).

A. Issue: Are spousal guarantors protected as "applicants" under the Equal Credit Opportunity Act ("ECOA")?

B. Facts.

1. Although technically not a case involving the Bankruptcy Code, the case is characterized in the popular press as a "bankruptcy case" and was the first decision since Justice Scalia's death in which the Court split 4 to 4, leaving in place the decision of the Eighth Circuit in *Hawkins v. Cmty. Bank of Raymore,* 761 F.3d 937 (8th Cir. 2014). To be clear, the Eighth Circuit's decision remains the law only of that circuit.

2. Hawkins and Patterson were wives who guaranteed the loans made by a bank to a real estate development company, PHC Development, LLC, the members of which were the plaintiffs' husbands.

3. The LLC defaulted under the loan, and the bank demanded payment from the plaintiffs as guarantors.

4. The plaintiffs asserted that they were required to execute the guaranties solely because of their marital status, in violation of the ECOA.

5. The district court granted summary judgment to the bank, and the plaintiffs appealed.

C. Court of Appeals Opinion.

1. The ECOA, explained the Eighth Circuit, makes it unlawful for any creditor to discriminate against an applicant, with respect to any aspect of a credit transaction…on the basis of marital status."

2. The statute defines "applicant" as "any person who applies to a creditor directly for …credit…."

3. Interpreting this definition, the Federal Reserve promulgated 12 C.F.R. § 202.2(e), which provides that the term “applicant” includes guarantors.

4. The court applied the two part test in *Chevron U.S.A., Inc. v. Natural Resources Defense Council,* 467 U.S. 837 (1984), to interpret the statute.

5. Under *Chevron,* the court first asks if the Congressional intent is clear. Only if the court determines that the statute is silent or ambiguous with respect to the specific issue presented does the court determine whether the agency's reading defines a term in a reasonable way in light of the legislature's design.

6. Applying *Chevron,* the Eighth Circuit determined that a guarantor does not request credit and therefore cannot qualify as an applicant under the "unambiguous text of the ECOA."

7. Affirming the district court, the Eighth Circuit noted that the Sixth Circuit came to the opposite conclusion in *RL BB Acquisition, LLC v. Bridgemill Commons Dev. Grp.,* 754 F.3d 380 (6th Cir. 2014).

8. The circuit courts in *Silverman v. Easterich Multiple Investor Fund, L.P.,* 51 F.3d 28 (3d Cir. 1995), and *Mayes v. Chrysler Credit Corp.,* 37 F.3d 9 (1st Cir. 1994), also applied the Federal Reserve's definition to include guarantors as applicants. The

Eighth Circuit noted that these decisions did not include a *Chevron* analysis and therefore found them to be not instructive.

9. The court concluded by indicating that the Federal Reserve Board's decision to expand the definition of applicant to include guarantors was motivated by the Board's dissatisfaction that only "applicants" had standing to sue.

10. Although the Board's definition would have the effect of enhancing protections under the EOCA, only Congress has the power to expand civil liability under the Act.

11. Consequently, given the Supreme Court's deadlock, whether guarantors have standing to sue under the EOCA presently depends upon the circuit in which the issue is raised.

12. In the Seventh Circuit, guarantors do not have the standing to sue under the EOCA. *See Moran Foods v. Mid-Atlantic Market Dev. Co., LLC*, 476 F.3d 436 (7th Cir. 2007).

CASES TO BE DECIDED THIS TERM

IV. *Off. Comm. of Unsecured Creditors v. CIT Grp. / Bus. Credit Inc. (In re Jevic Holding Corp.),* 787 F3d 173 (3d Cir. 2015).

A. Issue: May a bankruptcy court authorize the distribution of settlement proceeds in a manner that violates the priority scheme of § 507 of the Bankruptcy Code?

B. Facts.

1. Jevic was a trucking company headquartered in New Jersey, which, after a decline in business in 2006, was acquired by a subsidiary of Sun Capital Partners in a buyout financed by CIT Group.

2. Post-acquisition, the company continued to struggle and, after entering into a forbearance agreement, the company notified its employees that the business was closing and that they were terminated as of May 19, 2008. The company filed a Chapter 11 petition on May 20, 2008.

3. Jevic's truck drivers filed a class action suit against Jevic and Sun alleging that there was a violation of the applicable state and federal Worker Adjustment and Retraining Notification ("WARN") acts. The truck drivers prevailed on their claims against Jevic, but not against Sun.

4. In the bankruptcy case, the Committee brought a fraudulent conveyance action against CIT and Sun.

5. The Committee's litigation proceeded for over three years, and in March 2012 representatives of all of the major players, including the truck drivers, met to try to negotiate a settlement to apportion Jevic's remaining assets comprised of $1.7 million in cash (which was subject to Sun's lien) and the suits against CIT and Sun.

6. The Committee, Jevic, CIT and Sun reached a settlement which resulted in the suits being dismissed, and the $1.7 million and an additional $2 million paid by CIT being deposited into an account to pay administrative claims and tax claims, and then unsecured claims on a *pro rata* basis. The case was to be dismissed and the amounts paid in accordance with the settlement to the participating creditors, with nothing paid to the truck drivers.

7. The truck drivers, who asserted a claim of $12.8 million ($8.3 million of which was priority wages), objected to the proposed settlement.

8. The bankruptcy court noted that structured dismissals had been approved in other courts.

9. The court also found that there were insufficient assets to pursue the fraudulent transfer claim, no possibility of a confirmable plan, and that under any other disposition most of the creditors would receive nothing outside the settlement. This warranted approving the settlement.

10. The court concluded that, while plans of reorganizations must follow the absolute priority rule, settlements need not.

11. The truck drivers appealed and requested a stay of the approval order, which was denied by the bankruptcy court. The stay request was not taken to the district court, and the settlement was implemented, with 1,000 checks sent to priority tax and unsecured claim holders. The district court affirmed the order approving the settlement, and the truck drivers appealed.

C. The Third Circuit Opinion.

1. Bankruptcy Rule 9019 authorizes settlements as long as they are "fair and equitable."

2. In reviewing settlements, the court looks at a four-part test: (1.) the probability of success in the litigation; (2.) the likely difficulties in collection; (3.) the complexity of the litigation involved; and (4.) the paramount interest of the creditors.

3. The truck drivers did not contend, said the court, that these factors were not met or that the bankruptcy court did not follow the law with respect to dismissal.

4. Instead the truck drivers and the U.S. Trustee argued that the bankruptcy court had no legal authority to approve structured dismissals which deviated from the Code's priority scheme.

5. The truck drivers argued that there are three exits from Chapter 11: a confirmed plan; a conversion to Chapter 7; or a dismissal with no strings attached, as the Code does not authorize structured dismissals.

6. The Third Circuit acknowledged that there is no specific statutory authority for structured dismissals. However, it found that structured dismissals were really dismissals preceded by other orders of the court.

7. Although Code § 349 generally contemplates that a dismissal will reinstate the pre-petition state of affairs, the "for cause" language in the section allows a dismissal that results in something other than a "hard reset," citing *Matter of Sadler,* 935 F.2d 918 (7th Cir. 1991).

8. Having decided that structured dismissals are authorized by the Code, the court turned to the truck drivers' argument that the bankruptcy court's equitable powers may only be exercised within the confines of the Code and that it is improper to approve structured dismissals that violate the Code's priority scheme, citing § 103(a).

9. The court acknowledged that two circuits had split on the issue. *Matter of AWECO, Inc.,* 725 F.2d 293 (5th Cir. 1984), held that "fair and equitable" means compliant with the Code's priority scheme. *In re Iridium Operating LLC,* 478 F.3d 452 (2d Cir. 2007), criticized *AWECO* as being too rigid and remanded the case to determine whether a structured dismissal that did not follow the priority scheme was appropriate.

10. Admitting that it was a close call, the Third Circuit was persuaded by the reasoning in *Iridium* that, while compliance with the Code's priorities will usually be dispositive of whether a settlement is fair and equitable, where there are "specific justifiable and credible grounds," strict compliance may not always be required.

11. Without the settlement, the lawsuit would continue and threaten to deplete the entire estate. While it was unfortunate that the truck drivers were omitted from the settlement, there was no evidence that a viable alternative existed that would have better served the estate.

12. The court affirmed the district court.

13. Judge Sirica dissented, finding that the settlement maximized the estate for the unsecured creditors who would not have received anything in a liquidation or Chapter 11 cramdown, at the expense of the truck drivers who had a senior claim.

14. Structured dismissals that violate the Code's priority scheme raise the same issues as *sub rosa* plans, under *In re Braniff Airways, Inc.,* 700 F.2d 935 (5th Cir. 1983), and the cases that have followed it.

15. The cash distributed and the lawsuit were property of the estate, which distinguishes this case from *In re SPM Manufacturing Corp.,* 984 F.2d 1305 (1st Cir. 1993).

16. Judge Sirica would have ordered disgorgement of the settlement payments received and redistribution in accordance with the Code's priority scheme.

D. Petition for certiorari and the position of the truck drivers.

1. The petitioners framed the issue as follows: Whether a Chapter 11 case may be terminated by a "structured dismissal" that distributes estate property in violation of the Bankruptcy Code's priority scheme.

2. There are three ways, and only three, to resolve a Chapter 11 case: confirmation of a plan; conversion to Chapter 7; or dismissal which returns the estate's assets to its pre-bankruptcy owners and restores creditors' rights to pursue their claims against such assets.

3. The Code does not expressly require compliance with the priority scheme of the Code in its provisions authorizing dismissal or settlement because these provisions were never intended to allow a plan-like distribution.

4. Plans and liquidations must follow the priority scheme, and dismissal must reinstate the creditors' pre-bankruptcy rights, as contemplated by § 349.

5. No other provision of the Code grants authority for a priority-skipping structured dismissal. Bankruptcy Rule 9019, which is relied upon by the lower courts, is insufficient.

6. The "for cause" language in § 349(b) means an acceptable reason. The desire to make an end run around a statute is not an adequate reason, citing the Seventh Circuit's decision in *Sadler.*

7. Had the *Jevic* case simply been dismissed, creditors could have asserted their state law fraudulent transfer claims against CIT and Sun. However, the settlement gave CIT and Sun a release and skipped over the truck drivers, giving them nothing and eliminating their rights. Section 349 cannot be read to permit such an evasion of the priority scheme.

8. A bankruptcy court's equitable powers do not permit the court to determine the "least bad" alternative. Congress has carefully laid out the priority scheme in § 507, and to ignore it would violate the text and the structure of Chapter 11 and be inconsistent with the history and purpose of the priority scheme.

9. Ignoring the priority requirement would also foster collusion between senior and junior creditors or equity holders to squeeze out disfavored intermediate creditors. By contrast, following the priority scheme would foster settlement because everyone gains from predictability.

E. Petition for certiorari was granted on June 28, 2016.

F. Certiorari Opposition Brief of Respondents.

1. The decision below was correct. Nothing in the Bankruptcy Code provides that the priority system applicable to plans must be extended to settlements.

2. The *AWECO* decision sweeps too broadly. Moreover, the Fifth Circuit has not revisited the issue since 1984.

3. *Iridium* agreed with the central premise of *AWECO* that pre-plan settlements cannot be used to evade plan confirmation requirements but concluded that it did not consider the myriad of factual scenarios that may arise. Therefore, the circuit split is illusory.

4. Ordinarily, settlements must be fair and equitable, which means that they usually must comply with the Code's priority scheme. However, the scheme may be deviated from if there is "specific and credible grounds" to do so.

5. Here, this is the least bad alternative, and rejecting the settlement would result in making the other creditors worse off and the petitioners no better off.

6. In fact, had the case been converted to Chapter 7, CIT and Sun would have received all of the estate’s assets, in light of the bankruptcy court’s findings that the estates had no assets and could not obtain contingency counsel to pursue the avoidance claim.

7. The argument that affirming the decision will encourage collusion or reduce creditors' leverage is without merit. Reversing the decision will give recalcitrant priority creditors all of the leverage, reducing the prospect for a settlement that would be more beneficial for both senior and junior creditors.

G. Amicus Briefs.

1. Loan Syndication and Trading Association.

(a) Priority skipping settlements undermine the predictability upon which the commercial lending markets depend.

(b) Making routine unexplained departures from the pre-bankruptcy priorities that are neither transparent nor predicable through priority-skipping dismissals contradicts the pre-bankruptcy norm.

(c) Priority-skipping settlements disrupt the bankruptcy process by diverting the focus from prompt estimation of claims to compelling consent by threatening to divert value from creditors who are otherwise entitled to receive it.

(d) The structured dismissal process elevates the leverage in favor of settlements because it distorts the usual tension between settlement and going forward with the dispute. Undeniably meritorious claims can be threatened with the prospect that failing to agree will result in no recovery at all.

2. The United States.

(a) The priority scheme of the Code applies in Chapter 11, and a bankruptcy court cannot ignore Congress's judgement just because the court believes a different allocation would be fairer or more efficient.

(b) The only alternatives to following the priority scheme in a plan are conversion to Chapter 7 or dismissal without conditions.

(c) The Third Circuit was wrong in holding that the Code's priority rules do not apply to settlements.

(d) Had the case been dismissed, the truck drivers could have pursued the fraudulent conveyance claim. The court's disposition eliminated their priority rights and their pre-bankruptcy rights and gave them nothing in return.

3. Thirty Five States and the District of Columbia.

(a) There are three avenues to exit bankruptcy: confirmation of a plan of reorganization or liquidation; liquidation under Chapter 7; or dismissal.

(b) The proceeds of any settlement, whether outside of a plan context or pursuant to a plan, have to be distributed in accordance with the Code's priority scheme.

(c) Additionally, even if the "for cause" language of § 349(b) allows the distribution of all of the estate's assets, the distribution must be in accordance with the Code's priority scheme.

(d) Section 105(a) does not permit a bankruptcy court to arrogate to itself powers to do otherwise in connection with a structured dismissal.

(e) Settlements that attempt to avoid the priority scheme cannot be approved.

(f) A "bright line" rule prohibiting priority-skipping structured dismissals is necessary to fully protect creditors.

4. National Employment Law Project; National Consumers League; Legal Aid Society; and Asian American Legal Defense and Education Fund.

(a) Section 507 priorities are an essential and mandatory part of Congress's scheme and are critical to protecting employees, consumers and other small creditors.

(b) The Third Circuit decision violates the Code and would dramatically undermine creditor protections.

(c) A bankruptcy judge's discretion to determine whether a "settlement" is "fair and equitable" is an inadequate substitute for Congress's priority rule. Such discretion would weaken the bargaining positon of all priority creditors.

(d) The Bankruptcy Code has sufficient flexibility to achieve mutually beneficial results without priority-skipping structured dismissals.

(e) A simple dismissal would have preserved pre-bankruptcy rights to pursue the fraudulent transfer claims. A settlement that included the truck drivers was also a possibility.

5. Law Professors.

(a) The Third Circuit’s decision threatens the foundation of the bankruptcy system -- its priority structure. Congress, not the courts, determines payment priorities to advance bankruptcy policy.

(b) Settlements in bankruptcy are subject to the absolute priority rule.

(c) Subverting the Code's priority scheme will create costly uncertainty.

(d) *Jevic*'s triggers and limits are unclear, and this uncertainty will increase bankruptcy costs. V

V. *Johnson v. Midland Funding, LLC,* 823 F.3d 1334 (11th Cir. 2016).

A. Issues: (1) Whether a debt collector violated the Fair Debt Collection Practices Act ("FDCPA") when it filed an accurate proof of claim in the bankruptcy proceeding for a debt whose collection would now be barred by the statute of limitations; and (2) whether the Bankruptcy Code precludes a lawsuit under the FDCPA on the ground that the defendant debt collector filed a proof of claim for a debt arising beyond the statute of limitations?

B. Facts.

1. Midland, a debt purchaser, acquired Johnson's defaulted credit card account in the amount of $1,870.71.

2. Johnson filed a Chapter 13, and Midland filed a proof of claim which accurately listed the date of the last transaction as May 2003. Alabama, the relevant jurisdiction, has a six-year statute of limitations.

3. Johnson objected to Midland's proof of claim, and the bankruptcy court disallowed it.

4. Three days after the disallowance, Johnson sued Midland in federal district court, alleging that because Midland's claim was time-barred, the proof of claim constituted an unfair, deceptive or misleading debt-collection practice under the FDCPA.

5. Granting Midland' s motion to dismiss, the district court found that the statute of limitations does not extinguish a creditor's right to payment, but instead simply eliminates the creditor's legal remedy to obtain a civil judgment.

6. It went on to hold that the Code permits a creditor to file a proof of claim for an unextinguished time-barred debt, but noted an irreconcilable conflict between the Code and the FDCPA because, to comply with the FDCPA, the creditor must surrender its rights under the Code. Consequently, the FDCPA must give way to the Code.

C. The Eleventh Circuit opinion.

1. The Eleventh Circuit, in *Crawford v. LVNV Funding, LLC,* 758 F.3d 1254 (11th Cir. 2014), held that a debt collector violates the FDCPA when it files a proof of claim on a debt it knows to be time-barred.

2. The district court read the *Crawford* case as creating an irreconcilable conflict between the FDCPA and the Code. The Eleventh Circuit saw no conflict.

3. While the Code allows all creditors to file proofs of claim in bankruptcy cases, it does not protect them from liability. Debt collectors who file time-barred claims may be liable for a violation of the FDCPA.

4. While, when two statutes are in irreconcilable conflict, the later enacted statute repeals the former by implication, there is no irreconcilable conflict here because each statute provides different protections to different actors.

5. The Code allows all "creditors" to file proofs of claim. The FDCPA sanctions "debt collectors" for filing proofs of claim in violation of its provisions.

6. The Court concluded that the FDCPA and the Code can coexist. Any creditor may file a proof of claim, but debt collectors must face the consequences if the debt evidenced by the claim is time-barred.

7. Any party can file a frivolous lawsuit, but afterwards the filer may face sanctions. The same is true regarding the FDCPA and the Code. There is no irreconcilable conflict between the two statutes.

D. Petition for Certiorari and the Position of Midland.

1. There is a clear circuit split on this issue. The Fourth, Eighth, Ninth and Seventh Circuits have all rejected the Eleventh Circuit's decision in *Crawford. See Owens v. LVNV Funding, LLC,* 2016 WL 4207965 (7th Cir. Aug. 10, 2016) (Judge Wood, dissenting), petition for cert. pending, No. 16-315 (filed Aug. 26, 2016); *In re Dubois,* 2016 WL 4474156 (4th Cir. Aug. 25, 2016); *Nelson v. Midland Credit Management , Inc.* 2016 WL 3672073 (8th Cir. July 11, 2016); *Walls v. Wells Fargo Bank, N.A.,* 276 F.3d 502 (9th Cir. 2002) (FDCPA does not apply to attempting to collect a debt discharged in a Chapter 7; protections provided by Code only).

2. Uniform interpretation is fundamental to the proper administration of the bankruptcy system.

E. Petition for certiorari granted on October 11, 2016.

A SEVENTH CIRCUIT CASE THAT MAY BE DECIDED THIS TERM, IF CERTIORARI IS GRANTED

VI. *FTI Consulting, Inc. v. Merit Management Group, LP,* 830 F.3d 690 (7th Cir. 2016).

A. Issue: Does the Code §546(e) safe harbor insulate a leveraged buyout between two private parties from avoidance as a fraudulent transfer, if the sale proceeds are paid through a financial institution that acts only as a conduit?

B. Facts.

1. The owners of two privately owned entities operating race tracks were competing for a license to operate a "racino" (combination race track and casino).

2. Rather than fight over the license, one of the parties acquired all of the shares of the other, with the sale proceeds being paid through Citizens Bank of Pennsylvania. The acquirer borrowed money from several banks to accomplish the acquisition.

3. After the acquisition, the acquirer failed to obtain one of the necessary licenses and subsequently filed Chapter 11.

4. FTI, as trustee of a Chapter 11 litigation trust, brought suit against Merit, one of the selling shareholders, alleging that the acquisition was a fraudulent transfer avoidable under §§ 548, 544 and 550.

5. The district court found that the transfers were "settlement payments" made "in connection with a securities contract."

6. Further, the involvement of Citizens Bank caused the payments to be "made by or to" a financial institution, and therefore the transaction was within the § 546(e) safe harbor and not avoidable. The district court granted judgement on the pleadings in favor of Merit, and FTI appealed.

C. The Seventh Circuit opinion.

1. The court started with analysis of the language of the statute. The court noted FTI's argument that the statutory language is not dispositive.

2. For example, a post card sent in the mail could be said to be sent "by" the Postal Service or "by" the sender. Similarly, when a person's payment of a bill is made by electronic bank transfer, the payment could be said to have been made "by or to a financial institution" or made "by or to" the recipient of the payment.

3. The 2006 addition to § 546(e) of the language "or for the benefit of" in the clause "…a settlement payment…made by or to (or for the benefit of)…." the named parties is also ambiguous.

4. The court concluded that the language of the statute standing alone did not point the court in one direction or the other.

5. Is the statute, asked the court, intended to include intermediaries, or are its protections limited to real parties in interest?

6. FTI argued that Chapter 5 of the Code creates a system for avoiding a transaction and a safe harbor from avoidance. It therefore makes sense to understand that the safe harbor only applies to transfers that are eligible for avoidance in the first place.

7. Merit argued that the use of the words "incurred by" in §§ 544, 547 and 548, instead of the words "made by" in §546(e), refutes the argument that §546(e) was only intended to protect transactions made by a debtor.

8. The court concluded that the payment in question was not made on behalf of a debtor by a third party, but was made by the debtor using the bank as a conduit.

9. Additionally, the safe harbor in §548(a)(2) exempting charitable contributions from avoidance has to be read to apply to payments "by" the debtor, even if the payments are made by check or wire transfer. Otherwise, all such payments would be avoidable.

10. Similarly, §555, preventing the application of the automatic stay to termination of securities contracts by counterparties, applies only to the named counterparty and not to a conduit or bank for a counterparty.

11. In those instances, the court concluded that it is the economic substance of the transaction that matters and that § 546(e) should apply in the same manner.

12. Section 546(e) was enacted to protect the markets from systemic risks, and to prevent one large bankruptcy from rippling through the securities industry. The defendants here were not parties in the securities industry. Instead, they were simply corporations that wanted to exchange money for privately held stock.

13. The court ultimately found that § 546(e) does not provide a safe harbor against avoidance of transfers between non-named entities where a named entity acts only as a conduit.

14. The Seventh Circuit noted that, while the Eleventh Circuit in *Matter of Munford,* 98 F.2d 604 (11th Cir. 1996), agrees with its conclusion, five other circuits have interpreted §546(e) to include the conduit situation. *See In re Quebecor World (USA) Inc.,* 719 F.3d 94 (2d Cir. 2013); *Contemporary Indus. Corp. v. Frost,* 564 F.3d 981 (8th Cir. 2009); *In re QSI Holdings, Inc.,* 571 F.3d 545 (6th Cir. 2009); *In re Resorts Int'l. Inc.,* 181 F.3d 505 (3d Cir. 1999); *In re Kaiser Steel Corp.,* 952 F.2d 1230 (10th Cir. 1991).

15. A petition for certiorari arising out of the Second Circuit's decision in the *Tribune* Chapter 11 was filed on September 9, 2016. *See Deutsche Bank Tr. Co. Ams.v. Large Private Beneficial Owners (In re Tribune Co.),* 818 F.3d 98 (2d Cir. 2016) (petition for cert. pending, No. 16-317 (filed Sept. 9, 2016)).

APPENDIX

Pending Petitions for Certiorari

Sw. Sec., FSB v. Segner; Doc. No. 15-1223, (Ruling below: 811 F.3d. 691 (5th Cir. 2015)). Question Presented: Are secured creditors obligated, under Bankruptcy Code Section 506(c), to shoulder a trustee's maintenance costs when retaining encumbered property in the hope of benefiting other creditors for the period before a trustee abandons encumbered property?

U.S. Bank N.A. v. Vill. at Lakeridge LLC; Doc. No. 15-1509, (Ruling below: 814 F.3d 993 (9th Cir. 2016)). Questions presented: (1) Does an assignee of an insider claim acquire the original claimant's insider status, such that the assignee's vote to confirm a cramdown plan can't be counted under Bankruptcy Code Section 1129(a)(10)? (2) What is the appropriate standard of review for determining non-statutory insider status? (3) Does the proper text for determining non-statutory insider status require bankruptcy courts to consider an "arm's length" analysis or a "functional equivalent" test that looks to factors comparable to those enumerated for statutory insider classifications? (The Court has called for the views of the Solicitor General).

Whyte v. Barclays Bank PLC; Doc. No. 16-239, (Ruling below: 644 F. App'x 60 (2d Cir. 2016)). Question presented: Does the presumption against preemption of state law actions apply to the Bankruptcy Code and, in particular, to the displacement of fraudulent transfer claims under state law by creditors?

Owens v. LVNV Funding LLC; Doc. No. 16-315, (Rulings below: 2016 BL 258333 (7th Cir. 2016)). Question presented: Does the filing of a proof of claim on a knowingly time-barred debt violate the Fair Debt Collection Practices Act (FDCPA)?

Deutsche Bank Tr. Co. Ams. v. Robert R. McCormick Found.; Doc. No. 16-317, (Rulings below: *Deutsche Bank Tr. Co. Ams.v. Large Private Beneficial Owners*, 818 F.3d 98 (2d Cir. 2016)). Questions presented: (1) Did the Second Circuit correctly hold -contrary to several other courts appeals- that the presumption against federal preemption of state law does not apply in the bankruptcy context? (2) did the Second Circuit correctly hold - following the Third, Sixth, and Eighth Circuits, but contrary to the Seventh and Eleventh Circuits - that a fraudulent transfer is exempt from avoidance under Bankruptcy Code Section 546(e) when a financial institution acts as a mere conduit for fraudulently transferred property, or whether instead the safe harbor applies only when the financial institution has its own beneficial interest in the transferred property?

Smith v. Internal Revenue Service; Doc. No. 16-497, (Rulings below: 828 F.3d 1094 (9th Cir.)). Question presented: What constitutes a legitimate tax return? There is currently a circuit split on the ways that determine when a tax debt can be discharged in bankruptcy.

Marshall v. Honeywell Tech. Sys. Inc., Doc. No. 16-521 (Rulings below: 828 F.3d 923, 2016 BL 222629 (D.C. Cir.)). Question presented: Is a debtor's oral disclosure to the bankruptcy trustee of a pending administrative matter material evidence of mistake or inadvertence sufficient to defeat a motion for summary judgment on the ground of judicial estoppel in civil litigation arising out of a the administrative matter?

PEM Entities LLC v. Levin; Doc. No. 16-492 (Rulings below: (*PEM Entities LLC v. Province Grande Olde Liberty, LLC*, 2016 BL 261725 (4th Cir unpublished)). Questions presented: Should bankruptcy courts apply a federal rule of decision (as five circuits have held) or a state law rule of decision (as two

circuits have held, expressly acknowledging a split of authority) when deciding to recharacterize a debt claim in bankruptcy as a capital contribution?

Gil-de- la Madrid v. Bowles Custom Pools & Spa, Inc.; Doc. No. 16-519 (Rulings below: 817 F.3d 371, 2016 BL 93095 (1st Cir.)). Questions presented: (1) Did a bankruptcy judge lack power to provide an additional exception to the finality of the bar date to file a proof of claim? (2) Was the award of attorneys' fees by the Florida court unreasonable and unenforceable in Puerto Rico as contrary to law?