UNITED STATES SUPREME COURT

2014 CASE REVIEW

LOU JONES BREAKFAST

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I. *Executive Benefits Insurance Agency v. Arkison* (*In re Bellingham Insurance Agency, Inc.*), 134 S.Ct. 2165 (2014).

A. Facts.

1. Prepetition, the debtor transferred commissions it received to a long-time employee and a newly created entity, Executive Benefits.

2. The debtor filed Chapter 7, and the trustee filed a fraudulent conveyance action under section 548 of the Code and state law against Executive Benefits, which had not filed a proof of claim in the case.

3. The defendant filed a motion to withdraw the reference and demanded a jury trial, but asked the district court to stay its consideration of the motion to enable the bankruptcy court to rule on the trustee's motion for summary judgment filed in the bankruptcy court.

4. The bankruptcy court granted summary judgment, which was affirmed by the district court. However, in the course of its review, the district court considered the bankruptcy court's decision *de novo*.

5. The defendant appealed and for the first time moved to vacate the bankruptcy court's judgment, arguing that the bankruptcy court lacked subject matter jurisdiction under *Stern v. Marshall,* 131 S. Ct. 2594 (2011).

6. On appeal, the Ninth Circuit affirmed the district court decision.

B. Issues:

(a) Can a bankruptcy court issue findings of fact and conclusions of law in a core but unconstitutional proceeding?

(b) Can a bankruptcy court enter a final order in such a proceeding where the defendant impliedly consents to the bankruptcy court's jurisdiction?

C. Supreme Court Opinion.

1. Justice Thomas authored the unanimous opinion of the Court, which began by discussing *Northern Pipeline Constr. Co. v. Marathon Pipe*

Line Co, 458 U.S. 50 (1982); the Federal Judgeship Act of 1984 ("1984 Act") enacted in response to *Northern Pipeline;* and *Stern.*

2. The 1984 Act provided that in "core" proceedings the bankruptcy court can issue a final order; however, in "non-core" proceedings the bankruptcy court can only issue findings of fact and conclusions of law.

3. *Stern* made clear that some claims labeled by Congress as "core" claims may not be adjudicated by a bankruptcy court in the manner designated by 28 U.S.C. § 157(b), as these claims must be decided by an Article III court.

4. The Court then discussed the statutory gap of 28 U.S.C. § 157(b) determined by several lower courts as precluding a bankruptcy court from issuing findings of fact and conclusions of law relating to "core" but "unconstitutional" matters, as that section only addresses the issuance of proposed findings of fact and conclusions of law in "non-core" proceedings. *See, for example, In re Ortiz*, 665 F.3d 906 (7th Cir. 2011).

5. Justice Thomas quickly dismissed the argument, relying on the severability clause in the 1984 Act, Pub. L. No. 98-353, § 119, 98 Stat. 333, 344, note following 28 U.S.C. § 151:

> "If any provision of this Act or the application thereof to any person or circumstance is held invalid, the remainder of this Act, or the application of that provision to persons or circumstances other than those as to which it is held invalid, is not affected thereby."

6. Unless the statutory text or the context indicates Congress would have preferred no statute at all (which did not apply here), the severability clause causes the remainder of the statute to remain fully operative.

7. The Court assumed without deciding that the fraudulent conveyance claims were *Stern* claims, as the Ninth Circuit held. As such, the claims were not core but were otherwise related to a case under title 11, and therefore fit within the category of claims governed by 28 U.S.C. §157(c)(1).

8. Although the district court did not analyze whether the claims at issue were *Stern* claims or relabel the bankruptcy court's order as proposed findings of fact and conclusion of law, the district court reviewed the issues *de novo* before entering judgment for the trustee. The Court found that this was sufficient and affirmed the Ninth Circuit decision.

9. The Court did not address the consent issue with respect to *Stern* claims, which was of particular interest to Court observers.

10. Affirmed.

II. *Law v. Siegel*, 134 S. Ct. 1188 (2014)

A. Facts.

1. The debtor filed a Chapter 7 proceeding and in his schedules listed his home, valued at $363,000, as the sole asset. The home was encumbered by a $147,000 first mortgage to a bank and a $156,000 second mortgage to Lin's Mortgage and Associates.

2. The debtor claimed California's $75,000 homestead exemption, to which the trustee did not object.

3. During the case, the trustee commenced an investigation into the validity of the second mortgage, which spawned years of litigation, including a dozen appeals to the Bankruptcy Appellate Panel and several appeals to the Ninth Circuit, and which cost the estate over $450,000 in administrative expenses.

4. Ultimately, the bankruptcy court determined that the debtor had perjured himself twice. Prepetition, he drafted a note and a mortgage to Lili Lin of California, an acquaintance of the debtor, and asked her to hold the money realized from the mortgage for him. She refused to sign the documents, but the mortgage was nonetheless recorded.

5. Thereafter, a letter was received by the county indicating that Ms. Lin desired to commence a foreclosure action. Ms. Lin indicated she did not send the letter.

6. Later, the debtor presented Ms. Lin with a packet of documents purporting to transfer the note and mortgage to the debtor's brother, which Ms. Lin also refused to sign.

7. The debtor filed a motion to compel payment of the exempt amount. The trustee filed a motion to surcharge the debtor's exempt property. During this dispute, one Lili Lin of China, who had never visited the United States, appeared by counsel. The debtor said it was really this Lili Lin who held the mortgage.

8. The bankruptcy court granted the trustee's motion but the BAP reversed and remanded to determine the validity of the mortgage in light of Lili Lin's (China) appearance.

9. After review, the bankruptcy court again granted the trustee's motion. The BAP affirmed, and the Ninth Circuit affirmed in an unpublished opinion.

10. The debtor filed a motion for leave to proceed *in forma pauperis* and filed a petition for certiorari.

11. The trustee, in his response to the petition, correctly observed that it was difficult to determine what the petitioner asked the Supreme Court to review, and what grounds and the bases were for the relief sought.

B. Issue. Using its equitable powers, may a bankruptcy court surcharge a debtor's exemptions to which timely objections were not made?

C. Supreme Court Opinion.

1. Writing for the unanimous Court, Justice Scalia noted that 11 U.S.C. § 105(a) gives the bankruptcy court the authority to issue any order necessary or appropriate to carry out the provisions of the Bankruptcy Code. Additionally, the bankruptcy court has the inherent power to sanction abusive litigation practices, citing *Marrama v. Citizens Bank of Massachusetts*, 549 U.S. 365 (2007).

2. However, § 105(a) does not allow the bankruptcy court to override explicit mandates of other sections of the Code.

3. The Court rebuffed the arguments of the trustee and the United States as *amicus* that § 522 neither gives the debtor the absolute right to retain exempt property nor limits the bankruptcy court's authority to impose a surcharge.

4. The surcharge was unauthorized, said the Court, because it contravened § 522 of the Code, which sets forth "carefully calibrated exceptions and limitations" to the exemptions.

5. The trustee did not timely object after the exemption when claimed and before the bankruptcy court imposed the surcharge. This was fatal.

6. Where courts have disallowed exemptions for misconduct, the disallowance was of *state-created* exemptions based upon state law. The *federal law* provides that a bankruptcy court may not disallow an exemption on a ground not specified in the Code.

7. Although exemptions may not be surcharged, there are other remedies available to the bankruptcy court, including denial of discharge under section 727; imposing sanctions, including the reimbursement of reasonable legal fees and expenses under Federal Rule of Bankruptcy Procedure 9011; imprisonment for criminal conduct under 18 U.S.C. § 152; and other sanctioning powers under § 105(a).

8. If the offending conduct occurs post-petition, the Court observed that any monetary sanctions imposed survive the bankruptcy case and can be enforced through the normal procedures for collecting money judgments.

9. Reversed and remanded.

III. *United States v. Quality Stores, Inc. (In re Quality Stores, Inc.),* 134 S. Ct. 1395 (2014).

A. Facts.

1. Quality Stores, one of the nation's largest agricultural specialty retailers, closed its stores and distribution centers, terminated the employment of all of its employees, and made severance payments to all of its employees whose employment was involuntarily terminated.

2. The payments were made pursuant to a prepetition severance plan and a post-petition severance plan designed to encourage employees to defer job searches.

3. The government took the position that the payments constituted wages for Federal Insurance Compensation Act (" FICA") purposes. While the debtor collected and paid the tax, it took the position that the payments constituted supplemental unemployment compensation benefits ("SUBs"), and that the payments were not taxable under FICA, claiming it was due a refund.

4. The debtor filed an action in bankruptcy court seeking to recover the paid taxes, plus interest. The bankruptcy court held the debtor was not liable for the taxes and was entitled to a refund of over $1 million for FICA taxes previously paid.

5. The government filed a motion for reconsideration, which the bankruptcy court granted. On rehearing, the bankruptcy court ratified its prior decision.

6. On appeal, the district court affirmed. The government appealed, and the Sixth Circuit also affirmed

B. Issue. Whether severance payments made to employees whose employment was involuntarily terminated are taxable under the FICA.

C. Supreme Court Opinion.

1. Writing for the members of the Court other than Justice Kagan, who took no part in the decision, Justice Kennedy began by noting that FICA defines wages broadly as all remuneration for employment, including the

cash value of remuneration (including benefits) paid in any medium other than cash. "Employment" encompasses any service of whatever nature, performed by an employee for the person employing him.

2. Under this definition, the Court found that severance payments made to terminated employees are remuneration for employment.

3. Section 3121(a)(13)(A) of FICA exempts from taxable wages any severance payments made because of retirement for disability, and other sections have specific exemptions from the definition of wages that are not related to termination. The specificity of the definition is evidence that Congress intended the definition of wages to be broad.

4. The Court then addressed whether the language of Internal Revenue Code § 3402(o), which indicates that SUB's are to be treated *as if* they were payments of wages, indicates that such benefits are something other than wages.

5. Like FICA, the IRC has specific exemptions from the definition of wages, and severance payments are not exempted.

6. The Court examined the history of state unemployment benefits which frequently required the recipient to not be paid other "wages," prompting the IRS to issue a series of Revenue Rulings in the 1950's and 1960's taking the position that SUB payments were not "wages" under FICA and for the purposes of income tax withholding.

7. However, under the IRC, SUB payments were income to the employees, who faced significant tax liabilities at the end of the year. Congress's response was to enact IRC section 3402(o), which treated all severance payments "as if" they were wages for withholding purposes.

8. The Court determined that the statute permitted the IRS to treat certain SUB's which were linked to state unemployment benefits as being exempt from the definition of wages for the limited purpose of facilitating the receipt of state benefits, and solved the problem of year-end tax liabilities imposed upon on employees by treating all SUB payments "as if" they were wages for withholding purposes.

9. Where, as in this case, SUB payments are not linked to state unemployment benefits, in light of the legislative history, the Court found that Congress did not intend severance payments to be excluded from the definition of taxable "wages" under FICA.

10. Reversed and remanded.

IV. *Clark v. Rameker* , 134 S. Ct. 2242 (2014).

A. Facts.

1. The wife of husband and wife Chapter 7 debtors inherited a $300,000 IRA from her mother and claimed the funds exempt under §§ 522(b)(3)(C) and (d)(12) of the Code.

2. In the wife's hands, the funds retained their tax-exempt status, but were subject to required distributions one year after the receipt of the funds and could not be rolled over into the wife's IRA.

3. The trustee objected to the exemption, and Bankruptcy Judge Martin denied the exemption, finding that the funds in the inherited IRA did not constitute "retirement funds" in the hands of the debtor.

4. The district court reversed, finding the question close and that close questions should be decided in the debtors' favor. The trustee appealed.

5. Writing for the Seventh Circuit, Judge Easterbrook found that the exemption applied to the nature of the funds in the hands of the debtor, not whether the funds were retirement funds at any prior time.

6. Reversing the district court, the Seventh Circuit said that, to be exempt, the funds must be both tax exempt and retirement funds. Retention of the tax attributes is not enough.

B. Issue: Are inherited IRA's exempt retirement funds under §§ 522(b)(3)(C) and (d)(12) of the Code?

C. Supreme Court Opinion.

1. Writing for a unanimous Court, Justice Sotomayor began by indicating that there is no definition of "retirement funds" in the Code. The plain meaning of the term is sums of money set aside for the day an individual stops working.

2. Inherited IRAs have three attributes which differ from Roth or traditional IRAs: (1) No additional funds can be invested in them; (2) the holders of inherited IRA's are required to withdraw funds from the account no matter how far away from retirement they are; and (3) the holder may withdraw the entire balance at any time without penalty.

3. Allowing debtors to protect funds in traditional and Roth IRAs is consistent with the Code's purpose of protecting a debtor's essential needs to enable a fresh start. Funds in inherited IRA's do not protect the

debtor's needs at retirement, but instead the proceeds can be used for a vacation home or a sports car.

4. The Court rejected the petitioner's argument that so long as the original owner had the funds deposited in a traditional or Roth IRA, the exemption should apply.

5. To be exempt, said the Court, the funds must be both exempt from taxation and be "retirement funds." To allow anything that once was an exempt IRA to be withdrawn and reinvested for any purpose would read the "retirement funds" portion of § 522(b)(3) (C) out of the statute.

6. Similarly, the Court dismissed the petitioner's argument that, because § 522(b)(3)(C) did not include the language, "the debtor's interest in," as do other sections of 522, Congress did not intend to limit the exemption. The limitation in those sections was not to distinguish between the debtor's assets and the assets of another person, but to set a limit on the value of a particular asset the debtor may exempt.

7. In response to the petitioner's argument that the only reason to construe the statute as the trustee requested is to render inherited IRA's non-exempt, the Court said a statutory reading that would make one portion superfluous (retirement funds), is less faithful to what Congress intended than a reading that makes the whole statute meaningful but limited.

8. Finally, in response to the petitioner's suggestion that inherited IRA's could still be held for the debtor's retirement, the Court responded that the mere possibility that funds could be held for retirement was not enough. Otherwise, an ordinary checking account or an envelope of $20 bills could amount to "retirement funds," if they in fact were held for retirement.

9. Affirmed.

V. *Wellness Int'l Network, Ltd. v. Sharif,* 727 F.3d 751 (7th Cir. 2013).

A. Facts.

1. In 2003, Sharif, who was a distributor of health and wellness products for Wellness, sued Wellness in the district court for the Northern District of Texas alleging that Wellness was running a pyramid scheme.

2. Sharif ignored numerous discovery requests from Wellness which resulted in material facts being deemed admitted, leading to the district court entering summary judgment in favor of Wellness.

3. Sharif appealed, and the Fifth Circuit affirmed. On remand the district court entered a $655,000 judgment against him.

4. Wellness commenced post-judgment discovery requests against Sharif, which he ignored, resulting in Sharif's arrest for civil contempt, the court entering an order to compel, and ordering sanctions requiring the payment of Wellness' fees and costs. Sharif again ignored the district court's order.

5. In February 2009, Sharif filed a Chapter 7 petition in the Northern District of Illinois.

6. At the initial meeting of creditors, the Chapter 7 trustee asked Sharif to produce documents relating to a 2002 loan application to Washington Mutual showing assets of $5 million.

7. At the continued 341 meeting, Sharif admitted that he lied on the application and that the assets were held by a trust of which he was the trustee.

8. Wellness filed an adversary proceeding seeking a denial of discharge under § 727 of the Code, and seeking a declaratory judgment that the trust was Sharif's alter ego and should be property of the estate.

9. Sharif again refused to comply with Wellness' discovery requests, and the bankruptcy court granted Wellness' motion to compel and included a provision that failure to comply would result in a default judgment against Sharif.

10. Sharif provided some documents but did not provide tax returns or any documents relating to the alleged trust. The bankruptcy court held a hearing and took the matter under advisement. Thereafter, Sharif filed a motion for summary judgment.

11. The bankruptcy court determined that Sharif violated the court's discovery orders more than fifteen times and entered default judgment in both the bankruptcy case and the adversary proceeding, as well as awarding Wellness over $60,000 in fees and costs.

12. Sharif appealed to the district court, but did not raise any issues based upon *Stern*. However, in December 2011, Sharif's sister filed a motion to withdraw the reference, based upon *Stern.*

13. The district court, assuming for the purposes of the decision that the sister had standing, denied the motion to withdraw the reference because the motion was untimely and the issue was waived, and denied Sharif's motion for supplemental briefing. The district court affirmed the judgments of the bankruptcy court, applying a deferential standard of review.

14. Sharif appealed to the Seventh Circuit.

B. Seventh Circuit Opinion.

1. The Seventh Circuit framed the issues as follows:

   (a) Whether the bankruptcy court had the authority to enter a final judgment on the denial of discharge and the alter ego claims;

   (b) And if not, whether that is an issue which can be waived.

2. The court ruled that the counts of Wellness' complaint dealing with denial of discharge were core matters and that the bankruptcy court had the authority to issue a final judgment.

3. The court said that the alter ego claim relating to the trust was not listed among the core claims in section 157, but noted that the list was non-exclusive.

4. Sharif argued that the count dealing with the trust and the alter ego claim was a non-core matter and that the bankruptcy court lacked the constitutional authority to enter judgment on that claim.

5. While the court found that Sharif waived the issue, it continued with an extensive discussion of the constitutional authority of the bankruptcy court and *Stern.*

6. Regarding the waiver issue, the court acknowledged that there was a circuit split with the Ninth Circuit ruling in *Bellingham* that the issue of the bankruptcy court's constitutional authority could be waived and the Sixth Circuit ruling in *Waldman v. Stone,* 698 F.3d 910 (6th Cir. 2012), *cert. denied,* 133 S. Ct. 1604 (2013), that it could not be waived.

7. In the Seventh Circuit's view, nothing in *Stern* supported the view that a party may waive an Article III objection. Agreeing with *Waldman,* the court held that a party may consent to a final disposition of a non-core matter by the bankruptcy court, but may not do so with respect to a core but unconstitutional proceeding covered by *Stern.*

8. Regarding the bankruptcy court's authority to enter judgment on the alter ego claim relating to the trust, the Seventh Circuit found that, if the claim was a core claim, because it was based upon Illinois state law, the claim did not involve public rights and was a state law claim involving private rights wholly independent of federal bankruptcy law. The bankruptcy court therefore lacked the constitutional authority to enter final judgment.

9. If the alter ego claim was core, relying on its ruling in *In re Ortiz,* 665 F.3d 906 (7th Cir. 2011), the court held that the "statutory gap" of section 157(c)(1) prevented the bankruptcy court from proposing findings of fact and conclusions of law.

10. The court went on to distinguish bankruptcy judges from federal magistrate judges, indicating that while magistrates were authorized to preside over pretrial matters such as discovery, bankruptcy judges were not, and the only remedy available would be for the district court to withdraw the reference.

11. The court reversed and remanded for the district court to determine whether the alter ego claim was core or non-core, and recalculate the fees and costs to exclude costs relating to the alter ego claim.

C. Petition for certiorari and position of Wellness.

1. Wellness framed the issues on appeal as including the following:

(a) Whether a state law property law issue in an action to determine property of the estate under section 541 of the Code in the possession of the debtor means that the action does not "stem from the bankruptcy itself," precluding the bankruptcy court from having the constitutional authority to enter a final order deciding that issue?

(b) Whether Article III permits a the bankruptcy court to exercise the judicial power of the United States over claims against a debtor who has consented to the exercise of such judicial power by filing a voluntary petition?

(c) Whether Article III permits a bankruptcy court to exercise the judicial power of the United States on the basis of litigant consent, and whether consent based upon a litigant's conduct is sufficient to satisfy Article III?

2. Wellness argued that the Seventh Circuit has expanded *Stern* to provide that a bankruptcy court does not have the authority to decide disputes between a trustee and a debtor over what property belongs in the estate. This runs contrary to the Supreme Court's observation in *Stern* that it does not "change all that much."

3. In ruling that a section 541 action involving state law issues does not "stem from the bankruptcy itself," as discussed in *Stern*, the Seventh Circuit's decision directly conflicts with the Fourth Circuit in *Canal Corp., v. Finnman (In re Johnson),* 960 F.2d 396 (4th Cir. 1992) (decided after *Northern Pipeline),*which held that whether property belonged to the bankruptcy estate was inextricably tied to the question of who was entitled to the property and that both matters were intimately tied to the traditional bankruptcy functions and to defining the estate itself and, therefore, were core matters within the clear jurisdiction of the bankruptcy court.

4. The Seventh Circuit's conclusion that a section 541 claim is a state-law claim also conflicts with six circuits all of which hold that actions under section 541 are federal law claims even though these types of actions almost always involve issues of state law. *Croft v. AMS SAMgmt. L.L.C. (In re Croft),* 737 F.3d 372 (5th Cir. 2013); *Tyler v. DH Capital Mgmt., Inc.*, 736 F.3d 455 (6th Cir. 2013); *Parks v. Dittmar (In re Dittmar),* 618 F.3d 1199 (10th Cir. 2010); *Redmond v. Lentz & Clark, P.A. (In re Wagers),* 514 F.3d 1021 (10th Cir. 2007); *Abboud v. The Ground Round, Inc. (In re The Ground Round, Inc.),* 482 F.3d 15 (1st Cir. 2007); *Am. Bankers. Ins. Co. of Fla. v. Maness,* 101 F.3d 358 (4th Cir. 1996); *N.S. Garrott & Sons v. Union Planters Nat'l Bank of Memphis (In re N.S. Garrott & Sons),* 772 F.2d 462 (8th Cir. 1985).

5. Wellness also argued that the decision conflicts with *Longo v. McLaren (In re McLaren),* 3 F.3d 958 (6th Cir. 1993), where the court held that a debtor who voluntarily files for relief submits himself to the equitable jurisdiction of the bankruptcy court and consents to proceed without a trial by jury.

6. Regarding consent, *Stern* dealt only with the question of consent given by a party other than the debtor. Here, Sharif both expressly consented to the bankruptcy court's adjudication of the alter ego claim by voluntarily filing for relief and impliedly consented by his conduct.

D. The petition for certiorari was granted on July 1, 2014.

E. Amicus Briefs.

1. The American College of Bankruptcy.

(a) Citing *Northern Pipeline,* Wellness's alter ego claim is part of the "restructuring of debtor-creditor relations, which is at the core of federal bankruptcy power."

(b) In section 541 actions, the bankruptcy court exercises *in rem* jurisdiction over all property of the estate and adjudicates the competing claims of the debtor and the creditor to that property. The issue here is different from the common-law breach of contract suit against a third party in *Northern Pipeline* or the common-law tort counterclaim in *Stern.*

(c) The Court does not have to reach the issue of consent, but if it does, consent of the parties allows the bankruptcy court to exercise Article III power to adjudicate private rights, the same as a magistrate judge.

(d) The Federal Rules of Bankruptcy Procedure require the consent to be express.

2. The American Bar Association.

(a) Article III permits bankruptcy courts to hear and decide *Stern* claims with the consent of the party.

(b) Magistrate judges hear a "staggering volume" of cases. To require district courts to hear *Stern* claims *de novo* would burden the courts and cause delay in all other cases.

3. The United States.

(a) The bankruptcy court may decide matters that stem from the bankruptcy itself and which are integral to the restructuring of the debtor-creditor relationship.

(b) The Seventh Circuit's affirming the denial of discharge for concealing property of the estate is premised on a determination that the assets were property of the estate, which duplicates the premises of Wellness' alter ego claim.

(c) Determining what constitutes property of the estate is an *in rem* issue not reserved to Article III judges. The alter ego claim did not augment the estate, but merely established what property was available to creditors.

(d) In a bankruptcy proceeding, a right to a final adjudication by an Article III judge is a waivable personal interest.

(e) Consent to bankruptcy judge adjudication can be inferred from litigation conduct.

4. The Florida Bar Association.

(a) Consent is sufficient to confer authority on the bankruptcy court to adjudicate *Stern* claims.

(b) If the Court were to rule that parties cannot consent to permit bankruptcy courts to hear and decide *Stern* claims, all parties would seek district court adjudication and thereby overburden the district courts.

5. The National Association of Bankruptcy Trustees.

(a) Necessarily implied in objections to discharge under § 727 is the authority to determine property of the debtor and property of the estate. These issues "stem from the bankruptcy itself."

(b) Determinations of what constitutes property of the estate permeates the Code, including sections 362 (automatic stay); 364 (financing); 363 (use of property); 502 (allowance and disallowance of claims); 522 (exemptions); 542 (turnover); 544, 547, 548, 550 (avoidance actions); and 554 (abandonment).

(c) Adopts the petitioner's arguments regarding consent.

6. G. Eric Brunstad.

(a) The Seventh Circuit improperly extends *Stern* to matters which "stem from the bankruptcy itself."

(b) Litigants should be able to consent to the exercise of the judicial authority of the United States by bankruptcy courts.

(c) Constitutionally permissible consent may be implied.

(d) The sweep of the decision undermines the Court's insistence that *Stern's* holding was narrow.

VI. *Baker Botts, L.L.P. v. Asarco LLC(In re Asarco, L.L.C.)*, 751 F.3d 291 (5th Cir. 2014).

A. Facts.

1. Baker Botts and the Jordan Hyden firm represented ASARCO, a copper mining, smelting, and refining company beset by tax, environmental, toxic-tort, and cash-flow deficiency issues which precipitated a Chapter 11 filing in 2005.

2. Two years before the bankruptcy, ASARCO's parent, American Mining Corporation, directed the debtor to sell its crown jewel, Southern Copper Corporation, to the parent.

3. During the course of the Chapter 11, Baker Botts prosecuted a successful fraudulent transfer claim against the parent which resulted in a judgment of between $7 and $10 billion, perhaps the largest unreversed actual damage award in U.S. history.

4. Based upon the award, the debtor reorganized and solved its financial issues, confirming a plan which paid $3.56 billion of creditor claims in full.

5. Baker Botts requested a fee enhancement along with its core fees.

6. The parent objected to the fee request and in the course of the objection forced Baker Botts to produce *every* document Baker Botts received or sent during the 52-month bankruptcy, constituting six million pages.

7. After a six-day trial, the bankruptcy court awarded Baker Botts its core fees, a $4.1 million fee enhancement, and $5 million for fees incurred in successfully defending its fee application, concluding that the defense of fees was necessary to the administration of the case, beneficial to the estate, and necessary to prevent dilution of Baker Bott's core fees.

8. The parent appealed, objecting only to the fee enhancement and the fee defense award.

9. The U.S. Trustee did not object.

10. The district court affirmed the fee awards, calling the Chapter 11 the most successful in the history of the Code. The parent appealed.

B. The Fifth Circuit Opinion.

1. The court affirmed the fee enhancement award.

2. Regarding the award for the defense of fees, the court said that section 330(a)(4)(A)(ii) requires that to be allowable the fees must benefit the debtor's estate or be necessary to case administration.

3. The primary beneficiary of the defense award is the professional and not the estate, relying on *Grant v. George Schumann Tire & Battery Co.*, 908 F.2d 874 (11th Cir. 1990), which the court found factually similar.

4. Section 330(a)(6), which specifically allows fees to be charged for preparation of a fee application does not apply to the costs incurred defending the application.

5. The court noted that the Ninth Circuit in *In re Smith*, 317 F.3d 918 (9th Cir. 2002), found that, because resolving fee disputes was necessary to close the case, it was a necessary aspect of estate administration and awarded defense cost. However, the Fifth Circuit indicated that as between *Smith* and *Grant*, the result in *Grant* was closer to the statute's plain meaning.

6. The Court also rejected Baker Botts' argument that the defense-of-fee award was similar to federal fee shifting where counsel's time litigating a fee award is compensable. Federal fee shifting statutes, said the court, were created to give financially disadvantaged plaintiffs legal redress and were a specific exception to the American Rule requiring each litigant to pay its own fees.

7. Bankruptcy, the court found, is different. In bankruptcy, almost everyone loses something, and the cost required to defend a fee application is a cost of doing business.

8. Nor was the court persuaded by the argument that disallowing fees for defense unfairly dilutes a bankruptcy attorney's core fees, making them not comparable to fees of attorneys in non-bankruptcy cases, contrary to what Congress intended in enacting section 330(a)(4).

9. The court suggested that fees for bankruptcy attorneys have risen faster than for lawyers in other disciplines. Additionally, the $5 million defense-of-fee award was only 4.4% of the core fees. Whether this percentage is comparable to fees for lawyers in other types of legal practice is in the eye of the beholder.

10. Because (a) the American Rule applies without other statutory authority, (b) the Code contains no statutory provision for the payment of defense awards and (c) section 330 cannot be fairly read to include defense awards either as necessary to estate administration or to prevent dilution of counsel's core fees, counsel should not be able to recover them

C. Baker Botts' Petition for Certiorari.

1. Baker Botts noted the circuit split created by this case and the Ninth Circuit's *Smith* decision, where the costs of successful defense of fee objections were awarded.

2. The Eleventh Circuit in *Grant* dealt with a situation in which only a small portion of the core fees was allowed, and the court chastised the attorney and the trustee for abuses. This was clearly not a factually similar situation, as the Fifth Circuit suggests.

3. Baker Botts argued that one-third of U.S. bankruptcy courts have considered the issue, and many have exercised discretion to award successful defense costs. Where they have not, it was a matter of discretion, not legal preclusion.

4. Section 330(a) includes the authority to award successful defense costs, and section 330(a)(4) only enumerates what *cannot* be compensated.

5. Defense costs are necessary to case administration because approval of fees is necessary to a case's completion and is therefore an indivisible part of the fee administration process mandated by Congress.

6. Fee application preparation and defense are indistinguishable. There is no functional distinction between application preparation and defense, and both are equally beneficial to the estate as both contribute equally to

the accurate allocation of payments. Moreover, both are necessary to close a case.

7. The consequential dilution of core fees caused by refusing to allow successful defense costs thwarts Congress's intention that fees in bankruptcy be comparable to fees in other disciplines.

8. While the effect of disallowance was 4.4% here, the effect can be much greater in smaller bankruptcy cases.

D. The petition for certiorari was granted on October 2, 2014.

E. Amicus Briefs (briefing is not yet completed).

1. The Business Law Section of the Florida Bar.

(a) Fees incurred in litigating fee applications fit comfortably within section 330(a)'s zone of discretion. Bankruptcy cases cannot be closed until fee disputes are resolved, making them necessary to the administration of or beneficial towards the completion of the case.

(b) The Fifth Circuit's position is the minority view, and, although the court acknowledged that litigating fee applications is a necessary part of case administration, it singled out the cost of defense as never being necessary to the administration of or beneficial towards the completion of the case.

(c) The Fifth Circuit misread section 330(a)(6), which allows fees for preparation of fee applications, as precluding awards for defense of those applications.

(d) The Eleventh Circuit in *Grant* affirmed the lower court's exercise of discretion over fees, rather than denying the existence of discretion to allow them.

(e) Uncompensated fee litigation which dilutes compensation will diminish the quality of the bankruptcy bar or lead to inflated rates for bankruptcy work, or both.

2. State Bar of Texas Bankruptcy Section.

(a) Does not take a position on the merits but argues that the circuit split creates uncertainty and geographic disparity regarding attorney fee arrangements.