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34th Annual Advanced Bankruptcy Seminar: “Bankruptcy Unredacted”

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34th Annual Advanced Bankruptcy Seminar: “Bankruptcy Unredacted”

Cosponsored by the OBA Bankruptcy and Reorganization
Section

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Speaker Biographies

BRIAN HUCKABEE

Brian Huckabee is a Tulsa, Oklahoma, attorney with a practice concentrated in bankruptcy and business law. He has handled thousands of business, tax and consumer bankruptcy cases in the past three decades, consisting primarily of chapter 7 and 13 cases, but also including numerous chapter 11 business reorganizations and chapter 12 farm bankruptcies. He represents debtors but has credit union and creditor clients. He serves as an Adjunct Settlement Judge in the United States Bankruptcy Court for the Northern District of Oklahoma. He is a member of the Board of Governors of the Bankruptcy and Reorganization Section of the Oklahoma Bar Association. He is a frequent speaker at continuing legal education events. He is licensed in all of Oklahoma's federal judicial districts, but he concentrates in the Northern and Eastern Districts. He is a member of the Bankruptcy Section of the Tulsa County Bar Association. He received a Bachelor of Arts degree with Honors from Oklahoma State University in 1978 and a Juris Doctorate degree from University of Oklahoma in 1981. He has been married for 37 years. He has two grown children. He attends Harvard Avenue Christian Church in Tulsa.

SIDNEY K. SWINSON

Sidney K. Swinson is a shareholder in the Tulsa office of GABLEGOTWALS. He received a Bachelor of Business Administration degree in 1977 from the University of Notre Dame and a Juris Doctor in 1980 from the University of Tulsa College of Law. His practice has emphasis in the areas of bankruptcy, business reorganization and commercial litigation.

Mr. Swinson is a member of the Oklahoma Bar Association, a recipient of the OBA Courageous Lawyer Award in 1998, the recipient of the John E. Shipp Award for Ethics in 2009, and a director and former chair of the OBA Bankruptcy and Reorganization Section. He served on the OBA Professional Responsibility Tribunal and served as Chief Master from 2005 until 2007 and currently serves on the OBA Professional Responsibility Commission. Additionally, Mr. Swinson is a member of the American Bar Association, the American Bankruptcy Institute and the National Association of Bankruptcy Trustees. Since 2013 Mr. Swinson has been outside General Counsel for the Roman Catholic Diocese of Tulsa and Eastern Oklahoma.

From 1993 to 2015 Mr. Swinson was an adjunct professor of law at the University of Tulsa College of Law, and has served as bankruptcy trustee since 1986 for the United States Bankruptcy Courts for the Northern and Eastern Districts of Oklahoma. Since 2006 he has been a Fellow of the American College of Bankruptcy. Mr. Swinson is a frequent speaker at CLE programs.

SAM G. BRATTON II

Sam G. Bratton is a graduate of the University of New Mexico with degrees in Business Administration and Law. He is a partner with the Oklahoma law firm of Doerner, Saunders, Daniel & Anderson, L.L.P., specializing in creditors' rights, workouts, financial planning and bankruptcy reorganizations. He is listed as a bankruptcy expert in the *Best Lawyers in America* (2013 Lawyer of the Year for Bankruptcy, Debtor/Creditor Rights, Insolvency and Reorganization Law) and is listed in *Who's Who in American Law*. He was also selected as one of Tulsa's Best Lawyers by *Tulsa People* magazine, and as one of Oklahoma's Best Lawyers by *American Registry*. Mr. Bratton is co-author of Basic Bankruptcy in Oklahoma, National Business Institute, 1987, Oklahoma Collection Law for Creditors, Professional Education Systems, Inc., 1988, Protection of Secured Interests in Bankruptcy in Oklahoma, National Business Institute, 1991, Aligning Your Practice With The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, National Business Institute, and Principal Changes To The Bankruptcy Code Enacted by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Oklahoma Bar Association. Prior to his practice of law, Mr. Bratton was a management training officer with Security Pacific National Bank in Los Angeles. He is former chair of the Advisory Committee on Local Rules of Procedure of the Bankruptcy Court for the Northern District of Oklahoma and is a director and past Chair of the Bankruptcy and Reorganization Section of the Oklahoma Bar Association. Mr. Bratton also serves as an Adjunct Settlement Judge for the United States Bankruptcy Court for the Northern District of Oklahoma, and previously served as a Special Judge of the Oklahoma Court of Appeals, Temporary Division. Mr. Bratton is a member of the American Bar Association, the American Bankruptcy Institute, and the Commercial Law League of America.

Rebecca Garcia is the Standing Chapter 12 & 13 Trustee in Oshkosh, Wisconsin. She was appointed on December 1, 2014 as the Standing Chapter 13 Trustee and April 1, 2016 as the Standing Chapter 12 Trustee. Prior to her appointment she was a staff attorney for the Chapter 13 Trustee in Milwaukee. Ms. Garcia is a past member of the board of the Bankruptcy, Insolvency and Creditors Rights Section of the State Bar of Wisconsin and a member of the National Association of Chapter 13 Trustees, and the Association of Chapter 12 Trustees where she currently serves as vice-president.. She received her J.D. from Marquette University in 1996. She grew up on a dairy farm in Northwest Wisconsin and is a proud 4-H alumni.

WILLIAM E. WALLO

William E. Wallo is an attorney with Weld Riley, S.C. in Eau Claire, Wisconsin. His areas of practice include business transactions, debtor/creditor rights, insolvency, bankruptcy, restructuring, and commercial litigation. He graduated with highest honors from the University of Oklahoma College of Law in 1992 and practiced in Oklahoma City before moving to Wisconsin, where he became the career law clerk to the Honorable Thomas S. Utschig, U.S. Bankruptcy Judge for the Western District of Wisconsin. He joined Weld Riley following Judge Utschig's retirement. He is the current chair of the Bankruptcy, Insolvency, and Creditor Rights Section of the Wisconsin State Bar and is a frequent speaker on commercial law and bankruptcy-related issues.

Susan M. Freeman
Lewis Roca Rothgerber Christie LLP
SFreeman@LRRC.com

Susan M. Freeman is a partner at Lewis Roca Rothgerber Christie LLP, working primarily from its Phoenix, Arizona office. She graduated from New York University School of Law in 1975 as a Root-Tilden Scholar, and holds a B.A. from Mount Holyoke College, with distinction.

Ms. Freeman is a member of the National Bankruptcy Conference. She is a Fellow and former Director, Vice-President and Secretary of the American College of Bankruptcy. She is the Chair of the American Bar Association Business Bankruptcy Committee, and previously chaired several Subcommittees. She is a Life Member of the American Law Institute. Ms. Freeman has been a certified specialist in bankruptcy law since 1985. She is a frequent author and lecturer, including authoring Chapter 172 of *NORTON BANKRUPTCY LAW & PRACTICE* on Professional Responsibility in Bankruptcy Cases and *Are DIP and Committee Counsel Fiduciaries for Their Clients' Constituents or the Bankruptcy Estate? What is a Fiduciary, Anyway?* 17 Amer. Bankr. Inst. L. Rev. 291 (Winter 2009).

In addition to her business bankruptcy law practice, Ms. Freeman is an appellate lawyer, and has briefed over 300 civil appeals and argued over 100, many of which are bankruptcy appeals, including a U.S. Supreme Court appeal. She is a Fellow and former President of the American Academy of Appellate Lawyers, and is the co-author of the civil appeals chapter of the *ARIZONA APPELLATE HANDBOOK*. She was co-counsel for several law professors on *amicus curiae* briefs in *Tennessee Student Assistance Corp. v. Hood*, 541 U.S. 440 (2004) and *Central Virginia Community College v. Katz*, 126 S. Ct. 990, 1004 (2006), and she briefed and argued *Hall v. United States of America*, 132 S. Ct. 1882 (2012).



John M. Hickey

Shareholder

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John Hickey handles litigation matters ranging from commercial litigation and construction law disputes to bankruptcy, labor and employment, and real estate litigation. His experience encompasses both federal and state courts in cases involving complex, multi-state commercial lawsuits and bankruptcy proceedings, as well as employment discrimination litigation and complex construction arbitrations.

An experienced 30 year attorney, John serves as the lead shareholder for the Cannabis Law practice. Licensed in Oregon and Oklahoma, John has been working with clients for a number of years in the Cannabis Law area. From walking clients through the license application process to preparing agreements, John is knowledgeable in all aspects of the cannabis business.

In addition, John has been named an Oklahoma Super Lawyer in Construction Litigation and has an AV peer rating through Martindale-Hubbell.

Education

- University of Indiana (B.A., 1978)
- University of Tulsa College of Law (J.D., 1985)

Admissions

- Oklahoma, 1985
- Oregon, 2016
- U.S. District Court for the Eastern, Northern and Western Districts of Oklahoma
- U.S. District Court for the District of Oregon
- U.S. Tax Court
- U.S. Court of Federal Claims

- United States Supreme Court

Practices

- Cannabis Law
- Bankruptcy, Restructuring & Creditor's Rights
- Complex Commercial Issues
- Construction
- Litigation
- Real Estate
- Alternative Dispute Resolution (ADR)
- Ventures Growth

Honors & Awards



Legal Experience

- 2013-Present Hall Estill
- 2009-2013 Riggs Abney
- 1991-2009 Barber & Bartz
- 1988-1991 Assistant General Counsel, Thrifty Rent-A-Car System
- 1984-1988 Stainer & Stainer

Community Involvement

- YMCA, Member, Board of Directors
- Oktoberfest, Member, Board of Trustees
- Family Safety Center, Member, Board of Directors
- Tulsa Area United Way, member, Community Investment Panel
- Tulsa Rugby Club, coach
- Member, Leadership Tulsa Class XXVI
- Former Member, Advisory Board, Leadership Oklahoma

Professional Involvement

- Member, American Arbitration Association Roster of Neutrals
- Oklahoma Bar Association
- Tulsa County Bar Association

- Oregon Bar Association

Reported Cases

- 2015 OK Civ App 25, Capital One Bank, Plaintiff/Appellee v. Jennifer Sullivan, Defendant, McNellie's, LLC, Garnishee/Appellant, Case No. 111,989. February 19, 2015

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In the News

- Legal experts evolving in an age of decriminalized marijuana - Attorney John Hickey interviewed
- John Hickey and Courtney Kelley co-author Medical Marijuana article
- Hall Estill Attorney John Hickey successfully represents Garth Brooks - Jury awards \$1 million in lawsuit against Integris

Events & Presentations

- Hall Estill to present at Denver Startup Week - Cannabis & Intellectual Property: Strange Genetics
- Cannabis Attorney John Hickey featured at NASCUS Cannabis Banking Symposium in Los Angeles
- John Hickey speaking at 2019 Cannabis Expo in Tulsa

THE HONORABLE TERRENCE L. MICHAEL

Northern District of Oklahoma and a member of the Bankruptcy Appellate Panel of the Tenth Circuit. A native of Columbus, Nebraska, he received his Bachelor of Arts degree in history, magna cum laude, from Doane College in Crete, Nebraska in 1980 and his Juris Doctorate degree in 1983 from the University of Southern California's Gould School of Law. He is the author of over 100 published opinions and has authored or co-authored articles in the American Bankruptcy Law Journal (pending publication), Tulsa Law Review, Texas Tech Law Review, and Creighton Law Review. Judge Michael is an Adjunct Professor of Law at the University of Tulsa and has served as a speaker at seminars presented by the Federal Judicial Center, National Conference of Bankruptcy Judges, Judicial Conferences of the Eighth and Tenth Circuits, American Bankruptcy Institute, Nebraska State Bar Association, Oklahoma Bar Association, Tulsa County Bar Association, West Texas Bar Association, and Southwest Regional Turnaround Management Association.

Judge Michael's interests outside of the law include music, acting and golf. Since coming to Tulsa, he has appeared in numerous local theater productions, playing characters ranging from a murderous doctor (Cards on the Table), the bumbling director of an insane asylum (Dracula! The Musical), Linus Van Pelt (You're a Good Man, Charlie Brown), and John Adams (1776!). Terry was part of a multi-state select choir which sang in Carnegie Hall in 1996. He recorded his first studio album, The Bucket List, in 2018.

JANICE D. LOYD

Chief Bankruptcy Judge
Western District of Oklahoma

On December 12, 2014, Janice D. Loyd was sworn in as a bankruptcy Judge for the Western District of Oklahoma. Prior to her swearing in, Judge Loyd was an officer, director and shareholder with the Oklahoma City law firm of Bellingham & Loyd, P.C. She received a Bachelor of Arts degree in Political Science in 1983 from the University of Oklahoma and earned her Juris Doctorate degree in 1986 from the University of Oklahoma, College of Law. Prior to taking the bench, Judge Loyd's practice emphasized the areas of bankruptcy, reorganization and commercial litigation. She was a member of the Chapter 7 Trustee Panel for the United States Bankruptcy Court for the Western District of Oklahoma for 22 years, handling over 20,000 cases.

Judge Loyd is a member of the Oklahoma County Bar Association, the Oklahoma Bar Association, the Federal Bar Association, the American Bankruptcy Institute and is a Fellow of the Oklahoma Bar Foundation. She has served as the Chairman of the Bankruptcy Section of the Oklahoma County Bar Association and is a member of the Board of Directors for the Bankruptcy and Reorganization Section of the Oklahoma Bar Association. She has also served on the Mediation Advisory Board Committee and is a Permanent Member of the Standing Local Rules Committee for the United States Bankruptcy Court for the Western District of Oklahoma. In addition to the Oklahoma Bar, she has been admitted to practice before the United States District Court for the Western, Eastern and Northern Districts as well as the United States 10th Circuit Court of Appeals.

In 2006, Judge Loyd received the Oklahoma Bar Association Award for Outstanding Pro Bono Service and is a two time recipient of the Mona Salyer Lambird Service to Children Award for services provided as a volunteer for "Lawyers for Children".

THE HONORABLE SARAH HALL

Western District of Oklahoma and currently serves as Chief Bankruptcy Judge. On January 7, 2015, Judge Hall was appointed to a five-year term on the Tenth Circuit Bankruptcy Appellate Panel. She is a 1986 graduate of the University of Oklahoma with a bachelor's degree in Business Administration (with special distinction) in Finance and received her J.D. from the University of Oklahoma College of Law in 1989 (with highest honors). She was a member of Order of the Coif.

Her legal career began with Mock, Schwabe Waldo, Elder, Reeves & Bryant, a Professional Limited Liability Company, in Oklahoma City, Oklahoma, where she practiced law from 1989 until her appointment. Her practice primarily involved business litigation, bankruptcy and insolvency, debtor/creditor relations, commercial law, insurance insolvency and employment litigation.

Judge Hall served as an associate bar examiner for the Oklahoma Bar Association from 1996 to 2010. She is a member of the Oklahoma Bar Association (Bankruptcy and Reorganization Section, President 2014) and the Oklahoma County Bar Association (Bankruptcy Section, President 1997 - 1998). Judge Hall is also a member of the National Conference of Bankruptcy Judges, the American Bankruptcy Institute and the Federal Bar Association. She currently serves on the boards of the Historical Society for the United States District Court for the Western District of Oklahoma, the Western District of Oklahoma chapter of the Federal Bar Association and the Bankruptcy and Reorganization Section of the Oklahoma Bar Association. She also serves on the Board of Visitors of the Honors College at the University of Oklahoma. In 2011, Judge Hall was named a 2011 Journal Record 50 Women Making a Difference in Oklahoma. In October 2019, Judge Hall was appointed by Chief Justice Roberts to the Committee on the Administration of the Bankruptcy System of the Judicial Conference of the United States for a three-year term.

HONORABLE DANA L. RASURE

Judge Rasure was inducted as a bankruptcy judge for the Northern District of Oklahoma in 1997. She received a Bachelor of Arts degree in Economics, *summa cum laude*, from Washburn University in 1973, and a Juris Doctor degree from the University of Michigan School of Law in 1977.

Judge Rasure served as a member of the Judicial Conference Committee on Judicial Security and was the Tenth Circuit representative on the Bankruptcy Judges Advisory Group of the Administrative Office of United States Courts. She is currently a member of the American Bankruptcy Institute, the Oklahoma Bar Association and the Tulsa County Bar Association.

Judge Rasure has been honored by the Oklahoma Bar Association with its Judicial Excellence Award and by the Tulsa County Bar Association with the Presidential Award, the Golden Rule Award for Professionalism, and the Outstanding Senior Lawyer Award.

TOM R. CORNISH
United States Bankruptcy Judge
Eastern District of Oklahoma

Judge Tom R. Cornish was appointed as United States Bankruptcy Judge for the Eastern District of Oklahoma on February 8, 1994. He was reappointed to this position on February 8, 2008. In addition to his duties as bankruptcy judge, Judge Cornish sits on the Bankruptcy Appellate Panel for the Tenth Circuit Court of Appeals, and served as its Chief Judge. This court reviews a majority of all appeals from eight bankruptcy courts in the six states that comprise the Tenth Circuit. He has served on that Panel since its inception in 1996. He also serves as a mediator in each of Oklahoma's three federal judicial districts.

Judge Cornish is a third-generation Oklahoma lawyer. His grandfather, Melven Cornish, moved to McAlester, Oklahoma, as a young lawyer prior to Oklahoma's statehood. His father, William Cornish, practiced law in McAlester, Oklahoma. Judge Cornish is one of five children. After his father's death, he and his siblings were raised by their single mother. Two of Judge Cornish's brothers are attorneys: Richard Cornish, retired U.S. Magistrate Judge for the Eastern District of Oklahoma, and Fred Cornish, an attorney in Tulsa, Oklahoma.

Judge Cornish received his undergraduate degree from Oklahoma State University, his Juris Doctor degree from the University of Oklahoma College of Law, and his Master of Laws degree from the University of Virginia.

Prior to his appointment as Bankruptcy Judge, Judge Cornish served on the Oklahoma Court of Criminal Appeals from October 1977 until February 1984. He served as presiding judge of that Court from 1979 to 1981. The Court is a court of last resort for criminal cases in Oklahoma. Judge Cornish was the youngest judge ever appointed to a court of last resort in Oklahoma. He also has experience as a lawyer in private practice, having been a member of law firms in McAlester, Oklahoma, and Oklahoma City, Oklahoma. In private practice, Judge Cornish was primarily engaged in civil litigation in state and federal courts, with extensive arbitration and mediation experience for private corporations. As a Bankruptcy Judge, he has successfully incorporated his skills in mediation and arbitration, proving to be an innovative and practical judge, who treats all those who appear before him with compassion and respect.

In addition to his work as a Bankruptcy Judge and a Tenth Circuit Court of Appeals Bankruptcy Appellate Panel Judge, Judge Cornish has served on the Board of Governors of the National Conference of Bankruptcy Judges, and on its committee's on International Relations, Elections, and Site Selection. Judge Cornish attended the Sir Richard May Seminar on International Law and International Courts in The Hague, Netherlands. He was nominated and selected to attend this Seminar on the basis of his extensive experience in international relations, as well as the diversity of his experience as a judge and private attorney.

Judge Cornish has served as a leader in a variety of committees and organizations, including the Oklahoma Court on the Judiciary, Chairman of the Governor's Commission on Reform of State Government in Oklahoma, Chairman of the Oklahoma Development Finance Authority, the Juvenile Delinquency Committee of the Oklahoma Crime Commission, the Board of Governors of

the Oklahoma Bar Association, the Board of Directors and Board of Trustees of St. Gregory's University, Shawnee, Oklahoma.

Judge Cornish has traveled extensively. He has visited all seven continents of the world. He has participated in numerous events as a host of foreign judges. He has traveled with a delegation of judges and lawyers to the Soviet Union to observe its legal system. His court also assisted the District Court when it hosted a delegation of Russian judges who were observing U.S. court operations. During many of his international trips, he visits various courthouses and observes foreign legal proceedings.

34th ANNUAL ADVANCED BANKRUPTCY SEMINAR
BANKRUPTCY LAW UPDATE

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BANKRUPTCY LAW UPDATE

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34TH ANNUAL ADVANCED BANKRUPTCY SEMINAR BANKRUPTCY LAW UPDATE

U.S. SUPREME COURT

1. *Mission Product Holdings, Inc. v. Tempnology, LLC*, 139 S. Ct. 1652 (May 20, 2019)

Headnote: Rejection by debtor-licensor of trademark licensing agreement

Facts: Licensor, as Debtor in Possession, filed a motion to reject, as an executory contract, a trademark licensing agreement with its licensee, which the bankruptcy court granted. Because the parties disagreed whether the rejection of the trademark licensing agreement terminated the licensee's rights under the contract, the DIP sought a declaratory judgment on the issue. By negative inference, since the Bankruptcy Code does not expressly address the effect of the rejection of a trademark licensing agreement as it does with other executory contracts, such as license agreements under Section 365(n), the bankruptcy court held that the trademark licensee's rights were terminated by rejection. The BAP reversed because the rejection of an executory contract constitutes a breach, and a breach does not eliminate the rights of the non-breaching party. On appeal, the 1st Circuit reversed, and reinstated the bankruptcy court's decision.

Issue: Does the debtor-licensor's rejection of an executory trademark licensing agreement terminate the rights of the non-breaching party.

Holding: No. A rejection of an executory contract in bankruptcy has the same effect as breach outside bankruptcy, and does not terminate the rights of the non-breaching party previously granted, such as a trademark license. Section 365(n), for instance, was enacted to legislatively overrule an erroneous decision, *Lubrizol Enterprises v. Richmond Metal Finishers*, 756 F. 2d 1043 (4th Cir. 1985), not to create an exclusive example of when a non-breaching party may retain the benefits of a contract following a breach by the counterparty. No negative inference arises by the failure of Congress to include a provision in the Bankruptcy Code dealing with the effect of rejection of a trademark licensing agreement.

2. *Taggart v. Lorenzen*, 139 S. Ct. 1795, 204 L. Ed. 2d 129 (June 3, 2019)

Headnote: A bankruptcy court may hold a creditor in contempt of the discharge order if there is no fair ground of doubt as to whether the order barred the creditor's conduct.

Facts: Taggart owned an interest in an LLC for a commercial development in Oregon. The LLC and the two other members sued Taggart for breaching the operating agreement. Before trial Taggart filed chapter 7. After Taggart received his discharge, the state court entered judgment against Taggart. The judgment creditors then filed an application in state court for

their attorney fees incurred after Taggart filed bankruptcy, and were awarded \$45,000 in attorney fees. Taggart then asked the bankruptcy court to bar the creditors from attempting to collect the judgment as a violation of the discharge, but the bankruptcy court refused to do so, agreeing with the state court that Taggart had “returned to the fray.” Taggart then appealed to the federal district court which reversed and remanded because Taggart had not returned to the fray. The bankruptcy court then held the creditors in contempt, applying a strict liability standard (if creditor was aware of the discharge and intended the action), and awarded Taggart \$105,000 in attorney fees and costs, \$5,000 for emotional distress, and \$2,000 in punitive damages. The creditors appealed, this time to the BAP, which vacated the sanctions, and the 9th Circuit affirmed the BAP, applying a subjective standard: “a creditor’s good faith belief that the discharge order does not apply to the creditor’s claim precludes a finding of contempt, even if the creditor’s belief is unreasonable.” The Supreme Court vacated the judgment and remanded the case.

Issue: What is the standard for determining when a creditor has violated a court order such as a discharge injunction?

Holding: “Courts have long imposed civil contempt sanctions to ‘coerce the defendant into compliance’ with an injunction or ‘compensate the complainant for losses’ stemming from the defendant’s noncompliance with an injunction.” *United States v. United Mine Workers*, 330 U.S. 258, 303-304 (1947). A discharge order is an injunction. Section 524. A bankruptcy court has power in Section 105 “to issue any order or judgment that is necessary or appropriate to carry out the other bankruptcy provisions.” In civil cases outside the bankruptcy context, the Supreme Court has held that civil contempt “should not be resorted to where there is a fair ground of doubt as to the wrongfulness of the defendant’s conduct.” *California Artificial Stone Paving, Co. v. Molitor*, 113 U.S. 609 (1885). This is generally an objective standard; a party’s subjective belief will not insulate one from civil contempt if that belief is objectively unreasonable. A party’s good faith, however, may help determine the appropriate sanction. These standards “apply straightforwardly to the bankruptcy discharge concept.” The subjective standard relies too heavily on the difficult to prove state of mind; unnecessarily insulates creditors from liability who stand on shaky ground, and forces debtors back to bankruptcy court seeking relief. The strict liability standard ignores subjective good faith, but may force creditors back to bankruptcy court for advance determinations (comfort orders)

Note: The Court expressly stated that its holding does not apply in the automatic stay context, probably because the Bankruptcy Code contains statutory remedies for violation of the automatic stay.

CERT GRANTED

3. *Ritzen Group, Inc. v. Jackson Masonry, LLC*, S. Ct. No. 18-938

Issue: Whether an order denying stay relief is a final, immediately appealable order under 28 U.S.C. § 158(a)(1).

Status: The *Ritzen Group* case was argued on November 13, 2019 and is submitted for decision.

THIRD CIRCUIT COURT OF APPEALS

4. *In re Joy Denby-Peterson*, 941 F. 3d 115 (3rd Cir., 2019)

Headnote: It is not a violation of the automatic stay for refusing to surrender the collateral to the debtor.

Facts: In July 2016, the debtor bought a 2008 Chevrolet Corvette on credit for \$3,000 down, \$2,491 deferred down payment (for sales tax, registration fee and license plate) due August 11, 2016, and weekly installments of \$200 for 212 weeks (\$42,400 total). The contract was assigned to NU2U Auto World, an affiliate of the seller. Between July 2016 and February 2017, the debtor paid \$9,200. The vehicle was repossessed in February or March 2017 (the parties could not agree when). The debtor filed chapter 13 bankruptcy on March 21, 2017, and through her attorney, demanded return of the vehicle and threatened to seek damages, costs and attorney fees for violating the automatic stay. The creditor refused. The Debtor filed a motion for turnover and a request for sanctions. The bankruptcy court ordered turnover but denied the request for sanctions because there was no stay violation. The debtor appealed to the District Court which affirmed. Appeal was then taken to the Circuit.

Issue: Whether a creditor violates the automatic stay (exercising control over property of the estate) by refusing to turnover collateral repossessed from the debtor prior to the debtor's chapter 13 bankruptcy filing.

Holding: No. Adopting the minority view of the 10th and DC Circuits, the 3rd Circuit held that a secured creditor need not return collateral until a court order is entered to do so. There is no stay violation by merely retaining possession after the bankruptcy filing. Under the majority view of the 2d, 7th, 8th, 9th and 11th Circuits, upon learning of a bankruptcy filing, the creditor must return the collateral. Section 363(c)(3) of the automatic stay covers “**any act** to obtain possession of property of the estate **or to exercise control** over property of the estate.” The word “exercise” is a verb; the word “control” is noun. The statutory language is prospective in nature--the *exercise* of control is not stayed but the *act to exercise* control is stayed. Section 363(a)(3) requires a post-petition affirmative act to exercise control. *See In re Cowen*, 849 F.3d 943 (10th Cir. 2017). Section 363(c)(3) need not be read in conjunction with the turnover provision--Section 542(a): Section 542(a) is not self-executing; an adversary

proceeding must be initiated under Rule 7001; defenses are available to the creditor (the collateral must be property that the debtor may use; property must be claimed as exempt, in control of creditor; and not of inconsequential value or benefit to the estate; the onus should not be placed on the creditor to obtain a court order (creditor entitled to adequate protection; and there is no textual link between Sections 362 and 542.

Note: Certiorari has been requested in *City of Chicago v. Fulton*, 926 F.3d 916 (7th Cir. 2019) to hopefully resolve the split in the circuits.

TENTH CIRCUIT COURT OF APPEALS

5. ***Austin Fox Jennings v. Randy L. Royal***, 739 Fed.Appx. 505 (10th Cir., September 14, 2018) (*In re: Jennings*)

Facts: The debtor claimed an exemption in certain real property which the Bankruptcy Court only partially allowed. Debtor appealed.

Issue: Among the issues decided were issues relating to raising issues for the first time on appeal.

Holding: The Circuit held that, in addition to the debtor being wrong on the substantive issues of the trustee's standing to act, debtor's arguments designed to create an appellate issue for the first time on appeal were premature and, in any event, had not been preserved below and are therefore not subject to review on appeal. The Circuit definitively confirmed that it would not depart from the general rule that a federal appellate court does not consider an issue not passed upon below. The Circuit confirmed the ruling of the BAP that the issues on appeal were not preserved.

6. ***Lane v. Buckley, et al.***, 755 Fed.Appx. 745 (10th Cir., November 6, 2018)

Headnote: Estoppel based upon a prior inconsistent position taken in a bankruptcy case.

Facts: In his Chapter 7 bankruptcy case, debtor, Lane, sought to recover pension funds, alleged to be exempt, which were loaned to debtor's sister from an entity controlled by the debtor and his family. The trustee sought a turnover of the funds to which the debtor agreed pursuant to a turnover agreement whereby Lane and the funds would be excluded from the bankruptcy estate and would be turned over to the debtor. In the process, the debtor asserted several times that the loan to the sister was valid. The trustee filed an adversary proceeding against the sister, the controlled entity and other related persons and entities to obtain all the funds transferred to them. The parties settled the trustee's turnover complaint by entering into an agreement whereby the proceeds would be returned to the bankruptcy estate. The debtor objected to the turnover agreement contending that the property to be turned over was not property of the bankruptcy estate. The debtor withdrew his objection to the settlement and the trustee agreed that up to \$2.5 million in the proceeds and other assets would be turned over to the debtor. Debtor expected the trustee to provide the \$2.5 million dollars from the bankruptcy estate but the trustee refused arguing among other reasons, that the loan was fraudulent. The

Bankruptcy Court found that the trustee did not owe Lane any further amounts. Ultimately, debtor pled guilty to one count of falsification of records in the bankruptcy case. About five months after the Bankruptcy Court denied debtor's request to compel the trustee to turn over the \$2.5 million, debtor filed a complaint in Arizona state court against the sister, the controlled entities and other family members and their attorneys and law firms alleging, among other things, that Patricia had loaned herself the money, and had breached her fiduciary duties, violated the entities' operating agreement and various pension and IRA agreements and that the loan of the money was a fraudulent transfer that should be rescinded because it violated Arizona law and the Internal Revenue Code. The case was removed to federal court. The district court granted summary judgment in favor of the defendants which was appealed to the Circuit, subject to a *de novo* review.

Issue: Estoppel based upon prior inconsistent statements in a bankruptcy case.

Holding: On appeal, the Tenth Circuit ruled that notwithstanding Federal Rule of Evidence 408 requiring the redaction of "any offers of compromise" the Rule did not bar production of information contained in claims made to a bankruptcy court that were more akin to a complaint than an offer of settlement or compromise. The district court concluded that the debtor was estopped by virtue of the several prior assertions before the Bankruptcy Court that the loan was valid. "Litigants are barred from adopting views that are inconsistent with their previous positions in the same or related litigation."

7. ***Layng v. Rael, et al.***, 73 Fed.Appx. 649 (10th Cir., December 7, 2018) (*In re Rael*)

Headnote: Defense of a discharge injunction violation based on good faith belief, on advice of counsel that the offending act was not a violation.

Facts: The debtors obtained confirmation of a Chapter 11 plan which required them to satisfy a debt to Wells Fargo Bank by selling several parcels of real property and making monthly payments to the bank. After confirmation, the debtors voluntarily closed the Chapter 11 case. Subsequently, the debtor's defaulted on their monthly payments and Wells Fargo obtained state court judgments against them and filed liens against the properties. In response, the debtors filed motions to reopen the Chapter 11 case and to hold Wells Fargo in contempt for filing the state court proceedings. In the reopened case, the Bankruptcy Court, at the request of the debtors, entered an order approving a sale of the properties subject to Wells Fargo's liens and requiring the debtors to pay the proceeds of any sales to Wells Fargo. The Court also denied debtor's motions to hold Wells Fargo in contempt for obtaining state court judgments and filing the judgment liens. Debtors appealed to the Tenth Circuit BAP, which affirmed.

While the appeal of the contempt orders was pending, the debtors closed on the sale of one of the properties, but they did not give the proceeds to Wells Fargo as required by the Bankruptcy Court order. Soon thereafter they converted their Chapter 11 case to a Chapter 7 and filed a motion for discharge. The Chapter 7 trustee commenced an adversary proceeding to prevent discharge on the grounds that the debtors violated the sale order by not giving the property sale proceeds to Wells Fargo. Debtors filed a motion to dismiss the trustee's adversary proceeding which was denied by the Bankruptcy Court. Subsequently, a discharge was entered, the Bankruptcy Court finding that, although debtors had violated the sale order, their non-

compliance was not willful because they violated the order in reliance on the advice of their attorney.

On appeal through the District Court, the order granting their discharge was reversed, the District Court concluding that the Bankruptcy Court's ruling that the debtor's violation of the sale order was not willful, was clearly erroneous. In addition, the Bankruptcy Court had awarded attorneys fees against the trustee as a discovery sanction, which was also reversed.

Issue: Reliance on advice of counsel as a defense to a charge of willfully violating the discharge injunction. Denial of discharge for debtor's failure to obey a lawful order of the Court, notwithstanding debtor's good faith belief that the offending act was not in violation of the discharge.

Holding: The trustee's objection to discharge was based upon the debtor's failure to pay the proceeds of the court-ordered sale to Wells Fargo. The debtor defended, stating that his objective belief that he did not have to pay the funds to Wells Fargo was based upon advice of counsel and therefore was not willful.

The Circuit held that a party objecting to a discharge under § 727(s)(6) must demonstrate that "debtor received the (Sale Order) and failed to comply with its terms. Once the objecting party has shown that the debtor received the order and failed to comply, the burden then shifts to the debtor to explain his non-compliance. The Court may not deny a discharge under § 727(a)(6)(A) unless it finds that the debtors' non-compliance was willful. The Circuit found that a party acts "willfully" when he fails to comply with a court order even if he subjectively believes that the order to be invalid. In this case, the Bankruptcy Court found that the trustee had satisfied its burden of showing that the debtors received the Sale Order and failed to comply, but that the debtors did not meet their burden of showing that the violation was not willful because they acted on advice of counsel. The Court found that under certain circumstances, a party's reasonable reliance on the advice of counsel may diffuse otherwise willful conduct. The Court here found that the advice of counsel was received well after the debtors obtained sale proceeds and refused to turn the proceeds over to the bank.

8. ***In re Chernushin***, 911 F. 3d 1265 (10th Cir., 2018)

Headnote: Real estate owned by debtor in joint tenancy as property of the bankruptcy estate.

Facts: Debtor filed chapter 7 bankruptcy owning real estate in joint tenancy with his spouse. The debtor died before the debtor's interest in the real estate could be sold by the trustee. The bankruptcy court held that upon the debtor's death, the real estate passed by operation of law to his spouse and ceased being property of the bankruptcy estate. The District Court affirmed. Appeal was taken to the Tenth Circuit which likewise affirmed.

Issue: Whether real estate owned by a debtor in joint tenancy with his non-debtor spouse remained property of the estate upon the debtor's post-bankruptcy death.

Holding: No. Even though the debtor's interest in the real estate became property of the bankruptcy estate upon the filing of the petition, his bankruptcy filing did not prevent the property from passing to his spouse under Colorado joint tenancy law upon his death.

9. *Lee v. Peeples (In re Peeples)*, 2019 WL 3778361 (10th Cir., 2019)

Headnote: Objection to discharge for failure to preserve business records.

Facts: The debtors, a husband and wife with five young children, defaulted on the payment of rent to a landlord who sued to evict the debtors and obtained a judgment for \$49,000. The debtors had minimal assets, so they, along with their children, moved in with Mrs. Peeples' mother. Mr. Peeples had owned a failed business which sold commemorative coins over the internet. Mr. Peeples claimed to have kept a ledger of assets and liabilities of the business but lost it. The landlord used that as a basis for objecting to the debtors' discharge under Section 727(a)(3) ("fail[ure] to keep or preserve any recorded information, including books, documents, records, and papers, from which the debtor's financial condition or business transactions might be ascertained, unless such act or failure to act was justified under all the circumstances of the case." The bankruptcy court granted the debtors' a discharge because the business was so simple the business transactions could be ascertained from third party records (eBay or PayPal). On appeal, the BAP affirmed.

Issue: May debtors who operated a failed business receive a discharge even though they lost their business records?

Holding: Yes. Quoting *Martinez v. Sears (In re Sears)*, 565 B.R. 184, 189 (10th Cir. BAP), the Tenth Circuit noted: "A prima facie case under § 727(a)(3) requires a showing that a debtor failed to maintain and preserve adequate records and that the failure made it impossible to ascertain his or her financial conditions and material business transactions." If a creditor or trustee meets this initial burden, the burden shifts to the debtor to justify his or her failure to maintain the records." The ultimate burden under § 727 rests with the plaintiff and must be proven by a preponderance of the evidence." By all appearances the bankruptcy court was sympathetic to the destitute debtors who represented themselves pro se in the bankruptcy court, the BAP and the Circuit against the claims of the creditor who was an attorney. The opinion specifically noted that the bankruptcy court found that the creditor was guilty of overreaching because he improperly used requests for admission to get the debtors to admit disputed facts by their failure to respond to the requests for admission. Moreover, the bankruptcy court gave no weight to Mr. Peeples' testimony that it was impossible for the landlord to ascertain the debtors' financial condition without the ledger, by characterizing the testimony as a legal conclusion rather than a statement of fact.

Note: In addressing the standard of review on an appeal from the BAP, the court, quoting *First National Bank of Durango v. Woods (In re Woods)*, 743 F. 3d 689, 692 (10th Cir. 2014) noted: "Although this appeal is from a decision by the BAP, we review only the Bankruptcy

Court's decision. We treat the BAP as a subordinate appellate tribunal whose rulings are not entitled to any deference (although they certainly may be persuasive)."

10. ***The Slovak Republic v. Loveridge, Trustee, et al.*** 755 Fed.Appx. 825 (10th Cir., January 4, 2019), (*In re: EuroGas, Inc.*)

Headnote: Prudential standing.

Facts: In a reopened Chapter 7 bankruptcy case, the trustee entered into an agreement with EuroGas II and a creditor ("TEG") to dispose of certain of their claims. The principal terms included payment of \$250,000 to the trustee by EuroGas II, and TEG's agreement to withdraw its proof of claim in the estate in the amount of \$113 million. The trustee filed a motion to approve the settlement which included abandonment of certain claims held by the trustee ("TALC claims"). Another creditor, Slovak Republic, filed an objection to the trustee's motion to settlement and related motion to abandon. The principal basis for the objection asserted by Slovak Republic was that Slovak Republic was willing to pay for the TALC claims on a quit claim basis. The Bankruptcy Court denied the objection and approved the trustee's motion to compromise and abandon. The Slovak Republic appealed to the BAP and EuroGas II responded with a motion to dismiss the Slovak Republic's appeal for lack of standing. The BAP ruled that the Slovak Republic lacked prudential standing and, in the alternative, that the Slovak Republic's arguments fail on appeal because the Bankruptcy Court had not abused its discretion in its approval of the settlement and abandonment. The Slovak Republic lacked prudential standing because it was not a "person aggrieved" because the Agreement increased dividends to unsecured creditors without creating any demonstratable harm.

Issue: Whether the appellant had prudential standing to pursue the appeal defined and elements of approval of a settlement.

Holding: The Circuit stated that prudential standing holds that appellate review of a Bankruptcy Court order is limited to "persons aggrieved" by that order. A person aggrieved is a person whose rights or interests are "directly and adversely affected pecuniarily by the decree or order of the Bankruptcy Court." This standing rule is prudential limitation not an Article III limitation. In this case, the Court assumed, without deciding, that the elements of prudential standing were met for the Slovak Republic. Regarding the settlement, when deciding whether to allow or disallow a trustee to abandon an asset, the Circuit found that the Bankruptcy Judge must tackle four kinds of issues, legal, factual, a mixed question of law and fact and discretion. The first step is to identify the terms "burdensome" or "inconsequential," a legal determination.

Section 554(a) of the Bankruptcy Code provides that a trustee "may abandon any property of the estate that is burdensome to the estate or that is of inconsequential value and benefit to the estate." The first issue is legal, being the definition of "inconsequential" and "burdensome." The second issues are factual: the determination of the value of the asset, whether it is subject to litigation, whether the issues of ownership are complex, whether litigation was certain, the uncertainty of the results, whether the assets to be abandoned are easily administratable, among other items. The third standard requires a Bankruptcy Judge to determine whether the findings of fact satisfy the legal test, which is a mixed question of fact and law. The standard of review on the mixed question depends on the nature of the question. If the

Court is required to “expound on the law,” those aspects are reviewed *de novo* whereas questions that require the Court to immerse themselves in “case-specific factual issues” and “marshal and weigh evidence, are reviewed for clear error.” In this case, the factors considered by the Bankruptcy Court in finding whether the abandonment satisfied the legal test of whether the asset was burdensome or of inconsequential value was primarily factual work and was reviewed *de novo*. The fourth element is whether the Bankruptcy Court abused its discretion in approving the settlement and abandonment should decide to approve the abandonment is review for abuse of discretion.

11. ***Geringer v Strong***, 766 Fed.Appx. 620 (10th Cir., March 14, 2019.)

Headnote: Trustee’s ability to abandon a court-approved sale upon receipt of a subsequent higher or better offer.

Facts: A trustee of a corporate debtor entered into a contract to sell certain Property to DSS III and the contract was approved by the Bankruptcy Court. Subsequent to Court approval, but prior to closing of the sale, the trustee entered into an Agreement with Geringer, a former principal of the debtor, for a sale of the property at a higher or better price. Geringer and the trustee were aware of the previously approved DSS III contract, but believed that the trustee could terminate the earlier contract either for alleged breaches or because Geringer’s offer was higher and better. “As this appeal foreshadows, things did not go as Geringer planned.” Pursuant to the agreement with Geringer, the Liquidating Trustee served a Notice of Termination of Real Estate Purchase and Sale Agreement on DSS III and moved the Bankruptcy Court to terminate the contract with DSS III and approve the agreement with Geringer. DSS III understandably resisted. The trustee argued that DSS III had breached its contract and in any event, the trustee had a fiduciary duty to sell the property for the highest and best price. The Bankruptcy Court cut short the trustee’s argument, noting that DSS III had a “right to rely on orders of this Court” and stated that it was not going to allow the trustee to sell the property to somebody else when DSS III indicates that it is ready, willing and able to perform according to the contract that it had signed and the Court approved. As a result, Geringer was not able to buy the Property. Geringer then sued the trustee in federal district court claiming the trustee had violated the Agreement when it failed to terminate the contract with DSS III. The Court dismissed Geringer’s claims with prejudice finding initially that the trustee had no obligation under the Agreement to terminate the DSS III contract. The trustee and Geringer had previously entered into a Memorandum of Understanding whereby the trustee was obligated to give certain notices and terminate the DSS III contract, but the integration clause in the subsequent definitive Agreement between Geringer and the trustee stated clearly that the subsequent Agreement was the entire understanding of the parties and that no prior understandings survived. The subsequent Agreement itself did not provide any obligation for the trustee to terminate the DSS III contract. The Bankruptcy Court was adamant that the parties had a right to rely on orders of the Court and that DSS III was ready, willing and able to close and the Agreement should be enforced.

TENTH CIRCUIT BANKRUPTCY APPELLATE PANEL

12. *In re: Mendoza*, 595 B.R. 843 (10th Cir. BAP, February 25, 2019) (*Mendoza, et al. v. Montoya*, Bankr. No. 1610951; and *Dollman, et al. v. Montoya*, Bankr. No. 13-13057)

Facts: In separate Chapter 7 cases, the debtors requested to reopen their cases in order to list previously omitted personal injury claims. The trustee objected to the proposed amendments on the theory that the debtors had to demonstrate “excusable neglect” to amend schedules after the cases had once been closed. The Bankruptcy Court sustained the objection and the debtors appealed.

In each of the cases, the debtors, having received a discharge and having their cases closed, moved to reopen their cases to schedule undisclosed personal injury claims. Following the reopenings, the Chapter 7 trustee objected to the amended schedules and both Bankruptcy Courts sustained the Chapter 7 trustee’s objections on the basis that neither set of debtors could show excusable neglect for failing to amend their schedules prior to closing of the original cases.

Issue: Does a debtor have to show “excusable neglect” to reopen a bankruptcy case previously closed?

Holding: The Bankruptcy Court had concluded that Rule 9006(b) relating to amendments of schedules, required the debtors to file a motion within the time provided by the Rule and only in the case of excusable neglect should they be allowed to file after the time provided by the Rule. Bankruptcy Rule 1009 provides that a debtor’s schedules may be amended as a matter of course “at any time before the case is closed.” Rule 9006(b)(1) states that “when an act is required or allowed to be done at or in a specified period by these Rules. . .” the Court may permit the act to be done after expiration of the specified time “where the failure to act was the result of excusable neglect.”

The BAP concluded that Rule 9006 only pertains where the time period otherwise provided by the Code is for a “specified period” for the debtor to act. Rule 1009(a) does not provide a “specified period” but only a temporal requirement that the amendment to the schedules must occur “at any time before the case is closed.” The BAP applied a plain meaning analysis finding that the phrase “at any time before the case is closed” does not create a “specified period.” In these cases, the cases had been closed, but they had been reopened. Section 350(b), having to do with reopening a case, generally vests the decision to reopen in the Bankruptcy Court’s discretion, however, “the Bankruptcy Court has a duty to reopen a case whenever there is *prima facie* proof that a case has not been fully administered.” Rule 1009(a) contains no distinction between an original case and a case which has been closed and then reopened. Moreover, there is nothing in Rule 1009(a) indicating that the debtor’s right to amend is limited to the first case. In essence, it does not contain an ascertainable “specific period” during which a debtor may amend his or her schedules, thus, the Bankruptcy Court’s conclusion that the debtors must show excusable neglect for failure to amend within the pendency of the original case was legal error and the decisions were reversed and remanded for the Bankruptcy Court to determine the debtor’s claims relating to the amendment.

13. ***Bednar v. RCB Bank, et al.***, 2019 WL 2928844 (10th Cir. BAP, August 20, 2019) (*In re: Bednar*)

Headnote: Constitutional and prudential standing; *Rooker-Feldman* doctrine; discharge injunction.

Facts: Prior to bankruptcy, RCB Bank commenced a state court action to foreclose its second mortgage on the debtor's residence. Debtor filed bankruptcy and the Bank commenced a non-dischargeability action. The Bankruptcy Court granted relief from the stay to permit the continuation of the Bank foreclosure action *in rem*. The state court subsequently entered an *in rem* foreclosure judgment in favor of RCB Bank on its second mortgage, subject to the first mortgage of Franklin American Mortgage Company ("Franklin"). A sheriff's deed to RCB was issued and recorded, subject to Franklin's first mortgage. Franklin subsequently obtained an *in rem* foreclosure judgment in its favor, terminating the interest of RCB in the property. Franklin submitted the winning bid at a sheriff's foreclosure sale and the state court confirmed the sheriff's sale to Franklin. After the conclusion of Franklin's foreclosure action, Bednar filed an adversary proceeding in the Bankruptcy Court against Franklin alleging violations of § 524's discharge injunction by carrying out the second foreclosure action. The specific violations complained of were Franklin's initiation of the foreclosure proceeding, Franklin's obtaining a default judgment against Bednar in that proceeding and credit bidding at the sheriff's sale. Subsequently, Mr. Bednar amended his complaint adding RCB as a defendant, alleging RCB breached a settlement agreement with Bednar and by conspiring with Franklin to deprive him of the benefit of the settlement agreement, to-wit, title to the home free and clear. He sought enforcement of the settlement agreement and damages. Bednar also requested injunctive relief. The Bankruptcy Court entered an order denying Mr. Bednar relief on all count, mainly concluding that Bednar's complaints were barred by the *Rooker-Feldman* doctrine giving preclusive effect to state court judgments. The Bankruptcy Court also denied relief, determining that Bednar failed to allege plausible allegations that any defendant violated the discharge injunction and further that Bednar lacked standing to challenge any of the actions. Bednar appealed to the BAP.

Issues: Standing of the debtor to challenge the validity of the state court proceedings; the scope of the *Rooker-Feldman* doctrine in barring any review.

Holding: The Circuit held:

On the issue of standing, the Circuit stated that standing jurisprudence contains two strands: Article III standing (constitutional standing) and prudential standing which embodies judicially self-imposed limits on the exercise of federal jurisdiction. In distinguishing between the two strands, the BAP pointed out that constitutional standing is a jurisdictional question which may be raised at any time and which the BAP had an independent duty to examine on its own. Constitutional standing relates to the "case and controversy" limitation on federal jurisdiction imbedded in the U.S. Constitution. In order to meet the constitutional minimum of standing, a plaintiff must have (i) suffered an injury in fact, (ii) that is fairly traceable to the challenged conduct of the defendant, and (iii) this is likely to be redressed by a favorable judicial decision. In reviewing the record before it, the BAP found that Bednar's loss of property and allegations regarding the discharge injunction were sufficient to confer constitutional standing.

As to prudential standing, the BAP confirmed that prudential standing is not a jurisdictional limitation and thus the BAP is not obligated to consider the issue if it was not raised by one of the parties. No party had challenged standing on appeal. Since prudential standing is not jurisdictional, the Court found it could be waived on appeal and in this case had been forfeited, thus, the BAP turned to the merits. Regarding the merits, the Court explained the *Rooker-Feldman* doctrine as precluding a losing party in a state court who complains if injury caused by the state court judgment from bringing a case to review and reject that judgment in the federal court. However, *Rooker-Feldman* does not deprive a federal court of jurisdiction to hear a claim just because it could result in a judgment inconsistent with the state court judgment. The distinction is whether a federal action attempts to modify or set aside a state court judgment because the state court proceedings should not have led to the judgment, if an element of the claim to set aside the judgment is that the prior judgment was wrongful. The Court, in reviewing the debtor's attempts to invalidate the transfer of title to Franklin concluded that the judgments and sale orders were entitled to preclusive effect under *Rooker-Feldman* because the validity of the mortgages at issue and the sale order were found to be lawful under applicable state law, those rulings were binding on the federal courts because those judgments were final judgments and dealt with the issues raised by Bednar in his complaints to the Bankruptcy Court.

Bednar's claims for violation of the discharge injunction were likewise overruled. The BAP, referring to § 524 (discharge), noted that it only bars acts to collect or recover a discharged debt as a personal liability, but an act taken *in rem* was not enjoined. In the state court cases regarding both RCB and Franklin all of the actions and judgments of the state court were *in rem* notwithstanding that Franklin had credit bid its judgment to obtain title to the property, the judgment itself was *in rem*. Further, every violation of the discharge injunction does not entitle a debtor to relief. A creditor will be held in civil contempt for violating the discharge injunction where there is not a fair ground of doubt as to whether the conduct might have been lawful under the discharge order. This is an objective standard. A creditor's good faith belief that the discharge injunction does not apply to the creditor's act may be considered. Here, the creditor had proceeded pursuant to a valid and binding state court order and its actions were in furtherance thereof and Bednar was not able to show that the creditor intended the Bank's actions to violate the discharge order. The BAP therefore affirmed the ruling of the Bankruptcy Court.

14. *In re Wagenknecht*, 2019 WL 2353534 (10th Cir. BAP, 2019)

Headnote: Avoidance of payment made by third party to creditor of the debtor.

Facts: Prior to filing bankruptcy, the debtor borrowed \$21,672.65 from his mother and signed a promissory note in her favor. A few days before the bankruptcy filing, his mother wrote a check directly to a law firm to pay for services rendered on behalf the debtor. The trustee sued the law firm to recover the payment as a preferential transfer. The law firm defended on the basis that the payment was not a transfer of an interest of the debtor and in any event did not diminish the bankruptcy estate. The bankruptcy court, refusing to apply the earmarking doctrine (believing it applicable only to codebtors) granted summary judgment in favor of the trustee who argued that, even though the money was paid to the law firm directly by the mother, the debtor

had an interest in the transferred funds and the transfer was therefore a voidable preference. The law firm appealed to the BAP which affirmed.

Issue: Did the debtor have an interest in funds transferred by a third party directly to a debtor's creditor, making the transfer voidable as a preference.

Holding: Yes. The facts of this case are indistinguishable from the facts of *Parks v. FIA Card Servs., N.A. (In re Marshall)*, 550 F.3d 1251 (10th Cir. 2008), in which the debtor used a cash advance from one credit card to pay a debt on another credit card. The court held that the debtor had an interest in the funds transferred even though the payment went directly from one credit card company to the other. The debtor's right to control the disposition of the loan proceeds is sufficient to make the payment a transfer of an interest of the debtor in property. In the instant case, the debtor borrowed the money from his mother only because she was going to pay the money directly to the law firm.

BANKRUPTCY COURT, WESTERN DISTRICT OF OKLAHOMA

15. *In re: Stewart*, 603 B.R. 138 (Bankr. WD Okla., July 19, 2019)

Headnote: Factors in approving settlement of controversies.

Facts: The debtor and the trustee filed a motion to settle pending adversary proceedings for fraudulent transfer, equitable subordination and substantive consolidation on complex facts. The settlement also called for the trustee to release the debtors and their agents from any and all claims. A principal creditor objected. The Court held a hearing over a span of fourteen days, consuming more than 22,700 pages of trial transcript involving hundreds of exhibits, seven live witnesses and four by deposition and at the conclusion approved the settlement over the objection of a principal creditor.

Issue: A discussion of the factor involved in approving a settlement or controversy.

Holding: The Court laid out clearly the standards for approval of settlement of controversy. The Court held that, pursuant to Bankruptcy Rule 9019(a), approval of a compromise or settlement was within the sound discretion of the Bankruptcy Court. In exercising the discretion, the Bankruptcy Court must determine whether the compromise is fair, reasonable and in the best interest of the estate. The Court noted that compromises are favored in bankruptcy. In considering what is fair, equitable and in the best interest of the estate, the Court need not conduct a "mini trial" but only need to be apprised of those facts that are necessary to enable it to evaluate the settlement and make a considered and independent judgment. In this case, there was a substantial exposition of the facts as indicated by the time to try and number of exhibits and witnesses. The Court is not required to make a determination that the settlement is the best possible compromise, but that it falls in the range of reasonable alternatives, thus, the trustee's burden is not high. In considering whether a settlement is in the best interest of the estate, the Circuit sets forth four factors: (1) probability of success on the merits, (2) difficulty of collection, (3) the complexity and expense of the litigation and (4) the interest of the creditors in deference to their reasonable views. Some courts, including the

deciding Court in the Western District of Oklahoma, also give consideration as to whether the proposed settlement promotes the integrity of the judicial system.

After an analysis of all of the extensive facts and factors contained in the record, and applying the standards for review set forth above, the Bankruptcy Court approved the settlement. Along the way, the Court noted that many courts have held that § 727 claims relating to denial of discharge can never be compromised. “It is against public policy to sell discharges . . . selling discharges would be a disease that would attack the heart of the bankruptcy process, its integrity.” In this case, although there was a discharge complaint pending, it was not a part of the settlement and the Court could therefore approve the settlement.

16. *In re Grooms*, 599 B.R. 155 (Bankr. W.D. Okla., 2019)(Lloyd, J.)

Headnote: Property of the bankruptcy estate when debtor’s interest is disputed.

Facts: A chapter 13 debtor was the sole member of an LLC which owned some real estate in which there was some equity. The articles of organization of the LLC had been cancelled. The debtor attempted to sell the real estate in the bankruptcy case, claiming that under Oklahoma law, upon cancellation of the articles, property of the LLC reverted to its members.

Issue: Is property in which there is a bona fide dispute about the debtor’s ownership interest considered property of the bankruptcy estate?

Holding: Yes. There is no Oklahoma case law determining the disposition of property of an LLC upon cancellation of its articles of organization. Here, the outcome was the subject of a bona fide dispute. Following the holding of *In re Pickel*, 487 B.R. 289 (Bankr. D. N.M.), the bankruptcy court held that the automatic stay applies when the issue of whether the property is property of the estate is the subject of a bona fide dispute.

SMALL BUSINESS REORGANIZATION ACT OF 2019

On August 23, 2019, the Small Business Reorganization Act of 2019 (SBRA) was signed into law, taking effect on February 19, 2020. The SBRA is intended to help small businesses successfully reorganize under Chapter 11 by adding a new Subchapter V to Chapter 11 of the Bankruptcy Code. It incorporates many of the provisions of existing Chapter 11, but also contains a number of important new features. Among them are:

1. Eligibility: To qualify for Subchapter V, the debtor must be engaged in commercial or business activities and have aggregate, non-contingent liquidated secured and unsecured debts in an amount of no more than \$2,725,625, excluding debt owed to affiliates or insiders. Also, fifty percent or more of the debtor’s debt must arise from the debtor’s commercial or business activities. Individual debtors are eligible.

2. Debtor's Counsel: Debtor's counsel can hold a Pre-Petition claim against the debtor of less than \$10,000 and still be disinterested for the purpose of serving as debtor's counsel.
3. Property of the Estate: Post-Petition property and earnings are property of the Estate.
4. Standing Trustee: There is a standing trustee who serves until substantial consummation of the Plan. The standing trustee does not operate the business. The standing trustee is obligated to participate in the formulation of a Plan and has standing to appear and be heard on all matters in the case. The standing trustee will make all disbursements under a confirmed Plan unless otherwise provided.
5. Status Conference: There is a mandatory status conference to be held within sixty days after the entry of the order for relief. The debtor must file a report within fourteen days prior to the mandatory status conference which must detail the efforts the debtor has undertaken and will undertake to obtain a consensual plan of reorganization.
6. No Committee: No committee of unsecured creditors is appointed, unless the Court otherwise orders.
7. UST Fees: There are no U.S. Trustee fees in a Subchapter V case.
8. Plan Filing: The debtor must file a Plan within ninety days after the Petition Date. However, there is no deadline within which a Plan must be confirmed.
9. Competing Plans: Competing Plans are not permitted.
10. No Disclosure Statement: No disclosure statement is required, although certain disclosure items must be included in the Plan.
11. No Impaired Class Acceptance: A Plan under Subchapter V may be confirmed even if no impaired class votes to accept the Plan.
12. Administrative Expenses: May be paid over time through the Plan.
13. Absolute Priority Rule: The absolute priority rule is eliminated. The Court can confirm a Plan over the objection of a dissenting class of unsecured creditors provided the debtor devotes three to five years of net disposable income to the Plan. Cram down requirements for secured creditors are substantially unchanged.
14. Debtor Discharge (consensual plan): If the Court confirms a consensual Plan (i.e., all classes accept), the debtor will receive an immediate discharge at confirmation, the Standing Trustee's services are terminated, and all property reverts in the debtor.

15. Debtor Discharge (cram down plan): If the Court confirms a cram down Plan, the debtor may still get a discharge after Plan payments are completed, normally for a period of within three to five years. Also, post-petition property remains property of the Estate and the Subchapter V Trustee remains in place and handles disbursement to creditors.

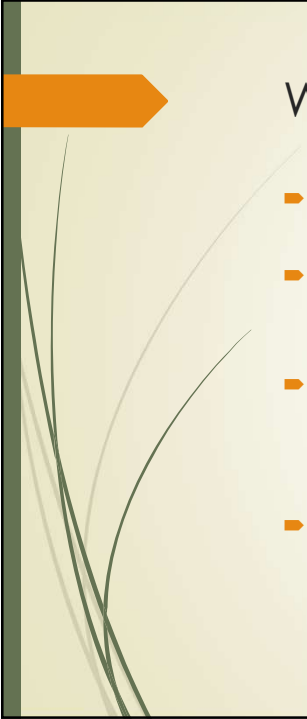
RULES:

The time between the SBRA being signed into law (August 23, 2019) and the effective date of February 19, 2020 is much shorter than the normal rules making process accommodates. Numbers of courts are enacting interim rules to implement the provisions of Subchapter V, including the districts in Oklahoma.



Chapter 12 Unobstructed

Why all bankruptcy attorneys should know the basics of Chapter 12.

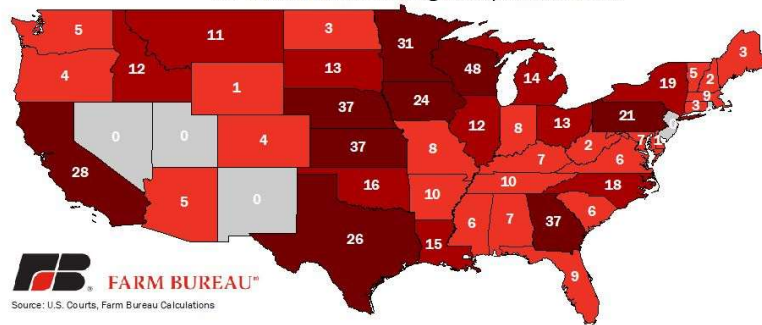


Why Chapter 12 now?

- Farm economy is struggling due to several factors including low commodity prices, tariffs and climate change
- New legislation that increased the Chapter 12 Debt limits to 10 million dollars. (*Pub. L. No. 116-51, H.R. 2336, 116th Cong., 133 Stat. 1075*)
- Recent legislation that can make capital gains taxes resulting from the sale of farm assets into dischargeable, non-priority unsecured debt. 11 U.S.C. § 1232. Over-ruling *Hall v. United States* 132 S. Ct. 1882 (2012).
- Next two (2) slides demonstrate the recent increases in chapter 12 filings via an excerpt from an October 30, 2019 article on the Farm Bureau website.

Total bankruptcies filed by state vary significantly, from no bankruptcies in some states to more than 20 filings in others, as shown in Figure 2. Bankruptcy filings were the highest in Wisconsin at 48 filings, followed by 37 filings in Georgia, Nebraska and Kansas. Iowa, Kansas, Maryland, Minnesota, Nebraska, New Hampshire, South Dakota, Wisconsin and West Virginia all experienced Chapter 12 bankruptcy filings at or above 10-year highs. Source: <https://www.fb.org/market-intel/farm-bankruptcies-rise-again>

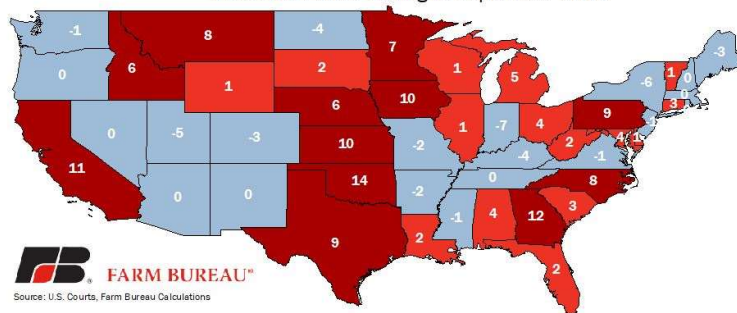
Figure 2. Total Chapter 12 Farm Bankruptcies by State
12-Month Period Ending in September 2019



As seen in Figure 3, the increase in farm bankruptcies was the highest in Oklahoma at 14, followed by Georgia at 12, California at 11 and Iowa and Kansas at 10 each. Oklahoma had the sharpest increase in bankruptcy filings, increasing from two filings last year to 17 during the previous 12 months.

Source: <https://www.fb.org/market-intel/farm-bankruptcies-rise-again>

Figure 3. Year-Over-Year Change in Chapter 12 Bankruptcy
12-Month Period Ending in September 2019



Topics we will cover -

- ▶ Advantages that Chapter 12 has over Chapter 11 or Chapter 13
 - ▶ Especially in regard to taxes
- ▶ Farm Leases
- ▶ Creative use of Chapter 12 plans – to “right size” the farming operation.
- ▶ Confirmation and feasibility issues
- ▶ Post-petition financing
- ▶ We are NOT talking about eligibility for Chapter 12, but we have included an eligibility checklist put out by the Association of Chapter 12 Trustees in the materials. More information available at www.act12.org

Chapter 12 is more flexible than Chapter 13 and less burdensome than Chapter 11

Chapter 12 Advantages over chapter 13

✓ Can modify secured debts with much greater flexibility. Compare 1225(a)(5) to 1325(a)(5):

REQUIREMENTS	CHAPTER 12	CHAPTER 13
Secured creditor options: accepts plan, cram down or surrender	Yes	Yes
Hanging paragraph with 910 and 365 day restrictions on cram down	No	Yes
Distributed through plan via equal monthly amounts	No	Yes
Monthly amounts must be enough to provide adequate protection	No	Yes
Lienholder retains lien until payment in full or discharge	No	Yes

Chapter 12 is more flexible than Chapter 13 and less burdensome than Chapter 11

- Compare § 1222(b)(2) to § 1322(b)(2)
 - § 1222(b)(2) doesn't have the restriction on modification of a personal residence that appears in Chapter 13, meaning . . .
 - You can cram down the homestead
 - You can also re-amortize the loan over 30 years or more – see § 1222(b)(9), no similar provision in Chapter 13.
- You can get rid of capital gains tax due, even post-petition, on the sale of farm assets
 - More on this later

Chapter 12 is more flexible than Chapter 13 and less burdensome than Chapter 11

Chapter 12 Advantages over chapter 11

- ✓ Less burdensome than Chapter 11

REQUIREMENTS	CHAPTER 11	CHAPTER 12
Only the Debtor proposes the plan – 11 U.S.C § 1221	No	Yes
Creditors vote on plan? 11 U.S.C. § 1126	Yes	No
Creditors committee?	Yes	No
Absolute priority rule? - 11 U.S.C. § 1129(b)(2)(B)(iii)	Yes	No
Treat Capital gains taxes on the sale of farm assets as dischargeable, non-priority unsecured debt – 11 U.S.C. § 1232	No	Yes



Getting rid of capital gains taxes in Chapter 12

- A little history
 - In the early days of chapter 12, tax questions were abundant as assets were sold to right size the farm.
 - If farm assets were sold pre-petition, the taxes were a priority debt and must be paid in full in 5 years
 - If farm assets were sold post-petition, the tax might not be an administrative expense treatable as a second priority claim, since a separate taxable estate is not created by the filing of a Chapter 12 case. 11 U.S.C. § 507(a)(2) and 26 U.S.C. § 1398(a) – short tax year applies to chapter 7 & 11 only.



Getting rid of capital gains taxes in Chapter 12

- A little more history
 - The family farmers did not have enough cash flow to pay the taxes in full and their plans were not confirmable.
 - As Part of BAPCPA, 11 U.S.C § 1222(a)(2)(A) was amended
 - Intention was to de-prioritize taxes arising from the sale, transfer, exchange or other disposition of any farm asset used in the farming operation, making it an unsecured claim, and a dischargeable one at that.

Getting rid of Capital Gains Taxes in Chapter 12

- A little more history
 - Allowed by *Knudsen v. Internal Revenue Service*, 581 F.3d 696 (8th Cir. 2008)
 - Subsequently over-ruled by *Hall v. United States*, 132 S. Ct. 1882 (2012).
 - Congress then acted, to enact 11 U.S.C. § 1232 to specifically over rule the Hall decision. Pub. L. 115-72, enacted October 26, 2017.

Getting rid of Capital Gains Taxes in Chapter 12

- How does § 1232 work?
 - Unsecured claim of a governmental unit that arises either pre- or post-petition but before discharge
 - As a result of the sale, transfer, exchange or other disposition of any property **used in** the debtor's **farming operation**
 - Required to be provided for under a plan - 11 U.S.C. § 1232(a)(3) – The materials include some sample plan language. (Ex. 1)

Getting rid of Capital Gains Taxes in Chapter 12

- ▶ How does § 1232 work?
 - ▶ The government may file a proof of claim if the claim arises after the date on which a petition is filed - 11 U.S.C. § 1232(d)(1)
 - ▶ Contemplates a debtor filing a return, and requires the Debtor to serve notices of the claim on the governmental unit, the governmental unit then has 180 days to file the claim, and if no claim is filed the debtor or trustee can file the claim – 11 U.S.C. § 1232(d)(2) & (3).
- ▶ **Unresolved issues**
 - ▶ To what assets does it apply, only capital assets or other assets used in the farming operation

Getting rid of capital gains taxes in Chapter 12

- ▶ **Unresolved issues**
 - ▶ What does the term “used in” the “farming operation” mean?
 - ▶ Is feed that is sold and not used for animal feed “used in” the farming operation?
 - ▶ Is the farming operation defined by 11 U.S.C. § 101(21), or, especially if post petition, can it be defined by the plan.
 - ▶ At the outset of the case who files? Make sure you file for the entity that will incur the tax. May need joint administration.



Getting rid of capital gains taxes in Chapter 12

■ Unresolved issues

- How is the amount of tax to be de-prioritized calculated?
 - These questions were raised in *Knudsen v. IRS*, 581 F.3d 696 (8th Cir. 2009), however that case was decided under the older amendment over-ruled by the *Hall* case.
- Included in the materials is a “Memo for Tax Preparers” prepared by Attorney Joseph Peiffer, who was counsel for the Debtor in the Knudsen case. (Ex. 2)



Farm Leases – Unusual Issues

- A farmer in bankruptcy may have interests in farm leases – either as a tenant or a landlord (or both).
- Farm leases are frequently informal, sometimes oral, and rarely detailed.
- Farm leases are often governed by statutory provisions which vary by state.
- For example, some states provide farm landlords with “landlord’s liens” on various assets, such as growing crops or equipment.
- Some states interpret farm leases as year-to-year leases which are *automatically* renewable despite the lack of relevant contract terms.

Farm Leases – Automatic Stay and Section 108(b)

- The automatic stay does not act to “toll” the running of a lease term. See In re Policy Reality Corp., 242 B.R. 121 (Bankr. S.D. N.Y. 1999); In re Matter of Compass Dev., Inc., 55 B.R. 260 (Bankr. D. N.J. 1985). The automatic stay prohibits creditor action, especially judicial activity or similar conduct; it does not affect the contractual running of time, or prevent a contract from terminating automatically on its own terms.
- The Code may give a debtor a bit more time to accomplish certain tasks, such as the giving of notice to the extent required under a lease. See 11 U.S.C. § 108(b) (if applicable nonbankruptcy law or an agreement fixes a period within which the debtor may file a “notice” or perform “any other similar act,” and the period has not expired prepetition, the trustee may perform the act before the later of “the end of such period” or “60 days after the order for relief”).

Farm Leases – Landlord's Liens

- Many states provide a “landlord's lien” on growing crops for rent and other advances.
- 11 U.S.C. Section 545 provides that the trustee (or a debtor in possession in a reorganization case) can avoid the fixing of a statutory lien on property of the debtor to the extent that such a lien is “for rent” or a “lien for distress of rent.” See 11 U.S.C. Section 545(3) and (4).
- Some landlords may also take a contractual security interest or consensual lien in crops or other assets. Such a consensual lien cannot be avoided under Section 545.
- But was the consensual lien properly perfected? Under §9-310 of the Uniform Commercial Code a financing statement is typically required to perfect an agricultural lien.
- An unperfected consensual security interest can be avoided by a bankruptcy trustee or debtor in possession. See 11 U.S.C. § 544(a). To the extent the landlord takes a lien after the fact (perhaps when it appears that the tenant may be unable to pay the rent, as often happens), such an interest may also be subject to avoidance as a preferential transfer under Section 547. See 11 U.S.C. § 547(b).

Farm Leases – Rent Claims

- A farm landlord's right to postpetition, pre-rejection rent is either an administrative expense claim or, perhaps, a superpriority claim entitled to payment even ahead of other administrative claims. See In re C.Q., LLC, 343 B.R. 915 (Bankr. W.D. Wis. 2005); In re Telesphere Communications, Inc., 148 B.R. 525 (Bankr. N.D. Ill. 1992); In re J.T. Rapps, Inc., 225 B.R. 257 (Bankr. D. Mass. 1998); In re Goody's Family Clothing, Inc., 401 B.R. 656 (D. Del. 2009).
- A motion for allowance of the claim - either as an administrative claim or a superpriority claim - is generally required, unless otherwise authorized by local rule or standing order. In jurisdictions where the rental obligation is regarded as a superpriority claim, the landlord could be entitled to immediate payment, ahead of other administrative claims. C.Q., Inc., 343 B.R. at 918 ("The trustee must immediately pay the rent obligation"). Even in jurisdictions which treat the rent claim as a standard administrative expense, it is important to get the administrative claim approved if there is any likelihood that the debtor's estate will have assets, because many bankruptcy estates end up "administratively insolvent," which means that there isn't enough money to pay the costs of the case, let alone provide a distribution to unsecured creditors.

Farm Leases – Rent Claims, Continued

- Farm leases can raise challenges because of the unusual rental terms. For example, if the lease in question is a crop-share or livestock-share lease (in which the "rent" payable to the landlord is a share of the products ultimately produced by the tenant), it must be remembered that the obligation of the trustee (or DIP) is to "timely perform all the obligations of the debtor."
- Farm leases also frequently contemplate payment of the rent at the end of the lease term (typically after harvesting is completed). One frequent situation involves a tenant who files bankruptcy after a crop year has ended but before the annual rent payment is "due." If the rent comes due after the petition is filed and before the lease is rejected (see below), many courts hold that § 365(d)(3) requires the debtor to perform any - and all - rental obligations through the date of rejection. See In re Burival, 613 F.3d 810 (8th Cir. 2010) (the Code requires "payment, in full, of post-petition, pre-rejection rent obligations in unexpired leases of nonresidential real property").
- Watch out for § 365(d)(4) a lease of nonresidential real property where the debtor is the lessee is deemed rejected the earlier of 120 days from filing or confirmation.

Farm Leases – Questions to Consider

- Is there a written lease? Is it a lease at all, or some other kind of arrangement (i.e., how will a “crop sharing” agreement be construed under state law)?
- What are the rent terms?
- How long does the lease term run? Does it automatically renew either by contract or law? Will the lease expire on its own terms during the pendency of the case?
- Is there a statutory “landlord’s lien?”
- Is there a contractual lien? If so, was it properly perfected?
- Is the debtor assuming or rejecting the lease? Has the debtor acted to assume the lease within the statutory timeline of Section 365?
- Does the creditor have an administrative claim for rent? If so, in what amount, and has the creditor properly sought payment of the claim?

Using Chapter 12 to Manage Change: Transitional reorganization plans

- Traditional plans
 - The operation had some kind of bump in the road, illness, bad weather, bad economy.
 - The farm had prior good years and whatever the problem was, it is resolved.
 - Chapter 12 is needed to cure arrears on secured debt, stretch out the terms of secured loans, pay priority debt and eliminate unsecured debt.

Using chapter 12 to manage change

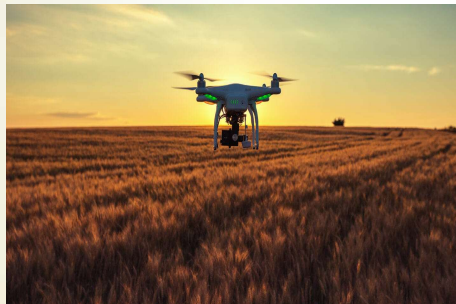
"It is not the strongest of the species that survive, nor the most intelligent, but the one most responsive to change."

Charles Darwin

1. Re-tooling or re- scaling the Farm
2. Developing New Sources of Income
3. Selling the Farm
4. Making Deals with Creditors in and out of Chapter 12
5. Transitioning the Farming Operations through a Chapter 12 Plan
6. Shifting Away from Farming (and Retaining the Home)
7. Providing for Retirement or Transferring the Farm to the Next Generation

1. Re-Tooling or re-scaling the farm

-take advantage of new technology



- provide for the acquisition of new equipment or supplies to produce new products



1. Re-tooling or re-scaling the farm

- Surrendering or selling unnecessary land, livestock & equipment
- Retaining greater control over sales (how and when sales occur)
- Distributing assets via the plan ("eat dirt" or "dirt for dollars" plans)
- Taking advantage of tax benefits only available in Chapter 12

Confirmation: "Dirt for Debt"

- *First Brandon National Bank v. Kerwin (In re Kerwin)*, 996 F.2d 552 (2d Cir. 1993). In *Kerwin*, the chapter 12 debtor proposed to surrender 125 acres of a 135-acre farm to the secured bank lender in full satisfaction of the debt and release of the lien on the remaining property. The bankruptcy court found that the value of the surrendered property covered the lender's claim in full and the Second Circuit upheld confirmation even though the bank was not taking back all of its collateral.
- *In re Holland*, (Bankr. Idaho, 2019), came to a different result stating that if not all the property securing the debt would be surrendered under § 1225(a)(5)(c), then the plan was not confirmable because the debtor had not shown that the liquidation value under § 1225(a)(5)(B) would cover the secured claim in full.

2. Developing New Sources of Income

- a. New Products
 - Organic vs. Conventional
 - Local (farm to table movement, and farmers' markets)
 - New types of crops (commercial (non THC) hemp is legal in 41 states)
 - Increasing demand for goat's milk
 - Diversification and value added marketing
- b. Agritourism (including Airbnb)
- c. Off farm income
 - farm equipment mechanic
 - custom farming

3. Selling the Farm



- maintaining control of marketing and having court oversight (avoiding a creditor's "fire sale")
- maximizing value and the farmer's equity / cramming down farmland mortgages
- taking advantages of unique tax benefits
 - §1232- discharge of capital gains on sales via plans
- possibility of selling just development rights
- maximizing options for selling to the next generation (note - a reorganized farm may be more likely to qualify for new financing if there is new ownership, less debt, and an updated business plan post-12) [See ex. 3 for more resources]

4. Working with Creditors

■ Pros and cons of pre-filing consultation with creditors

- Can determine posture and goals of creditors
- Creditors often have key information, which counsel may not get from the client
- Creditors who actively negotiate, and play a role in, the drafting of the plan are less likely to object
- Creditors may enable Debtor to surrender unnecessary equipment in satisfaction of debt prior to filing
- BUT Creditors who are hostile to Debtor and Debtor's reorganization may take advantage of early notice

4. Working with Creditors

■ Waiting until Post-Filing to attempt Negotiations with Creditors

- Ensures Debtor is protected by the stay when communicating with Creditors about the chapter 12 filing, and seeking input about the chapter 12 plan
- Debtor has the "cram down" weapon in hand if the Creditors are unwilling to negotiate repayment terms with the Debtor
- Can often negotiate terms for the use of cash collateral (e.g., from sale of crops, or milk checks) to both fund the farming operations and make payments to "adequately protect" Creditors' secured interests
- Creditors may be receptive to, and collaborate with the Debtor re, sale of all or a part of the farm's real estate, equipment, or livestock to maximize the Creditors' return and/or success of the plan



5. Transitional Chapter 12 Plans ~ Examples

- 1. Downscale dairy ops, sell part of the farm, or transfer farm to next generation with new financing, to preserve homestead exemption and land.
- 2. Downscale dairy ops, sell excess acres and dairy equipment, convert to beef, hay and crop production.
- 3. Sell development rights, sell herd, convert to beef production, surrender equipment, and preserve family homestead.



More Examples of Transitional Plans

- 4. Sell herd, distribute or sell excess acreage, sell or surrender most equipment, work as a farm mechanic or do custom farming.
- 5. Sell entire dairy farm and herd, preserve equity, discharge debts, and avoid capital gains tax.
- 6. Convert from dairy to sheep, downscale and surrender land to mortgagee in full satisfaction of mortgage debt.



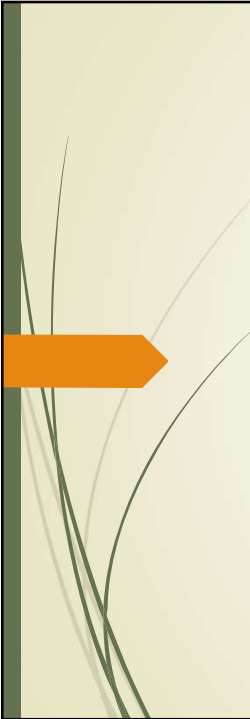
6. Shifting Away from Farming

- Chapter 12 is not just for farmers who want to continue to farm.
- Sales through Chapter 12 can preserve equity and reduce transfer tax liability.
- Chapter 12 Debtors can discharge their debt, preserve their homestead, and modify their home mortgage.



7. Providing for Retirement

- 64% of farmers have no form of estate plan.
- Chapter 12 can provide farmers looking to retire (or semi-retire) with a cost-efficient way to downsize their farms
- While the number of large-scale production farms is decreasing, there is an increase in the number of "lifestyle" or "hobby" farms (especially in Mid-Atlantic and Northeast)
- Farmers looking to retire and/or transition to smaller farming operations (for themselves or the next generation) can use chapter 12 to sell excess acreage and down scale their equipment (to less horsepower)



PROVING FEASIBILITY

DEVELOPING, NEGOTIATING AND CONFIRMING A CHAPTER 12 PLAN



FEASIBILITY-WHAT IS IT?

- **Not a guarantee of success**
 - “farming is inherently risky”
 - In re Perkins, 581 B.R. 822 (B.A.P. 6th Cir. 2018)
- **Instead, what is the “probability” of success?**
 - whether the farmer “has met his burden of establishing a reasonable probability of the plan's success”
 - In re Ellis 478 B.R. 132, 139 (Bankr. N.D.N.Y. 2012);
 - “debtors must provide reasonable assurance that the plan can be effectuated”
 - In re Chickosky, 498 B.R. 4 (Bankr. D. Conn. 2013)



WHY IS FEASIBILITY IMPORTANT?

- Proposing or confirming unfeasible plans is a waste of resources and, in the long run, does not assist the farmer.
- Requiring feasible plans increases the chances that a plan will succeed and that creditors will get paid.
- The Bankruptcy Code requires courts find plans are feasible for confirmation § 1225(a)(6), that “the debtor will be able to make all payments under the plan.”



THE ROLE OF DEBTORS COUNSEL

- Explore the debtor's goals, challenge assumptions, and explore all available options
- Engage in careful pre-bankruptcy planning:
 - should some assets be sold, surrendered, or distributed to creditors pre-petition?
 - what steps might maximize exemptions?
- Negotiations with key creditors pre-bankruptcy if possible
 - informing creditors might minimize likelihood of objections
 - assessing the posture, issues, and goals of creditors and their openness to negotiations will inform plan formulation



THE ROLE OF DEBTORS COUNSEL

- Creditor representatives may have useful information
 - better to hear it early rather than at 341 meeting or in an objection to plan
- Gather solid data and build a plan based on reasonable projections
 - may require use of experts or ag extension services



The role of Creditor and their counsel

- Comply with deadlines to file claims and object to the plan.
- Set realistic expectations and get "wins" where you can
 - For secured creditors valuation and interest rates may be areas for negotiation
 - Determine a range of better outcomes for your client, a stream of payments with interest? Or just getting the property back.
- Attend the 341 meeting of creditors
 - Puts the trustee and the debtor on notice of possible issues

THE TRUSTEE'S ROLE

- Initiate discussions of potential issues
 - discuss issues at Sec. 341 meeting with the goal of settling any potential disputes
 - mediate disputes between the debtor and creditors, to the extent possible, pre-confirmation
- Visit the farm or hire experts to do so
- Review and test assumptions underlying the Debtor's proposed plan
 - provide advice, support, and objective feedback to the Debtor's attorney about the proposed plan
- Make a recommendation to the Court at the confirmation hearing
 - to what extent does Trustee take a position at a disputed confirmation hearing? and should Trustee comment on both procedural & substantive issues?

THE COURT'S ROLE

- Independently assess feasibility as condition for entry of a confirmation order?
- What does Sec. 1225 require?
 - What must the Debtor present to show they have a reasonable likelihood of being able to make all of the plan payments?
- The Judge must make statutory findings, including feasibility
- Does the Court's level of scrutiny vary depending on whether a creditor has objected?

BUILDING A FEASIBLE PLAN: PROJECTION BASICS

- ▶ What will the farm produce?
- ▶ How much will it produce?
- ▶ What will it cost to produce it?
- ▶ What price will it sell for?

WHAT WILL THE FARM PRODUCE?



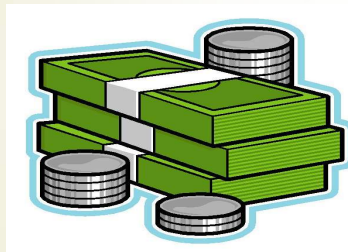
- ▶ What has it produced in the past?
- ▶ What is it equipped to produce now?
- ▶ What could it produce with changes?
- ▶ What are those changes and what will they cost?
- ▶ Which choice will be most profitable?

HOW MUCH WILL THE FARM PRODUCE?



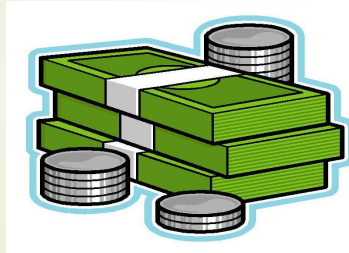
- ▶ Historic production
 - ▶ need reliable records that are admissible into evidence
 - ▶ must include yield per acre
- ▶ Reasonable projections
 - ▶ industry standard
 - ▶ expert testimony
 - ▶ county-wide average
- ▶ What changes could affect yields
 - ▶ fertilizer (type and rate)
 - ▶ organic vs. conventional
 - ▶ seed varieties

WHAT WILL IT COST TO PRODUCE THIS?



- ▶ Historic costs for the specific farm at issue
- ▶ Adjusted by changes in approach/product:
 - ▶ i.e. improved technology, new techniques, new products or varieties
- ▶ Adjusted by changes in cost:
 - ▶ labor, supplies, energy, water, other services
- ▶ Adjusted by changes in scale:
 - ▶ more or less acreage planted or livestock numbers

WHAT PRICES WILL THE FARMS PRODUCTS SELL FOR?



- Based on historic prices
- Adjusted by accepted forecasts
- Considering alternative markets when applicable (direct retail sales, farmers markets, internet sales)

PUTTING IT ALL TOGETHER: THE MASTER SPREADSHEET



- Is based on historic production and prices (including post-pet monthly operating reports)
- Quantifies projected changes in production, costs and sales
- Includes all production and operating costs
- Substantiates the Debtor's ability to fund projected plan payments
- Presents all figures related to the operation in a single spreadsheet (avoiding math errors)

PREPARATION FOR THE CONTESTED CONFIRMATION HEARING

KEY QUESTIONS FOR WHEN NEGOTIATIONS FAIL

- Is an expert witness or witnesses needed? If so whom to use?
- Will the farmer(s) be a good witness? How much trial preparation does the farmer need?
- Will experts need to be deposed?
- Will trial counsel or special counsel be needed?
 - different skillset required for trial compared to plan drafting
- Can the Debtor fund the cost of litigation?
- Who will prepare projections and, if needed, the expert witness reports?
- Does each party have *admissible* evidence to establish their positions?

TRIAL OF ISSUES RAISED IN A DISPUTED CONFIRMATION HEARING

- How does the Court resolve conflicting evidence?
- Who has the burden of proof on feasibility?
- What do the Local Rules require?
- Options for conditionally approving a Plan
 - may have conditional RFS attached to confirmed plan
 - may confirm a plan subject to various litigated outcomes still TBD (e.g., objections to claims, avoidance of liens, or property valuations)

TABLE OF FEASIBILITY CASES (OR, A DOZEN WAYS TO FAIL TO PROVE FEASIBILITY)

CIRCUIT	CASE NAME	CONFIRMED?	COURT'S CONCLUSIONS
2	In re Chickosky, 498 B.R. 4 (Bkr. D. Conn. 2013)	NO	No cash flow statements, failure to put invoices into context, farm not profitable in past, projected to double in income.
2	In re Simpson, No. 17-10442 (Bankr. D. Vt., June 22, 2018)	YES	Creditors' CPA lacked knowledge or expertise in agricultural projections and the Debtor provided compelling testimony, along with detailed exhibits and projections
4	In re Akers, 594 B.R. 362 (Bankr. W.D. Va. 2019)	NO	4th Plan, "vastly varying" and "overly optimistic" projections Mistakes in financial records and reports.
4	In re Keith's Tree Farms, Case No. 15-71262, 2016 WL 1086758 (Bankr. W.D. Va. Mar. 18, 2016)	NO	Multiple recent previous cases not confirmed on feasibility grounds. (Bar to re-filing imposed).

TABLE OF FEASIBILITY CASES (OR, A DOZEN WAYS TO FAIL TO PROVE FEASIBILITY)

CIRCUIT	CASE NAME	CONFIRMED?	COURT'S CONCLUSIONS
5	In re Morris, 590 B.R. 753 (Bankr. N.D. Miss. 2018)	NO	Debtor testified but did not provide specific documentary evidence showing his farm operation grossed \$200,000/yr.
6	In re Jubilee Farms, Case No. 18-30080, 2018 WL 6841352 (Bankr. E.D. Ky. Dec. 28, 2018)	NO	court found that: (1) the debtor's projections for crop yield were almost 10 bushels per acre greater than the historical yield and (2) the projected price per bushel was overly optimistic.
6	In re Perkins, 581 B.R. 822 (B.A.P. 6th Cir. 2018)	YES	Off farm income and related entity income may be used to fund the plan of the farm being reorganized. Plan found feasible.
6	In re Penick, Case No. 17-20178, 2017 WL 3772620 (Bankr. E.D. Ky. Aug. 28, 2017)	NO	The debtors didn't offer any monthly operating reports to explain and support their projected income and expenses

TABLE OF FEASIBILITY CASES (OR, A DOZEN WAYS TO FAIL TO PROVE FEASIBILITY)

CIRCUIT	CASE NAME	CONFIRMED?	COURT'S CONCLUSIONS
7	In re Johnson, 581 B.R. 289 (Bankr. W.D. Wis. 2018)	NO	debtor's projections were unpersuasive and lacked any credibility. The debtor's projections showed an increase in profit while reducing expenses.
7	In re Blake, 585 B.R. 539 (Bankr. S.D. Ill. 2018)	NO	debtors' projections were much more optimistic than any historic performance suggested.
7	In re CF Beef & Grain, LLC, 590 B.R. 849 (Bankr. E.D. Wis. 2018)	NO	The court found that the individual members couldn't pay their own mortgage and the property of the individuals was in foreclosure. In addition, the Court held that the debtor's projections were overly optimistic.

TABLE OF FEASIBILITY CASES (OR, A DOZEN WAYS TO FAIL TO PROVE FEASIBILITY)

CIRCUIT	CASE NAME	CONFIRMED?	COURT'S CONCLUSIONS
8	In re Meinders, Case No. 14-01459, 2016 WL 1599508 (Bankr. N.D. Iowa Apr. 18, 2016)	NO	based on the debtors' testimony about the cost of additional cows and lack of licensing, that the plan was not feasible and denied
10	In re Graves Farms, Inc., Case No. 18-10893, 2019 WL 1422891, (Bankr. D. Kan. Mar. 28, 2019)	NO	debtor's projected cash flow was heavily dependent upon a successful cotton crop -- a crop the debtor had almost no experience raising. The court held that the lack of historical performance evidence prohibited confirmation on feasibility grounds, where the debtor's projections of crop yields greatly exceeded the average historical county yield.

TABLE OF FEASIBILITY CASES (OR, A DOZEN WAYS TO FAIL TO PROVE FEASIBILITY)

CIRCUIT	CASE NAME	CONFIRMED?	COURT'S CONCLUSIONS
10	In re Furman, Case No. 17-10790, 2017 WL 6520721 (Bankr. D. Kan. Dec. 18, 2017)	NO	no evidence provided that the relative-lessee could afford to make the proposed lease payments for the equipment. Given the overwhelming evidence that the debtors themselves could not make the payment to the creditor without income from the lease, the court held the plan was not feasible.
10	In re Bright Harvesting, Inc., Case No. 15-11178-tr12, 2015 WL 7972717 (Bankr. N.D.N.M. Dec.)	YES	Court viewed operation of the debtor-corporation and debtor-shareholders together, even though the cases were not jointly administered or consolidated. Court concluded plan was feasible based on reasonable projections grounded in fact.

Post-Petition Financing: Crops and More

- Farmers often need post-petition financing, whether to plant a new crop or simply to fund ongoing operations.
- The challenge: providing collateral.
- Most farm security agreements include after-acquired property clauses.
- Farmers can seek approval of post-petition "production money" financing.
- 11 U.S.C. Section 364 deals with credit. A debtor (with powers of a trustee) may obtain unsecured credit "in the ordinary course of business." If the debtor is unable to obtain unsecured credit, the court may authorize secured credit under certain circumstances.

Post-Petition Financing: Secured or "Super Priority" Financing

- A court can authorize credit which has (i) "priority over all administrative expenses," (ii) is secured by unencumbered property, or (iii) is secured by a junior lien on property of the estate that is subject to a lien. 11 U.S.C. Section 364(c).
- A court may authorize credit to be secured by a "senior or equal lien" on property of the estate only if (i) the debtor cannot obtain such credit otherwise; (ii) there is "adequate protection of the interest of the holder of the lien on the property of the estate on which such senior or equal lien is proposed to be granted." 11 U.S.C. Section 364(d).
- The debtor has the burden of proof on these issues.

Post-Petition Financing: Effect of 11 U.S.C. Section 552

- This section limits the postpetition effect of a creditor's prepetition security interest.
- General rule: property acquired by the estate or the debtor after commencement of the case is not subject to any lien resulting from any security agreement entered into by the debtor before the commencement of the case. 11 U.S.C. Section 552(a).
- Exception: if the prepetition security agreement covers proceeds, products, offspring, or profits of collateral, the security interest extends to such proceeds, products, offspring, or profits acquired after commencement of the case, **except to any extent that the court, after notice and a hearing, and "based on the equities of the case," orders otherwise.** 11 U.S.C. Section 552(b).

Post-Petition Financing: Superpriority and Adequate Protection

- Section 364(d) contemplates that in order to provide a “priming” or “superpriority” lien to a post-petition creditor, the existing secured creditor must receive “adequate protection” of their interest.
- Adequate protection is defined by Section 361 (a).
- Adequate protection may be provided by (i) cash payments to the extent of a decrease in the value of the secured creditor's interest in property; (ii) additional or replacement liens; or (iii) other relief that will result “in the realization by [the secured creditor] of the indubitable equivalent of [its] interest in such property.”
- Key Point: adequate protection is designed to preserve the secured creditor's position as it existed at the time of the debtor's bankruptcy filing. *In re Windsor Hotel, LLC*, 295 B.R. 307, 314 (Bankr. C.D. Ill. 2003).

Post-Petition Financing: Is an Existing Secured Creditor “Adequately” Protected?

- The debtor must show the original creditor's interest is not being jeopardized. This inquiry considers “all of the relevant facts,” with a “particular focus” on the value of collateral, the likelihood it will depreciate or appreciate over time, the prospects of a successful reorganization, and the debtor's performance in accordance with the plan. *In re Old Prairie Block Owner, LLC*, 448 B.R. 482, 493 (Bankr. N.D. Ill. 2011).
- In some instances, an equity cushion in the form of property value has been found to provide adequate protection. *Id.*; see also *In re James Wilson Assoc.*, 965 F.2d 160, 171 (7th Cir. 1992) (“[A secured creditor] has no right to fence off the entire collateral in which it has an interest so that no other creditor can get at it. Its only entitlement is to the adequate protection of its interest.”).

Post-Petition Financing: Questions to Consider

- Can the credit be obtained on an unsecured basis?
- Is it for the acquisition of post-petition property (new crops, new animals, new equipment)?
- Will the debtor be using proceeds, products, profits or offspring of prepetition collateral?
- Are existing secured creditors oversecured?
- What effect will the financing have on the overall value of the debtor's estate? Does it enhance the value, maintain the status quo, or decrease it?

Rebecca Garcia & William Wallo



Rebecca Garcia is the Standing Chapter 12 & 13 Trustee in Oshkosh, Wisconsin. She is currently the vice-president of the Association of Chapter 12 Trustees. She received her J.D. from Marquette University in 1996. She grew up on a dairy farm in Northwest Wisconsin and is a proud 4-H alumni.



William E. Wallo is a shareholder with Weld Riley, S.C., in Eau Claire Wisconsin. A former career clerk to a bankruptcy judge, he is the current chair of the Bankruptcy, Insolvency, and Creditor Rights Section of the State Bar of Wisconsin. He grew up in Oklahoma and is a 1992 graduate of the University of Oklahoma College of Law.

Debtor:
Case No.

Chapter 12

Eligibility Checklist for Individual Farmers

Updated August 23, 2019

	Yes	No
1. Individual or individual and spouse Family Farmer - 11 U.S.C. 101(19)	☐	☐
2. Engaged in a farming operation on date of filing - 11 U.S.C. 101(21)	☐	☐
3. Aggregate debts are less than \$10,000,000.00 (8/23/19) 101(18)	☐	☐
4. Not less than 50% of debts (excluding residence) arise out of a farming operation	☐	☐
5. More than 50% of gross income arises from farming operation in the taxable year before filing	☐	☐
Or		
More than 50% of the gross income arises from farming operation in each of the 2d and 3d taxable years preceding filing	☐	☐

Eligibility Checklist for Corporate or Partnership Farmers

(Note: Not based on income at all)

	Yes	No
1. More than 50% of o/s stock or equity is held by one family, or by one family and the relatives of the members of such family	☐	☐
2. Such family or such relatives conduct the farming operation	☐	☐
3. More than 80% of the value of the assets consists of assets related to the farming operation	☐	☐
4. Aggregate debts do not exceed \$10,000,000.00 (8/23/19) 101(18)	☐	☐
5. Not less than 50% of aggregate noncontingent, liquidated debts (excluding dwelling used by shareholder or partner as principal residence) arise out of a farming operation	☐	☐
6. If a corporation issues stock, the stock is not publicly traded.	☐	☐

Chapter 12
Eligibility for Individual Family Fisherman

- | | Yes | No |
|---|--------------------------|--------------------------|
| 1. Individual or individual and spouse engaged in a commercial fishing operation (11 U.S.C. 101 (7A)) | ☐ | ☐ |
| 2. Aggregate debts do not exceed \$2,044,225 (4/1/19) 101(19)(A) | ☐ | ☐ |
| 3. Not less than 80% of debts (excluding principal residence) arise out of commercial fishing operation owned or operated by debtor | ☐ | ☐ |
| 4. More than 50% of gross income for the taxable year preceding filing arise from the commercial fishing operation | ☐ | ☐ |

Eligibility for Corporate or Partnership Fishermen
(Note: Not based on income at all)

- | | Yes | No |
|---|--------------------------|--------------------------|
| 1. 50% or more of the o/s stock is held by | ☐ | ☐ |
| a. 1 family that conducts the fishing operation | | |
| or | | |
| b. 1 family and the relatives of the members of such family, and such family or relatives conduct the fishing operation | ☐ | ☐ |
| and | | |
| 2. More than 80% of the value of its assets consists of assets related to the commercial fishing operation | ☐ | ☐ |
| 3. Aggregate debts do not exceed \$2,044,225 (4/1/19) 101(19)(A) | ☐ | ☐ |
| 4. Not less than 80% of debts are related to the commercial fishing operation | ☐ | ☐ |
| 5. If a corporation, none of the stock is publicly traded. | ☐ | ☐ |

Sample plan Language – 11 U.S.C. § 1232

Capital Gains on Sales. The capital gains arising as a result of the sale(s) of farm assets in this case shall be treated as a general unsecured claim pursuant to 11 U.S.C. § 1232. Any such claim shall be calculated as follows:

- i. Step 1: The Debtor shall calculate the tax due if all income is reported as being taxable (the “Traditional Return”)
- ii. Step 2: The Debtor shall calculate the tax due if the income from the sale of the farm assets is excluded (the “Pro Forma Return”)
- iii. Step 3: The Debtor shall subtract the tax due found in Step 2 from the tax due found in Step 1
- iv. The difference between the Traditional Return and the Pro Forma Return, as found in Step 3 of the calculation, is the tax treatable under 11 U.S.C. §§ 1222(a)(2)(A) and 1232, and shall be the unsecured claim amount that the governmental entity assessing the tax shall be permitted to file as a proof of claim in this case pursuant to § 1232(d).
- v. The chapter 12 trustee shall not make any disbursement to the general unsecured claimants until the time period for filing claims pursuant to §1232(d) has passed and all allowed general unsecured claims have been determined.



Chapter 12 De-prioritization of Income Taxes for Family Farmers

Memo for Tax Preparers:

How is the Amount of Tax Treatable as an Unsecured Claim Pursuant to § 1232 to be Calculated?

The de-prioritization of income taxes is very important for family farmers. It allows them to have claims of governmental units that arise because of the sale, transfer or other disposition of farm assets used in the farming operation whether sold before or after filing a Chapter 12 bankruptcy as well as pursuant to a confirmed Chapter 12 Plan of Reorganization, treated as a pre-petition unsecured claim that will be discharged in the Chapter 12 bankruptcy.

The Debtors' Methodology—The Marginal Approach

Step 1: Prepare a Traditional Return: Calculate the tax due if all income is reported as being taxable. (Prepare both federal and state returns just like you would normally prepare them).

Step 2: Prepare a Pro-forma Return: Calculate the tax due if income from sale of farm assets used in debtor's farming operation is excluded. This is called the Pro-Forma Return. It is sent to the IRS and state department of revenue along with the Traditional Return as well as the calculations set forth below showing how much tax is deprioritized and is therefore dischargeable through the Chapter 12 Plan of Reorganization. *Do not hesitate to contact the lawyer handling the Chapter 12 case for the taxpayer to make sure which assets are to be excluded when preparing the Pro-forma Return.*

Step 3: Subtract the tax due as found under Step 2 from the tax due under Step 1.

The difference between the tax shown on the Traditional Return and the Pro-Forma Return is the tax treatable under § 1232, which is de-prioritized and is dischargeable. The tax shown on the Pro-Forma Return is the priority tax that must be paid by the debtor. The lead case on de-prioritization of taxes is *Knudsen*.¹ The calculations of priority and de-prioritized and dischargeable tax due under the Marginal Methodology approved by the Court for the Knudsens for their federal return was as follows:

Traditional Return	\$55,319.00
Pro-Forma Return (Priority Tax)	<u>(12,701.00)</u>
Tax Treatable Under § 1232 (Dischargeable Tax)	\$43,248.00

¹ *In re Knudsen*, 389 B.R. 643, 665-69 (N.D. Iowa 2008) *affirmed* 581 F. 3d 696 (8th Cir. 2009).

Analysis: Marginal Methodology

The courts in *Knudsen* and *Ficken* are the only courts that have published opinions examining the methods of calculating the amount of tax that is to be de-prioritized under § 1222(a)(2)(A).² You will note that reference is made to the courts in *Knudsen* and *Ficken* being the only courts that have considered how much tax qualifies for de-prioritization. These cases were decided before Congress passed, and President Trump signed Pub. L. 115-72 on October 26, 2017. That law codifies the de-prioritization of claims of governmental units arising from sales, transfers or other dispositions of qualified farm assets used in the farming operation. The predecessor law has saved individual family farmers hundreds of thousands of dollars since its enactment on April 20, 2005. Since the language used in the old law 11 U.S.C. § 1222(a)(2)(A) is very similar to the language used the current code provision, 11 U.S.C. § 1232, I believe the marginal methodology approved in *Knudsen* and *Ficken*, is appropriate, and is explained above. Hopefully, no court will choose to employ the Proportional Approach suggested by the IRS. In *Knudsen*, the de-prioritized tax would have only been \$8,816.00, a decrease in tax savings of \$34,432.00 by employing the Marginal Methodology suggested by the Debtors.

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² *In re Knudsen*, 389 B.R. 643, 665-69 (N.D. Iowa 2008) *affirmed* 581 F. 3d 696 (8th Cir. 2009); *In re Ficken*, 430 B.R. 648, 659-663 (Bankr. D. Colo. 2009) *affirmed* 430 B.R. 663 (10th Cir. BAP 2010) *rev'd on other grounds* 433 Fed. Appx. 682 (10th Cir. 2011).

Addendum:

Resources on Farm Transition

There are a number of excellent resources that farmers can utilize in planning a path to economic stability or generational transition. The following list is by no means exhaustive, but may serve as a useful starting point:

1. Shannon L. Ferrell, Rodney Jones & J.C. Hobbs, Oklahoma State Univ. Dep't of Agric. Econ., Farm Transitions, (April 26, 2013), available at <http://agecon.okstate.edu/farmtransitions/>.
2. KEVIN SPAFFORD, LEGACY BY DESIGN: SUCCESSION PLANNING FOR AGRIBUSINESS OWNERS (Marketplace Books 2006).
3. Univ. of Minnesota Extension, Transfer and Estate Planning, <https://extension.umn.edu/business/transfer-and-estate-planning#treatment-of-heirs-and-relationships-1246912> (last visited Apr. 3, 2019).
4. U.S. Dep't of Agric. (USDA), Planning What's Next: Building the Next Generation on the Land, <https://newfarmers.usda.gov/planning-whats-next> (last visited Apr. 3, 2019).
5. Univ. of Vermont, The Farm LASTS Project Online Manual, <http://www.uvm.edu/farmlasts/> (last visited Apr. 3, 2019).
6. Cornell Univ., Directory of Northeast Land Link Programs, <http://smallfarms.cornell.edu/resources/beginning-%20farmer/> (last visited Apr. 3, 2019).
7. Int'l Farm Transition Network, Resources, <https://www.farmtransition.org/resources/> (last visited Apr. 3, 2019).
8. Ctr. For Dairy Profitability, Univ. of Wisconsin, Business Arrangements & Farm Transfers, <https://cdp.wisc.edu/category/paw/paw-farmsuccession/> (last visited Apr. 3, 2019).

2019 Bankruptcy Ethics Update

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I. Disclosures and Disinterestedness

Jay Alix (Mar-Bow) versus McKinsey

In re Old ANR, LLC, 2019 WL 2179717 (Bankr. E.D. Va. May 17, 2019)

In 2016, the *Alpha Natural Resources* (“ANR”) bankruptcy court granted a Mar-Bow motion to compel McKinsey to disclose the names of its creditor clients, disclose connections arising from McKinsey’s captive investment firm MIO, and disclose information concerning McKinsey’s unorthodox process for determining connections – but with all disclosures *in camera*. In that 2016 order, the ANR bankruptcy court also ruled that McKinsey was indeed a bankruptcy professional just like a law firm, and was, therefore, a fiduciary for the estate obliged to comply with Rule 2014 disclosure requirements. And it ruled that Mar-Bow was a creditor with standing to move for McKinsey’s compliance. However, the bankruptcy court later granted McKinsey’s motion to dismiss Mar-Bow’s objections to McKinsey’s fee applications, ruling that because any fee disgorgement would not be shared by Mar-Bow under the confirmed reorganization plan, Mar-Bow lacked standing to contest the fee award. On appeal, the district court granted McKinsey’s motions to dismiss for the same reasons: Mar-Bow would not benefit pecuniarily from any sanctioning of McKinsey because of the plan treatment of Mar-Bow’s claim, so it lacked standing to appeal. The Fourth Circuit affirmed for the reasons stated by the district court, and the Supreme Court denied certiorari. *Mar-Bow Value Partners, LLC v. McKinsey RTS*, 578 B.R. 325 (E.D. Va. 2017) and 2017 WL 4414155 (E.D. Va. Sept. 30, 2017), *aff’d*, 736 F.App’x 412 (4th Cir. 2018), *cert. denied*, 139 S.Ct. 1601 (Mem) (2019).

In 2018, Mar-Bow moved to re-open ANR after discovering that McKinsey’s partners and employees had invested in first lien lender claims against the ANR estate through MIO’s investment in Whitebox investment funds – with investments so massive that Whitebox received over 11% of the shares in the NewCo entity (“Contura”) that acquired most ANR assets under the confirmed plan. Mar-Bow calculated the profits from MIO’s share of Whitebox’s share of Contura shortly after the closing at over \$50 million. While the McKinsey officer who signed McKinsey’s disclosures in ANR testified shortly after the closing that Whitebox was one of the largest first lien lenders, he did not testify to MIO’s investments in Whitebox, and that was not disclosed in McKinsey’s *in camera* filings. And while McKinsey denied knowing about MIO’s investment in Whitebox, it was not only in public records, but McKinsey RTS’s founder and President, Jon Garcia, was simultaneously on MIO’s board of directors and a member of its Investment and Audit Committees from 2006 to 2017.

Mar-Bow’s motion to reopen ANR was supported by the U.S. Trustee, asserting that

McKinsey had misled it by claiming that MIO was a “blind trust,” and saying that McKinsey had never answered the U.S. Trustee’s questions regarding MIO in a forthright and satisfactory manner. The ANR court reopened the case, called the allegations against McKinsey extremely serious, and ordered a joint mediation in the ANR, *Westmoreland Coal* and *SunEdison* cases. Under a mediated settlement between McKinsey and the U.S. Trustee over disclosure objections only – not fraud on the court or lack of disinterestedness, or criminal liability – McKinsey agreed to pay \$15 million, including \$5 million for the benefit of the ANR estate

The bankruptcy court granted McKinsey’s motion to dismiss Mar-Bow’s fraud on the court claims on grounds of standing. The court again held that Mar-Bow would not benefit monetarily from any McKinsey disgorgement or other sanctions because the plan confirmation order is a final, binding order. 2019 WL 2179717 *6. The bankruptcy court acknowledged that it was empowered to determine Mar-Bow’s fraud on the court claims, but held that Mar-Bow must have standing to be the one litigating such claims. The court could appoint *amicus curiae* to pursue investigation and prosecution of the fraud on the court claims, but declined to do so, noting that the U.S. Trustee or U.S. Attorney could still pursue such litigation.

Mar-Bow has appealed. *Mar-Bow Value Partners, LLC v. McKinsey Recovery & Transformation Services US, LLC*, U.S. Dist. Ct. E.D. Va. Case No. 3:19cv552. Mar-Bow’s opening brief argues that standing is determined as of the commencement of litigation, *i.e.* when Mar-Bow began contested matters against McKinsey disputing its Rule 2014 disclosures, fee applications, and confirmation of the plan formulated with McKinsey’s conflicted involvement. A request for relief alleging fraud on the court is a continuation of the litigation that led to challenged judgments. In such “ancillary proceedings,” Article III jurisdictional factors are evaluated based on the state of things before entry of the judgment allegedly infected by fraud on the court, not the Rule 60(d)(3) motion date the bankruptcy court used.

Mar-Bow’s brief argues its Article III and Bankruptcy Code §1109(b) standing as a creditor when it raised its objections, and points out that the orders approving McKinsey’s disinterestedness based on McKinsey’s allegedly-fraudulent disclosures and approving McKinsey’s fees and confirming the plan were entered against Mar-Bow and bind Mar-Bow. It contends that the success of McKinsey’s alleged fraud on the court through plan confirmation cannot deprive Mar-Bow of standing in the continued ancillary proceeding to seek relief from the very fraud that resulted in these orders. “Loss” of standing is really a matter of mootness, as jurisdiction is not divested by subsequent events, and Mar-Bow’s fraud on the court claims are not moot.

Mar-Bow argues that even if analyzed as of the Rule 60(d)(3) motion date, Mar-Bow retained its standing. It is still a creditor, whose claim cannot be collected because of the allegedly fraudulent orders, which are binding specifically on Mar-Bow and diminish the value of Mar-Bow’s property. Creditor Mar-Bow had, and has, a legally-protected interest in conflict-free and fully-disclosing professionals advising the debtor and formulating the plan disposing of Mar-Bow’s claim. Civil penalties can redress Mar-Bow’s injuries by deterring McKinsey from ongoing and future disclosure and disinterestedness violations in bankruptcy cases. And Mar-

Bow argues that a monetary distribution to Mar-Bow from sanctions awarded against McKinsey is also likely, because fraud on the court is not a cause of action or estate asset, and need not be distributed under the plan. Indeed, McKinsey's sanctions should not be distributed under the plan because then McKinsey's partners and employees would recoup a significant portion on account of their hidden investments.

Even if Mar-Bow lacked standing, Mar-Bow argues that the bankruptcy court had a duty to resolve the fraud on the court claims that it characterized as extremely serious and impacting the whole integrity of the bankruptcy system by appointing *amici* or an investigator to investigate and present the facts to the court for resolution on the merits, while providing McKinsey with the full protection of an adversary proceeding.

Alix v. McKinsey & Co., 2019 WL 3889855 (S.D.N.Y. Aug. 19, 2019)

While recognizing that Alix's allegations against McKinsey in its RICO action are "certainly troubling," the court dismissed that suit on proximate cause grounds. The decisions of debtors and trustees not to hire AlixPartners was independent, intervening third-party conduct that most directly inflicted any harm.

In re SunEdison, Inc., 2019 WL 2572250 (Bankr. S.D.N.Y. June 21, 2019)

Mar-Bow was held to lack standing to prosecute a claim of fraud on the court against McKinsey, given that any such cause of action was assigned to a litigation trust under a confirmed plan. The court declined to conduct its own investigation, and left the question of whether and how to investigate Mar-Bow's allegations to the Department of Justice.

In re PG&E, U.S. Bankr. N.D. Cal., Case No. 19-30088 Dkt. 4426, Oct. 23, 2019

A recent declaration by Jay Alix, filed in *In re PG&E*, describes the status of Mar-Bow's litigation against McKinsey in various cases. A copy is attached as Exhibit 1.

In re Westmoreland Coal Co., U.S. Bankr. S.D. Tex., Case No. 18-35672 (DRJ)

Mar-Bow acquired a claim and objected to McKinsey's employment application and disclosures in *Westmoreland Coal* early in that bankruptcy case, before McKinsey's employment was approved, avoiding the "standing" arguments McKinsey made in *ANR*. The U.S. Trustee also objected. One argument is that McKinsey's partners and employees held indirect equity interests, through MIO-managed investments, in 35 *Westmoreland Coal* creditors, including three that acquired assets from the debtors under the plan in satisfaction of their claims.

After the U.S. Trustee-McKinsey settlement agreement reached in the *ANR*, *SunEdison*, *Westmoreland Coal* joint mediation was announced, but before the settlement motion was filed, the court approved confirmation of the *Westmoreland Coal* reorganization plan, and its effective date occurred. The *Westmoreland Coal* court later approved the McKinsey-U.S.

Trustee mediated settlement. In connection with the joint mediation, McKinsey proposed that it retain an expert to work with McKinsey to develop new disclosure protocols, and then file new disclosures in *Westmoreland Coal* in accordance with the protocols, deferring McKinsey's employment application and Mar-Bow discovery in the meantime.

D. Jan Baker agreed to serve as that expert, declining any compensation. The protocol he developed was filed in the *Westmoreland Coal* case at docket 1907-1. A copy is attached as Exhibit 2.

McKinsey withdrew its initial employment application and filed a new one on July 3, 2019, with new declarations referring to the protocol. The U.S. Trustee responded that McKinsey's disclosures remained incomplete, inadequate, and raised questions. These included failure to disclose connections of all McKinsey affiliates and withholding of critical information about how it keeps consulting services separate from MIO, what information McKinsey professionals have about MIO investments and vice versa, and whether McKinsey restricts MIO investments in McKinsey clients. Mar-Bow also filed a detailed objection. Court-authorized discovery included lengthy depositions of Jay Alix and McKinsey's disinterestedness declarant, Mark Hojnacki. McKinsey filed additional disclosures, which Mar-Bow criticized.

On October 29, 2019, Bankruptcy Judge Jones denied McKinsey's motion to dismiss Mar-Bow's objections to McKinsey's employment for lack of standing. The court said that he put the integrity of the bankruptcy process above all else, and would not let anyone or anything taint it. He ordered an evidentiary hearing, where he can judge the credibility, honesty and integrity of the witnesses, instead of lawyer-prepared declarations, to decide "who survives and who does not." The court said that "if McKinsey has done something wrong, it will be an incredibly harsh result." (TR 10/29/19 at 77-78) It promised detailed findings of fact and conclusions of law, ordered completion of discovery by January 31, 2020, and scheduled trial on February 5-6, 2020.

Underlying Caselaw on Professionals with Interests in Interested Parties

Fiduciaries of a bankruptcy estate are prohibited from holding an interest adverse to the estate "not because such interests are always corrupt but because they are always corrupting." *Mosser v. Darrow*, 341 U.S. 267, 271 (1951). When a professional "has served under an undisclosed disqualifying conflict of interest, the bankruptcy court cannot always assess with precision the effect the conflict may have had either on the results achieved or the results that might have been achieved by following 'the road not taken.'" *Rome v. Braunstein*, 19 F.3d 54, 62-63 (1st Cir. 1994) (quoting *Woods v. City Nat'l Bank & Trust Co. of Chicago*, 312 U.S. 262, 269 (1941)); see also *In re Interwest Bus. Equip., Inc.*, 23 F.3d 311, 317 (10th Cir. 1994) ("We also find it is impossible to know if the terms of the confirmed plans were affected by the joint representation.").

Estate fiduciaries cannot hold or acquire an interest in estate assets or creditors' claims, directly or indirectly. 11 U.S.C. §§101(14)(C), 327(a). They cannot involve themselves with

parties acquiring estate property, or attempting to do so, without becoming disqualified. *In re New River Dry Dock, Inc.*, 497 F. App'x 882, 887 (11th Cir. 2012); *In re W. Delta Oil Co.*, 432 F.3d 347, 356-57 (5th Cir. 2005); *In re Brook Valley VII, Joint Venture*, 496 F.3d 892 (8th Cir. 2007). A professional's employees cannot hold equity interests in interested parties in the case. *E.g. In re Leisure Dynamics, Inc.*, 33 B.R. 121, 122-23 (D. Minn. 1983); *In re Intech Capital Corp.*, 87 B.R. 232, 234-35 (Bankr. D. Conn. 1988); *Matter of Cropper Co., Inc.*, 35 B.R. 625, 630-31 (Bankr. M.D. Ga. 1983).

Likewise, estate professionals cannot advise investors to acquire estate assets without losing disinterestedness status. *Rome*, 19 F.3d at 61 (The professional's role affords "unique access to inside information concerning the nature and value of [estate] assets, information that [the professional] could have used (or been tempted to use) to enable his other client . . . to submit a better calibrated bid than arm's-length bidders could venture."); *In re Unitcast, Inc.*, 214 B.R. 979, 987-88 (Bankr. N.D. Ohio 1997) (debtor's financial advisor who "performed a wide variety of tasks which largely shaped the companies' financial and operational structure," and also advised a major secured creditor who was to buy the estates' assets under the plan, became non-disinterested on account of the inherent conflict of interest.).

Hidden involvement and concealed profit of a debtor's CEO in a purchase of estate assets has been held a fraud on the court. *In re Intermagnetics Am., Inc.*, 926 F.2d 912, 914-18 (9th Cir. 1991). Failure to disclose disqualifying connections as required by Bankruptcy Rule 2014 has also been held a fraud on the court. *In re eToys, Inc.*, 331 B.R. 176, 188 (Bankr. D.Del. 2005); *see Pearson v. First NH Mortg. Corp.*, 200 F.3d 30 (1st Cir. 1999) (colorable claim for fraud on the court when conflicts of interest were not disclosed in Bankruptcy Rule 2014 statement, justifying discovery and evidentiary proceedings); *Denison v. Marina Mile Shipyard, Inc.*, 2012 WL 75768 *5 (S.D. Fla. Jan. 10, 2012), *aff'd*. *New River Dry Dock*, 497 F. App'x at 885-86; *In re M.T.G., Inc.*, 366 B.R. 730, 748-53 (Bankr. E.D. Mich. 2007) (all elements of fraud on the court claim met when attorneys failed to disclose potential conflicts of interest, deceiving bankruptcy court), *aff'd*, 400 B.R. 558, 568 (E.D. Mich. 2009); *In re Southmark Corp.*, 181 B.R. 291, 296 (Bankr. N.D.Tex. 1995) ("The court finds that Coopers' failure to fully disclose connections and activities with and regarding Drexel prevented the court from fully performing its function under the Bankruptcy Code and thereby frustrated the purposes of the Code to assure that the professional person employed by the examiner tenders undivided loyalty and provides untainted advice and assistance."); *see also Am. United Mut. Life Ins. Co. v. City of Avon Park*, 311 U.S. 138, 142-48 (1940) (plan confirmation order vacated pursuant to creditor's petition because fiscal agent authorized to solicit votes was also a creditor and did not fully disclose its interests and benefits it would receive from confirmation).

Other 2019 Disclosure and Disinterestedness Cases

In re Stewart, 600 B.R. 425 (BAP 10th Cir. 2019), affirming 583 B.R. 775 (Bankr. W.D. Okla. 2018)

The bankruptcy court did not abuse its discretion by sanctioning a chapter 7 debtor's attorney \$25,000, but not disgorgement of all \$350,000 of compensation received, for failure to

disclose the amount and source of his fees. The lawyer did not disclose the payments until a hearing on approval of an adversary settlement, two years after the lawyer started working.

Fee reasonableness was not questioned in the bankruptcy court, just disclosures, so the BAP considered only Code §329(a), Rule 2016(b) and penalties for disclosure violations. It noted that complete disgorgement could have been ordered. The Tenth Circuit has not adopted a multi-factor test to determine appropriate sanctions, nor has it expressly set forth the relevant factors a bankruptcy court should consider. Accordingly, the BAP held it was within the bankruptcy court's discretion to consider not only the egregiousness of the nondisclosure, but also factors relevant to sanctioning under Rule 9011 and under the court's inherent powers, and decisions from other circuits.

Westlaw shows a further appeal is pending to the circuit.

In re M&P Collections, Inc., 599 B.R. 7 (Bankr. W.D. Ky. 2019)

The court held that a law firm was not disqualified from serving as DIP counsel to multiple debtors in jointly administered chapter 11 cases merely because of inter-company debt. They were liquidating cases, with insufficient funds to fully satisfy the claims of priority creditors. It was extremely unlikely there would be any distribution on inter-company claims. The firm received \$35,000 from one client to fund a \$25,000 retainer for that debtor and a \$10,000 retainer for the other debtor.

Mere creditor status is not disqualifying under §327(c), and multiple courts have held that the presence of intercompany claims between debtors represented by the same firm does not automatically warrant disqualification. There is only a potential conflict until and unless there are funds available to pay unsecured creditors. Such potential conflicts are not disqualifying. And the two debtors were operating to achieve a common goal, not to obtain an advantage over each other, so there was no active competition between the interests of the two where one could only be served at the expense of the other. DIP counsel was directed that if an actual conflict were to arise, the firm should notify the court. The firm should take no action on any inter-company dispute, but instead notify the court and U.S. Trustee, and the court would determine what, if any, remedies should be put into place.

In re Earl Gaudio & Son, Inc., 2019 WL 1429978 (Bankr. C.D. Ill. Mar. 29, 2019)

The debtor filed its chapter 11 petition in 2013, through a bank designated as the company's custodian in state court shareholder litigation between warring family members. The custodian's counsel in the state litigation avowed disinterestedness and lack of any present connection with the estate, creditors or other parties in interest, acknowledging that it held an unsecured claim against the debtor and represented certain creditors on other matters. The custodian likewise asserted that it held an unsecured claim, but avowed no other connections, and made no mention of any prepetition payments.

The debtor, through the custodian, sold most assets shortly after the case was filed, with only a warehouse left to sell. It then filed an adversary complaint against the seller of the warehouse to the debtor, who still owned adjacent property, along with numerous other adversary complaints to recover money or property or determine liens. Some significantly benefited the estate, while others cost the estate significantly with little benefit. In 2017, the debtor finally sold the warehouse to the original owner and only participating bidder. DIP counsel filed fee applications, and admitted at the application hearing that the estate was insolvent, with professional fees exceeding assets by approximately \$1.3 million. They proposed a plan with a \$30,000 carve-out for unsecured creditors. Then they objected to a \$708,000 claim of the estate of the company's deceased founder.

Only after the probate court denied approval of a proposed settlement of that claim objection (that the custodian opposed, through DIP counsel), in 2018, did the custodian and DIP counsel disclose that the custodian was the trustee of prepetition revocable trust agreements of the deceased founder and his widow. And the deceased founder had allegedly guaranteed the debtor's prepetition loan to the warehouse buyer and assigned his interest in the trust assets as security. This had led to probate litigation over the trust funds in 2016-17, including complaints against the custodian who refused to honor the buyer's payment demand, where the custodian was represented by DIP counsel. The 2018 supplemental disclosure included the custodian's claim in the founder's probate action for indemnification and reimbursement of fees relating to the trust agreements and litigation. When DIP counsel later filed a final fee application after plan confirmation, the firm disclosed that it had received an interim payment from the custodian of over \$120,000 in 2015, resulting in an overpayment to the firm under the plan, that adversely impacted the parties' ability to negotiate the plan at all. The fee application generated a number of objections, including to \$35,000 in fees drafting and negotiating the confirmation order.

The custodian and DIP counsel contended that their involvement in the probate matters never "rose to the level of a 'connection' under Rule 2014." They also tried to distinguish between their roles as custodian and counsel to the debtor and as trustee and trustee's counsel for trusts covering the same assets to which some of the debtor's creditors had claims. The court held that any such distinction was for the court to draw, and whether or not the connections would ever prove to be problematic is irrelevant to Rule 2014 disclosure obligations. The court denied all fees not previously approved and paid, and ordered disgorgement of all amounts paid without court authorization.

In re Sanabi Investments, Inc., 2019 WL 4010811 (Bankr. S.D. Fla. Aug. 23, 2019)

DIP counsel for a chapter 11 LLC was held to have violated ethics rules by representing the debtor and its principal in a manner that violated counsel's duties to the LLC debtor. He allowed the debtor's principal to take undisclosed distributions to fund the principal's own chapter 13 plan even though the LLC needed the money. The lawyer disclosed the dual representation when the chapter 13 case was filed, but never recognized, acknowledged or

disclosed the conflict that arose from the transfer of funds from one debtor to the other. The court allowed counsel to keep his retainer, but disallowed all other fees.

In re Davis, 2019 WL 4127146 (Bankr. D.N.J. Aug. 29, 2019)

The court ordered disgorgement of fees charged by a chapter 13 debtor's counsel, on the debtor's motion after her case was dismissed. The debtor argued that her lawyer had colluded with counsel for her mortgage creditor, but the court ruled on other grounds. The lawyer's Rule 2016 declaration was inaccurate with respect to the retainer amount and in stating that he would represent the debtor in adversary proceedings, while the retainer agreement limited representation to exclude such litigation. More importantly, the lawyer failed to provide the debtor client with the written disclosures mandated by Code §527. Under §526(c), the engagement agreement was therefore void and unenforceable by anyone other than the client. The court held that it could order fees to be disgorged partially or entirely, depending on the debtor's willingness to pay anything. Only the debtor can enforce a void contract under §526(c), and this debtor wanted all fees disgorged. Moreover, the court noted that counsel refused to acknowledge that he committed a serious error and showed no remorse.

In re Brenda Diana Nestor, 2019 WL 4735833 (Bankr. S.D. Fla. Sept. 26, 2019)

An individual chapter 11 debtor engaged "a parade of professionals," to represent her, with repeated disclosure violations and later discovery of non-disinterestedness, before and after appointment of a chapter 11 trustee. After the trustee's appointment, when engaged by the debtor not acting as DIP, counsel's actions adverse to the interests of the bankruptcy estate may still be held to violate ethics duties to a former client (the trustee as replacement manager of the DIP). Filing a complaint like one previously prosecuted on behalf of the DIP, that interfered with the trustee's settlement efforts, was held to be substantially related to the previous representation and barred by Rule of Professional Conduct 1.9. This warranted an offset to allowed fees in the amount of harm incurred by the trustee, its attorneys' fees.

Some professionals were sanctioned for incompetence, and some for accepting postpetition payments without court approval or disclosure. The court also held that when its approval order is not *nunc pro tunc*, and when the particular services performed are not within the scope of authorized work, the professional is not entitled to compensation.

In re Sugarloaf Holdings, LLC, 2019 WL 1494544 (Bankr. D. Utah Apr. 2, 2019)

Like *Nestor*, the professional's employment approval order was not entered *nunc pro tunc*. The factors considered in the Tenth Circuit for such relief were not met. The professional could not collect fees for services billed before the application to employ was filed.

In re Sanasy, 2019 WL 642836 (Bankr. D. Me. Feb. 14, 2019)

A chapter 7 trustee was not permitted to engage a law firm that previously represented the debtor as §327(e) special counsel to file a fraudulent conveyance adversary complaint against the debtor. The firm, as plaintiff itself, had sued the debtor to recover fraudulent transfers and sought to recover damages from the debtor's son, who was a source of the debtor's income, as well as from the debtor. It therefore held an interest adverse to the debtor with respect to the matter on which the attorney sought to employ the firm, disqualifying the firm under §327(e). Moreover, the law firm learned of at least some facts relevant to the trustee's proposed litigation in the course of the firm's prior representation of the debtor. That is a disqualifying conflict of interest in light of the firm's duties to its former client.

In re NNN 400 Capital Center 16, LLC, 2019 WL 5073844 (Bankr. D. Del. Oct. 9, 2019)

A group of lenders moved for an OSC requesting sanctions, including an assessment of their attorneys' fees in bringing the motion, after the court expressed concern over the accuracy of professionals' disclosures in connection with their special counsel employment application. The professionals argued that because their failure to disclose was not in bad faith, the court could not impose fee-shifting sanctions pursuant to its inherent power. The court held that it nevertheless could impose such sanctions under Code §105, and under Rule 9011. The court need only find "objectively unreasonable conduct," which was met by finding the professionals' conduct to have been, at a minimum, negligent. The lenders sought fees and costs exceeding \$238,000 for 30 pages of briefing and oral argument by three law firms. The court agreed with the professionals that the amount was excessive, and ordered a reduced amount in a separate order.

Moffa & Breuer, PLLC v. Marchelos, 2019 WL 1979367 (S.D. Fla. May 3, 2019)

The Moffa law firm filed a chapter 11 case as counsel for a corporate debtor, purportedly authorized by a 50% shareholder claiming to be its president, despite having reviewed state court litigation where the other 50% shareholder was designated president under a mediated settlement. A chapter 11 trustee was appointed to operate the company during the bankruptcy case while the state court concluded litigation (after stay relief) confirming the other shareholder's status as the true corporate president.

While representing the debtor, the Moffa firm filed a notice of appearance on behalf of a trust that owned stock in the debtor that previously belonged to the purported president's deceased husband. Mr. Moffa was trustee of the trust. The bankruptcy court ordered the Moffa firm disqualified to represent the trust and the debtor, then disqualified to represent the debtor. The Moffa firm moved to represent the trust again, which was denied. Yet the Moffa firm still filed a competing chapter 11 plan to the one filed by the other shareholder/true president and chapter 11 trustee. Under the competing plan, Mr. Moffa would be the president of, and manage the debtor. The Moffa firm also filed a ballot rejecting the true

president/chapter 11 trustee plan, an objection to its confirmation and a motion to dismiss the case, prompting an OSC from the court why the firm should not be disciplined. Then the Moffa firm, as “former counsel for the debtor,” moved for court approval of fees and costs exceeding \$110,000.

The court disallowed all fees on grounds the firm did not prove its work was beneficial at the time the service was rendered toward completion of the case, and was not reasonably likely to benefit the estate. The court found that the firm filed the case without proper corporate authority and acted in its own self-interest, revealed by its proposed plan that would place Mr. Moffa in control of the debtor as president. The district court held that under these findings, Moffa’s lack of disinterestedness justified denial of compensation under Code §328(c).

In re Crawford, __ F.App’x __, 2019 WL 3891378 (11th Cir. Aug. 19, 2019)

The DIP paid DIP counsel \$34,400, requested in a fee application, before the court ruled on the application, and reported it in the monthly operating report. Despite court orders to prove the funds remained in the attorney’s trust account as he represented, DIP counsel spent the money for personal reasons. The bankruptcy court held the attorney committed professional misconduct by failing to keep the funds in trust, spending the money, and misrepresenting to the court that the funds were to compensate him for legal services rather than to facilitate plan confirmation. The court ordered the attorney to refund the debtor \$34,400, pay the attorneys’ fees of the creditor who litigated the trust account issue, and return previously allowed interim fees to compensate the debtor for “actual losses.”

The appellate court held the attorney did not misrepresent the funds as a fee payment, but he did violate §330 and ethical rules by taking the funds out of trust before court approval. The only part of the sanctions it questioned was the order to disgorge interim fees previously paid. It held the bankruptcy court could have ordered the attorney as a sanction, but must explain its reasons on remand because that disgorgement would not compensate the debtor for actual losses.

In re Duro Dyne National Corp., 2019 WL 4745879 (Bankr. D.N.J. Sept. 30, 2019)

The most appropriate standard by which to evaluate the appointment of a future claims representative is the disinterested person standard under Code §101(14). *Contra, In re The Fairbanks Co.*, 601 B.R. 831 (Bankr. N.D. Ga. 2019) (appointment of a future claims representative involves the same considerations as appointment of a guardian ad litem).

II. Professional Duties

In re Mack Industries, Ltd., 2019 WL 3822315 (Bankr. N.D. Ill. Aug. 14, 2019)

The bankruptcy court refused to disqualify an attorney who represented chapter 7 debtors from concurrently representing defendants in avoidance actions brought by the

chapter 7 trustee. The lawyer had also represented on debtor for a few days in its chapter 11 case, assisting DIP counsel to evaluate and consent to appointment of chapter 11 trustee.

While chapter 7 debtors have duties under Code §521 to cooperate with the trustee and turn over documents and information, no such duties are imposed on counsel for a chapter 7 debtor. That debtor's attorney's duties are governed by rules of professional conduct, with fiduciary duties only to the debtor client, not the estate or chapter 7 trustee. The court noted a few reported cases stating that chapter 7 debtor's counsel owed such a duty, but found them unpersuasive.

III. Appearance Counsel

In re Gross, 2019 WL 3731535 (BAP 9th Cir. Aug. 7, 2019)

The court defined "appearance counsel" as an attorney other than counsel retained to represent the debtors in their cases, who for a fixed fee agrees to represent the debtors solely for the purpose of a court appearance. It noted that appearance counsel often appear at routine hearings in bankruptcy cases without adverse results, but they typically are ill-prepared to address any issues that arise requiring an understanding of the history of their clients or their bankruptcy cases. In *Gross*, appearance counsel attended a chapter 13 plan confirmation hearing. The chapter 13 trustee did not file written objections to the amended plan, but raised concerns about the debtors' chapter 13 eligibility for the first time, and appearance counsel was unable to adequately address the new issues. Nor did he specifically request a continuance or a chance to amend the plan or argue about the trustee's factual computation errors. Appearance counsel suggested that regular counsel should have an opportunity to brief the debt limit issue. The court ruled that the debtors had seven days to convert to chapter 7 or the case would be dismissed.

The debtors' chapter 13 counsel instead moved for relief under Civil Procedure Rules 59 and 60, alleging denial of due process by not being given a reasonable or adequate opportunity to address the trustee's objections. The bankruptcy court denied the motion and dismissed the case. The BAP ruled this was an abuse of discretion, including because the chapter 13 trustee admitted the debtors were indeed eligible for chapter 13.

In re Schatz, 601 B.R. 864 (Bankr. D. Conn. 2019)

The court defined appearance counsel as an attorney who appears at proceedings at the request of and on behalf of the debtors' chosen attorney. It noted that they are not generally disclosed to the court or debtor client before their appearance, and often know little or nothing about the case. Both primary and appearance counsel in *Schatz* were sanctioned for noncompliance with Rule 2016(b). They did not work at the same law firm, but shared a mailing address and perhaps office space. Primary counsel's Official Form 2030 disclosed her compensation agreement, and represented that there was no fee-sharing agreement. However, she advised the client that appearance counsel would cover some of the hearings and

she would share her retainer with him. She did pay appearance counsel \$500, and he appeared at five hearings, where the court deemed him “generally ineffective,” repeatedly deferring to the absent primary attorney regarding facts and actions needed to confirm the debtor’s chapter 13 plan. Primary counsel told the court that she did not share fees, but paid appearance counsel as an operating expense.

The court noted that the Rule 2016 requirement to disclose fee sharing arrangements except with a member, partner or regular associate of the lawyer’s firm tracks the provisions of Code §504, and that “regular associate” is defined in Rule 9001(10). Under that definition, most courts prohibit debtor’s counsel from hiring contract attorneys. The practice of undisclosed appearance attorneys creates problems with respect to negotiation and communications among the debtor, creditors and trustee, and can promote a lack of accountability. They rarely are listed as counsel of record, raising questions as to their authority to speak for the debtor. The use of appearance counsel also implicates RPC 1.1 (competence); 5.1 (supervisory counsel and client communication).

If primary counsel needs assistance from another attorney, she should require the additional attorney to (1) execute a written retention and fee agreement with the debtor, (2) file a notice of appearance and Form 2030 at the commencement of representation, (3) seek compensation directly from the debtor, and (4) create a document outlining the tasks and responsibilities to be completed by each attorney. Any payments not previously disclosed must be supplementally disclosed within 15 days after payment, under Rule 2016(b).

In re Bennett, 2019 WL 3805975 (Bankr. D. Conn. Aug. 13, 2019)

In this companion case to *Schatz*, the judge sanctioned the same primary debtor’s counsel by denying fees not timely disclosed and ordering their disgorgement, and sanctioned the same appearance counsel (who was not paid by the debtor) by a fine of \$500 payable to a pro bono fund, with both attorneys ordered to complete 3 hours of ethics CLE. Appearance counsel failed to file a notice of appearance in violation of a local bankruptcy rule. While he was not paid by the debtor, primary counsel billed the debtor for his time, and appearance counsel did not provide competent representation.

IV. Internet Bankruptcy Law Firms

Law Solutions of Chicago LLC v. Corbett, 2019 WL 1125568 (N.D. Ala. Mar. 12, 2019)

UpRight Law settled adversary proceedings with the U.S. Trustee in two cases, where it agreed to pay \$50,000 to the trustees in those cases, a 6-month bar on filing new cases in the district, and provide the services referred to in its standard retention agreement to clients who retained the firm before a specified date without charging additional attorneys’ fees except for adversary proceedings. The agreement did not expressly require UpRight to amend retention agreements or Rule 2016 disclosure statements. The court agreed with the U.S. Trustee that after the settlement, UpRight should have changed its standard disclosure statements, and

acted in bad faith when the firm did not do so, even though UpRight said they did not intend to and did not charge the additional fees referenced in the disclosures.

The district court upheld the bankruptcy court's severe sanctions (18-month ban on new filings; total refund of all fees to clients whose cases had not yet been filed; monetary penalties of \$150,000 and disgorgement of all fees in post-settlement cases). The bankruptcy court had authority to impose such sanctions, the record supported misrepresentations in fee disclosures, and that supported the finding that UpRight was undeterred by the original settlement agreement sanctions and additional measures were necessary to prevent further abuse of the bankruptcy process.

In re Butler, 2019 WL 2618069 (Bankr. S.D. Tex. June 26, 2019)

Attorney A contracted with Synergy Law, LLC, an internet bankruptcy company that prepared and filed bankruptcy petitions, to make court appearances on Synergy cases for a flat fee. Attorney A authorized Synergy to use his ECF filing credentials, and demonstrably failed to comprehend the extent and severity of his ethical breaches at a hearing on grossly deficient Synergy filings. At a hearing on Attorney A's proposed sanctions order, negotiated with the U.S. Trustee, a former client objected and disclosed that Attorney A had also negotiated a \$15,000 settlement with Attorney B of that former Synergy client's claims of improper filing. Attorney A offered to refer Synergy clients to Attorney B if Attorney B would settle the former client's dispute for a reduced amount. The court concluded that it had a mandatory duty to report Attorney A to the U.S. Attorney and FBI pursuant to 18 U.S.C. §3057(a) for his attempted bribe, violating 18 U.S.C. §152(6).

In re Blevins, 2019 WL 575664 (Bankr. N.D. Tex. Feb. 12, 2019)

A Texas attorney in a "partnership agreement" with Law Solutions Chicago LLC, d/b/a UpRight Law LLC, where he had no voting rights or equity or ownership status, met the status of a being in a "firm" and the lawyer being, at least, a "regular associate," for purposes of avoiding the prohibition on fee sharing in Code §504(a) and Rule 9001. The court followed *In re Williams*, 2018 WL 832894 at *21-24 (Bankr. W.D. Va. Feb. 12, 2018).

Matter of Banks, 770 F. App'x 168 (5th Cir. 2019), affirming *Law Sols. Chicago LLC v. United States Tr.*, 592 B.R. 624 (W.D. La. 2018)

The Fifth Circuit affirmed the district court in a memorandum opinion. The district court said last year that the bankruptcy court's characterization of UpRight Law as a "referral service" and "marketer of legal services" (*In re Banks*, 2018 Bankr. LEXIS 315 (Bankr. W.D. La. Feb. 2, 2018)) was *dicta*, but even if a finding of fact, was not clearly erroneous.

V. 2019 Sanctions Cases

In re Gravel, 601 B.R. 873 (Bankr. D. Vt. 2019)

The bankruptcy court imposed sanctions on a chapter 13 mortgage lender for violating Rule 3002.1. The court had entered orders that the debtors in several cases had cured all prepetition mortgage defaults and were current on all postpetition payments, then the creditor consistently and repeatedly sent them incorrect statements that additional fees were owed. The district court held that the bankruptcy court could only impose sanctions “short of punitive sanctions” under its inherent power. On remand, the court analyzed the sanctions it had authority to impose.

The court found (1) it has the authority pursuant to Rule 3002.1, pertinent caselaw, and its inherent powers, to impose punitive sanctions on a creditor for its violations of Rule 3002.1; (2) it has the authority, pursuant to § 105(a) and its inherent powers, to sanction the creditor for its breach of orders that the debtors were current on their payments; (3) there are specific dollar amount caps which set the outer limits of “modest,” or “less than serious,” sanctions; (4) those caps may be adjusted to correlate to the present value of those dollar amounts; (5) the bankruptcy court has the authority to impose punitive sanctions on the creditor for its Rule and current payment order violations, provided the amount of the sanction imposed in each case does not exceed the caselaw-defined cap for a non-serious sanction; and (6) based on the facts and circumstances of these cases, it was appropriate for the creditor to pay the sanctions for its Rule 3002.1 violations to the chapter 13 trustee and the sanctions for its court order violations to Legal Services Vermont.

In re Willis, 604 B.R. 206 (Bankr. W.D. Pa. 2019)

A chapter 13 debtors’ lawyer was sanctioned for mishandling 32 cases. He charged each debtor an expense retainer of \$500 for filing fees, then filed each petition without paying the filing fees, and instead moving for permission to have them paid in installments. The motions averred inability to pay, yet the retainers were sufficient to pay the fees in full, received prior to his filing the motions, and some of the debtors had additional assets. The lawyer received payment of attorneys’ fees in some cases, despite the Rule 1006(b)(3) prohibition on fee payments before completing the filing fee installment payments. And he commingled the funds received for costs in his operating account instead of his trust account. When cases were closed or dismissed, he did not return unused filing fees to his clients, and none of his clients saw or signed the installment motions, which were marked “/s/”. When the court asked about other e-signed documents without “wet” signatures, he claimed to always obtain them, then identified 42 cases without debtor “wet” signatures.

The lawyer mitigated his misconduct by accepting responsibility and taking remedial steps promptly. The opinion describes the lawyer’s professional conduct rule violations, and held that the mitigating factors warranted permitting the lawyer to continue practicing in the bankruptcy court. Further remedial action was also ordered, including the return of expense

retainer funds, refunding \$100 to each client whose “wet” signature was not obtained, continuing CLE and cooperation with an IOLTA audit.

In re Frillman, 2019 WL 4412272 (Bankr. M.D. Fla. Sept. 13, 2019)

The court approved a settlement between a consumer debtors’ attorney and the U.S. Trustee. The lawyer stipulated to multiple instances of misconduct and a pattern of substandard services, including filing petitions and schedules without client “wet” signatures, not timely noticing hearings as required by the court, causing significant administrative problems for chapter 13 trustees by his overuse of motions to vacate dismissals, and representing debtors who file multiple, incomplete bankruptcy petitions to improperly delay foreclosure sales. His cases often resulted in sanctions for himself or his clients, and often were dismissed without discharges. He was suspended from practice in bankruptcy court for 180 days, during which he was required to take 15 hours of CLE, with suspension stayed for 30 days to allow him to close or transfer existing cases.

In re Pina, 602 B.R. 72 (Bankr. S.D. Fla. 2019)

A chapter 7 debtor’s attorney who filed schedules and SOFA with false representations that they were executed by the clients violated Rule 9011 in this and “over 100” other cases. The schedules and SOFA also were incomplete and misleading, concealing relevant financial information. Neither the attorney nor her client attended the 341 meeting, and she suggested (without moving for) dismissal when confronted with the absence – a practice of allowing dismissal that enabled her deception to proceed for years. When ordered to produce originally-signed versions of court filings for the previous two years, she produced none, and acknowledged that original client signatures were on drafts with variations from the filed documents. In many instances, she filed basically blank schedules, not claiming exemptions or listing known creditors. Dollar amounts on ECF filings differed from client-signed drafts. Some filings were made by ECF tens or even hundreds of days after the client signed drafts. She was suspended for two years, and referred to the Florida bar disciplinary authority with a recommendation of disbarment. *See Patricia Redmond and Ashley Champion, Getting Debtors Back to the Future: The Case for Abolishing the “Wet Ink” Signature Requirement*, ABI Journal 22 (Oct. 2019).

See also In re Klitsch, 587 B.R. 287 (Bankr. M.D. Pa. 2018)

While some jurisdictions require “wet” pen to paper signatures, in Pennsylvania an original signature can be electronic under a state statute. The court noted that neither the Code nor the Bankruptcy Rules requires a “wet” signature. It said the real issue is compliance with the verified signature requirements on all documents of Bankruptcy Rules 1008 and 9011. The ECF user’s electronic signature on e-filed documents serves as a signature for Bankruptcy Rule 9011 purposes. The debtor’s lawyer cannot endorse petitions and schedules for the client. The lawyer’s e-signature instead is a statement that the lawyer is in possession of a document signed by the individual debtor prior to the e-filing.

The local UpRight Law lawyer acknowledged filing petitions that had not been signed by the clients. His filings were therefore “tantamount to forgery.” The court noted that Rule 9011 provides a ready remedy for securing the proper execution of documents, but the safe harbor provisions of that rule result in false certifications not generally reaching the court’s attention.

Here, the trustee filed a motion seeking relief under § 105 and the court’s inherent power. The court found no evidence that the filings were contrary to client wishes or that the lawyer acted in bad faith or to perpetrate a fraud. The court sanctioned UpRight Law and the local attorney under Rule 9011(c) as a “lesser included offence” of paying the trustee’s attorneys’ fees. It also found that the lawyer’s false certification of client signatures compelled a referral to the U.S. Attorney. And UpRight Law and the local partner were ordered to prepare a 10-page memorandum on the necessary elements of Bankruptcy Rule 1008 and possible penalties for violation of that rule, and to circulate it to the 400+ partners of Upright Law within 30 days.

In re Hazlett, 2019 WL 1567751 (Bankr. D. Utah Apr. 10, 2019)

This case thoroughly discusses the legal and ethical issues of bifurcated fee arrangements for chapter 7 debtors and factoring client fee payments, and clients using electronic signatures. A debtor lacking funds to pay an up-front cash retainer was offered two alternative payment arrangements by a firm named Capstone Law:

(1) “\$500 Down” – a \$500 prepetition agreement to prepare and file the petition and application for installment filing fees, after which the debtor would have the options of (a) proceeding *pro se*, (b) hiring another attorney to complete the case, or (3) entering into a postpetition fee agreement with Capstone to complete the case, at a cost not stated in the opinion; or

(2) “Zero-Down” – a prepetition arrangement with the same postpetition options, but \$0 for prepetition work, and pay 10 monthly installments of \$240 – the option chosen by the client (which ended up being \$207/month for a \$2,000 fee plus filing fees).

The opinion does not quote the disclosures, explanations and warnings to the client, but says they were extensive, including some 50 paragraphs of ink-initialed instructions prepetition, and more postpetition. The bankruptcy papers were e-signed by the debtor using AdobeSign, with the attorney maintaining a log of documents emailed to the debtor, reviewed by him, and when he signed and returned them. Capstone made timely filing fee installment payments as part of the postpetition fee agreement. It received monthly payments through automatic withdrawals from an account of the debtor’s non-filing spouse. The debtor filed a consent to Capstone’s factoring relationship with a collection agent. The bankruptcy case proceeded smoothly, with Capstone representing the debtor at the 341 meeting, otherwise assisting the

debtor in all tasks, no adversary proceeding filings, the debtor receiving a full discharge, and the no-asset case being closed.

On a motion of the U.S. Trustee, the case was reopened. The trustee moved for cancellation of the fee agreement, fee disgorgement, and monetary sanctions. The court's analysis discusses the challenges faced by debtors and their counsel when the debtors can't afford an up-front retainer. The court held that the bifurcated fee arrangement is not prohibited by the Code or state rules of professional conduct, and helped the debtor. In doing so, the court distinguished Capstone's agreement to represent the debtor during the entire case, contingent on signing the postpetition agreement, from problematic "unbundling" where debtors are left on their own. The court explained that its decision was informed by the analysis and opinions in Utah Ethics Advisor Opinion Committee Opinion 17-06 issued August 16, 2018.

The court found that use of bifurcated fee agreements in consumer chapter 7 cases are not *per se* prohibited or unfair, and do not *per se* implicate ethical issues. They may be employed where (1) it is in the best interests of the client; (2) the attorney provides appropriate disclosures, options and explanations; (3) the client gives informed consent in writing; and (4) the fees and costs are reasonable and necessary. Capstone's arrangement does not violate the Utah Bankruptcy Court's Local Rule 2091-1 on the scope of required representation. Disclosure of all aspects of the compensation agreement is mandatory, and subject to review under §329.

The court also held that Capstone's factoring arrangement with BK Billing, which had the right to collect all fees in exchange for immediate payment to Capstone of \$1,800 (a 25% discount), is discouraged, given the concerns raised in the Utah ethics opinion and in *In re Wright*, 591 B.R. 68 (Bankr. N.D. Okla. 2018). The court found the arrangement in *Hazlett* did not justify the imposition of sanctions, however, as it generally complied with the principles stated in the ethics opinion.

The court also held that Capstone's use of e-signatures did not justify a sanction. Capstone maintained the wet-ink signed agreements and AdobeSign signature papers. Federal Rule of Evidence 1001(d) and Utah's adoption of the Uniform Electronic Transactions Act and Utah District Court Rule 5.1(a) (allowing e-signatures on court documents) supported the reasonableness of Capstone interpreting "original signatures" in the local rule mandating retention of signatures as including e-signatures.

In re Rent-a-Wreck of America, Inc., 596 B.R. 112 (D. Del. 2019)

The bankruptcy court did not abuse its discretion in denying a creditor's motion for Rule 9011 sanctions against the debtor and its counsel despite having dismissed the debtor's chapter 11 petition as having been filed in bad faith. Failure to carry the burden of proving good faith under the multi-factor test for dismissal is not equivalent to bad faith or clear and convincing evidence of an improper purpose, or patently unmeritorious or frivolous positions.

In re Nuñez, 598 B.R. 696 (Bankr. E.D.N.Y. 2019)

Lawyer who represented debtor and his girlfriend postpetition, without appearing in the chapter 7 bankruptcy case, was sanctioned by an order of disgorgement of half of the fees collected under one matter; the other half was deemed received for representation of the non-debtor girlfriend. The court exercised discretion not to order disgorgement of fees received for separate state court representation concerning foreclosure of property after the foreclosing creditor obtained stay relief in the bankruptcy case. The court held that noncompliance with Code §329 and Bankruptcy Rule 2016 is not excused by lack of knowledge of the bankruptcy, or payment by a non-debtor.

In re Harrison, 599 B.R. 173 (Bankr. N.D. Fla. 2019)

A foreclosing creditor's counsel was held to have intentionally violated a *pro se* chapter 7 debtor's automatic stay along with his creditor client. The lawyer was assessed punitive as well as compensatory damages, and ordered to show cause why Rule 9011 sanctions should not additionally be imposed. The attorney did not take steps to immediately reverse a post-petition foreclosure sale that violated the automatic stay, or terminate the creditor's locking the debtor out of her property. He did not disclose the stay violation to the court, and or even mention it until 82 days after appearing in the case and then only in response to the debtor's sanctions motion. Instead of acknowledging the stay violation, counsel's court filings were phrased in seeking "to proceed" with the foreclosure, and misrepresented previous creditor motions and court orders. The court described the creditor's bankruptcy counsel's actions as "reprehensible" and "shock[ing] the conscience."

In re Schemelia, 2019 WL 4690912 (Bankr. D.N.J. Sept. 25, 2019)

Counsel filed a chapter 13 case listing the debtor as owner of real property, and that property as an estate asset subject to a lien, with minimal other creditors. But the property had been sold at a foreclosure auction and conveyed by Sheriff's deed to the secured creditor more than a month before the petition, and a writ of possession for the property had been issued prepetition. The lawyer opposed the creditor's stay relief motion and filed an infeasible plan. He later admitted to the court that he knew the property had been transferred and the redemption period had expired prepetition.

The creditor did not send a "safe harbor" letter before seeking sanctions, but the court held the sanctions still appropriate under Rule 9011 and its inherent power to sanction because the lawyer failed to conduct a reasonable inquiry before filing the petition. He filed the petition for the improper purpose of delaying eviction under the guise of attempting to save ownership of the property. He also filed a nominal payment chapter 13 plan insufficient to pay the mortgage debt even if it could have been reinstated, and the unsecured debt could have been discharged through a chapter 7.

A law firm specializing in prosecution of state Consumer Collection Practices Act cases on behalf of chapter 7 trustees (“CCPA Firm”) filed an adversary complaint against a creditor at the request of a chapter 7 trustee, then dismissed the complaint with prejudice within the safe harbor period after receiving a letter response and proposed motion for sanctions from the creditor. The creditor then began “a five-year quest to punish” the CCPA Firm and trustee, first suing them for racketeering, then moving for sanctions on the court’s inherent authority and 28 U.S.C. §1927. The district court reversed summary judgment for the defendants based on statistics it had requested about cases filed by the CCPA Firm. This decision reconsiders the summary judgment in light of the statistics, under the district court’s mandate, and again declines to award sanctions.

The CCPA Firm filed between 2,865 and 3,324 complaints during a 4-year period, of which only 135 were attributable to the trustee against whom sanctions were sought. The court found that most CCPA Firm cases were settled, generally for statutory damages, costs and attorneys’ fees, of under \$5,000. The net recovery to the chapter 7 estate is typically \$1,300-\$2,000 per case, with every settlement noticed to creditors and approved by the court. In every instance, the CCPA Firm’s employment as special counsel to the trustee is also approved, and no fees are paid without court approval. Estates recovered 100% of statutory damages and 70% of actual damages, with the CCPA Firm receiving 30% of the actual damages plus attorneys’ fees awarded. In settled cases, the CCPA firm received a discounted amount of less than \$2,000. The CCPA Firm relied on 341 testimony to support filing its cases.

The court found that lots of CCPA cases arise in individual chapter 7 cases, as Congress found when enacting the federal counterpart statute. Instead of prolonging cases and “milking them for fees,” the CCPA Firm and trustees settled before trial. Fee awards generally exceeded the estates’ recoveries, which the court expected from a statutory private right of action authorizing fee shifting for nominal statutory damages. Many cases are dismissed with prejudice after early disclosure and exchange of information, as contemplated by Rule 7026.

The court found use of contingency fee lawyers to pursue such cases, based on the debtor’s sworn testimony, to be sensible from the trustee’s and estate creditors’ perspective, even when the expected statutory recovery is less than \$2,000. The CCPA Firm providing trustees with a list of questions to ascertain potential claims, and sending a paralegal to 341 meetings to make notes, was also sound practice. It enabled trustees to evaluate these estate assets, just as the trustee asks about car accidents to uncover personal injury claims, and enabled the CCPA firm to evaluate debtor testimony up front. The CCPA Firm worked only for the trustee, not the debtor. The key evidence was the debt collector’s phone records and call logs, which was not available when complaints were filed.

The court found the sanctions motion to be meritless. But it required henceforth that prospective special counsel would need to declare not only that it read or listened to the debtor’s testimony at the 341 meeting, but also (i) spoke directly with the debtor, or (ii) sent a

request to the debt collector for call logs that went unanswered for 14 days, or (iii) engaged in some other pre-suit investigation.

In re Sundquist, 2019 WL 994027 (BAP 9th Cir. Feb. 27, 2019)

This is a continuation of the saga where the court imposed sanctions exceeding \$6 million (plus \$45 million to consumer bankruptcy organizations and law schools) against the debtor's home mortgage lender for willful, egregious violations of the automatic stay. *Sundquist v. Bank of America, N.A.*, 566 B.R. 563 (Bankr. E.D. Cal. 2017).

The BAP noted that the chapter 13 attorney took no steps to stop the stay violations during the chapter 13 case. When she prosecuted the debtors' §362(k)(1) cause of action after dismissal of the chapter 13, she failed to timely file a Rule 2016(b) fee disclosure. The contingency fee disclosure she finally filed was backdated and doctored, and the court found that it would result in a fee exceeding the reasonable value of her services under §329(b), as well as be unworkable in determining §363(k) damages. The attorney then documented fees and costs of \$68,874.55, with no evidence to rebut the lodestar presumption against a bonus, and the court awarded \$70,000, finding her work to be "barely adequate". But she filed a lien to extract a higher fee, impeding settlement efforts between the debtor (though new counsel) and the lender.

The BAP upheld the bankruptcy court's order cancelling the contingency fee agreement of a chapter 13 debtor's attorney and limiting her compensation to \$70,000. The BAP held that the court did not err in finding the contingency agreement to be incompatible with §363(k)(1), or that it would result in an award grossly disproportionate to the quality of services rendered, or that this was appropriate in light of counsel's Rule 2016 violation. Nor did the court abuse its discretion in expunging the lien or awarding \$70,000.

VI. 2019 Non-Sanctions Attorneys' Fees Cases

Matter of Riley, 923 F.3d 433 (5th Cir. 2019)

The Circuit affirmed the bankruptcy court's interpretation of its "no-look" chapter 13 attorneys' fees order. Under that local practice, attorneys are not permitted to charge and recover filing fees advanced by the attorney in addition to the no-look fee amount.

The bankruptcy court had held that courts can authorize reimbursement of fees that increase or maintain the value of the bankruptcy estate under §503(b)(1)(A), but the filing fee, credit counseling fee and credit report fee are not necessary to preserve the estate. Instead, attorney advances for such costs satisfy personal, prepetition obligations of the debtor that should not be borne by creditors. The Fifth Circuit disagreed. It held that "compensation...for representing the interests of the debtor in connection with the bankruptcy case" in §330(a)(4)(B) is broad enough to include reimbursement of expenses. Thus, bankruptcy courts have discretion to authorize compensation to a chapter 13 debtor's lawyer when the underlying

obligation fulfills a personal obligation of the debtor connected with the case, but are not required to do so.

In re Hosp. Partners of America, Inc., 597 B.R. 763 (Bankr. D. Del. 2019)

Fees incurred by a chapter 7 trustee's counsel consumed 163% of the proceeds from that litigation. The U.S. Trustee objected to their fee application, arguing breach of their duty to perform a reasonable cost-benefit analysis of avoidance actions. The court held that §330(a)(4)(A) does not require fee disallowance simply because the estate ultimately does not profit from the professional's services. The services must only have been reasonably likely to benefit the estate at the time they were rendered, objectively determined.

In re Contreras, 2019 WL 1868622 (Bankr. S.D. Tex. Apr. 25, 2019)

The court held a substantial portion of the attorneys' fees billed by a chapter 13 debtor's firm to be unreasonable in three cases. Many professionals worked on each case, duplicating services, and paralegals billed for clerical work.

The court also noted that if, as the trustee alleged, the firm collected a fee from a client whose case was dismissed on account of services performed in the dismissed case, it would have a conflict of interest precluding the firm from filing a second chapter 13 case for that client. While chapter 13 attorneys need not be disinterested, if the firm received a preference or conditioned future representation on payment of unpaid fees, it would have a conflict materially affecting the representation. Likewise, debtors' "voluntary" payments of approved but unpaid chapter 13 fees after dismissal and before re-filing "could be extremely problematic." Debtors faced with collection activity are extremely vulnerable, often make unjustified payments, and their attorneys' relationships and payments are viewed more stringently than other payments because of their influence, under §329.

The court also cautioned that chapter 13 attorneys must exercise judgment in their billing because increased attorneys' fees necessarily result in decreased dividends for unsecured creditors. Because their plans are not affected by increased fees, debtors have little incentive to object or negotiate their attorneys' fees, and individual unsecured creditors usually have little economic incentive to object. Fee applications in Chapter 13 cases require close court scrutiny, but the court lacks the resources to review them carefully. The court accordingly adopted a "rough justice" approach, considering its experience and the "no look" fee guideline to determine fee reasonableness.

In re Reynolds, 2019 WL 4645385 (D. Utah Sept. 24, 2019)

Code §330(a)(4)(A) prohibits courts from allowing fees for services that are unnecessarily duplicative, not reasonably likely to benefit the estate, or unnecessary to administration of the case. If a court finds that services are not compensable under that section, it does not need to address whether fees are reasonable, or undertake a lodestar

analysis. The court cited *In re Bird*, 577 B.R. 365, 374-75 (BAP 10th Cir. 2017), citing *In re Lederman Enters., Inc.*, 997 F.2d 1321, 1323 (10th Cir. 1993); See also *In re Universal Factoring Co., Inc.*, 329 B.R. 62, 78-79 (Bankr. N.D. Okla. 2005) (explaining that § 330(a)(4) was added to the statute subsequent to the Tenth Circuit's *Lederman* decision, but that "[u]nless the court determines that a service was reasonably likely to confer a benefit upon the estate, the inquiry goes no further, and the fees are not compensable.")).

In its order denying compensation, the bankruptcy court stated:

The symbiosis between some trustees and their regular counsel is too obvious to miss by any standard except willful blindness. The same trustees routinely hire the same one or two attorneys at all times, regardless of the issue. The trustees become all too willing to pay any rate for any service that the court approves. The attorney will provide fantastic personal service and free the trustee's time for other paying endeavors while the trustee's commission is calculated at a fixed expense...The disconnect is that the American legal system is an adversarial system, and this piece of the bankruptcy system has no adversary. Moreover, the client (the trustee) is not dealing with his or her own money. The front line responsibility for controlling the cost of legal services has been shifted from the trustee to the court. This is not how the system was designed to operate.

The bankruptcy court is simply asking that professionals scrutinize their own fee requests by eliminating duplicative and unnecessary charges, as they would when billing a regular client. In a like manner, the bankruptcy court also asks trustees to monitor professional's services as a private client would do, calling into question unnecessary services and reining in costs when fees grow disproportionate to the available proceeds. This court finds this requirement reasonable and not beyond the bankruptcy's court's discretion. A normal client would not agree to pay for services it found to be unnecessary, duplicative, unreasonable, or without benefit.

In re Schaller, 595 B.R. 730 (Bankr. E.D. Mich. 2019)

A professional is not entitled to compensation from the bankruptcy estate or debtor incurred in defending allegations of having violated Bankruptcy Rule 9011 and 28 U.S.C. §1927. As with fees incurred in defending objections to fee requests, at issue in *Baker Botts L.L.P. v. ASARCO LLC*, 135 S. Ct. 2158 (2015), the fees incurred may be reasonably and necessarily incurred, but they benefit only the professional, not the debtor or the estate.

In re Soelberg, 2019 WL 3805980 (Bankr. D. Idaho Aug. 13, 2019)

The bankruptcy court refused to issue a writ of garnishment for a chapter 13 debtor's counsel to collect attorneys' fees approved by the court but unpaid under the debtor's plan or converted chapter 7 case, after the chapter 7 trustee's final account was approved. Chapter 7 administrative expenses and a priority domestic support obligation had consumed all available estate funds. The court held that a compensation award is an administrative expense and not

an executable money judgment, citing *Ziino v. Baker*, 613 F.3d 1326, 1237-29 (11th Cir. 2010) (creditor with undischarged allowed claim does not hold a “money judgment” subject to execution under Fed.R.Civ.P. 69(a)(1); it must file a direct action against the debtor for breach of obligation to obtain executable money judgment before attempting to levy assets).

Note that the Seventh Circuit held in *In re Sweports, Ltd.*, 777 F.3d 364, 367 (7th Cir. 2015), that the bankruptcy court has post-dismissal ancillary jurisdiction to award fees. And if it does so, the “ruling would create a debt of [the debtor] to [the professional] and if [the debtor] refused (as [the professional] expects it would) to pay, he could, like any other creditor, sue [the debtor] in state court.” See also *Id.* (“The judgment to which [the professional] was and is entitled would merely establish a debt; to collect it he will undoubtedly have to initiate a collection suit in state court.”) The bankruptcy court thereafter held that it lacked ancillary jurisdiction to enforce the fee award with a writ of execution. *In re Sweports, Ltd.*, 565 B.R. 129, 136 (Bankr. N.D. Ill. 2017)

In re John Q. Hammons Fall 2006, LLC, 600 B.R. 436 (Bankr. D. Kan. 2019)

The court denied legal fees incurred by a financial advisor who provided services under a Code §328 agreement providing for restructuring and sale transaction fees and a monthly advisory fee, plus expenses, because the legal fees were incurred in defending objections to the advisor’s fee application. The advisor argued under *In re Hungry Horse, LLC*, 574 B.R. 740 (Bankr. D.N.M. 2017), the rule against fee defense fees set forth in *Baker Botts, L.L.P. v. ASARCO LLC*, 135 S.Ct. 2158 (2015) did not prevent approval of a fee-defense provision as “reasonable” under §328. The court held that a determination that the terms and conditions of a fee agreement are “reasonable” under §328 does not determine whether they were actually rendered. And *Baker Botts* held that fee-defense work is not “services rendered” under §330. *In re Chieftain Steel, LLC*, 2019 WL 1225716 (Bankr. W.D. Ky. Mar. 13, 2019)

Whether a cash collateral carve-out for professionals’ fees requires the lender to pay those fees depends on the language of the carve-out and the language of any confirmed plan. In this case, the lender was not required to pay, unlike *In re Licking River Mining, LLC*, 911 F.3d 806 (6th Cir. 2018).

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UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF CALIFORNIA
SAN FRANCISCO DIVISION

In re:

PG&E CORPORATION,

-and-

PACIFIC GAS AND ELECTRIC
COMPANY,

Debtors.

Case No. 19-30088

Chapter 11

(Lead Case)
(Jointly Administered)

STATEMENT OF JAY ALIX

Non-party Jay Alix, through his attorneys, hereby submits this Statement and the attached Declaration, annexed hereto as “**Exhibit A**,” to address and correct certain statements regarding Mr. Alix that were made in the Application of Debtors Pursuant to 11 U.S.C. §§ 363(b) and 105(a) for Authority to Enter into, Perform under and Make Payments under Certain Consulting Contracts with McKinsey & Company, Inc. United States (the “**Application**”), filed in the above-captioned proceedings on September 17, 2019 (Dkt. 3919).

The purpose of the attached Declaration is to correct certain misstatements in the Application regarding Mr. Alix and litigation proceedings involving McKinsey. Mr. Alix takes

1 no position on whether the Application should be granted. Nor does Mr. Alix seek any relief from
2 the Court.

3
4 Dated: October 23, 2019

BUCHALTER
A Professional Corporation

5
6 /s/ Jeffrey K. Garfinkle
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EXHIBIT A

EXHIBIT A

**UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF CALIFORNIA
SAN FRANCISCO DIVISION**

In re:

PG&E CORPORATION,

-and-

PACIFIC GAS AND ELECTRIC
COMPANY,

Debtors.

Bankruptcy Case
No. 19-30088 (DM)
Chapter 11
(Lead Case)
(Jointly Administered)

DECLARATION OF JAY ALIX

JAY ALIX, pursuant to 28 U.S.C. § 1746, declares under penalty of perjury, as follows:

1. I respectfully submit this Declaration to address and correct certain misstatements made regarding myself and various litigation proceedings involving McKinsey & Company, Inc. and its subsidiaries (collectively, “**McKinsey**”) in the Application of Debtors Pursuant to 11 U.S.C. §§ 363(b) and 105(a) for Authority to Enter into, Perform under and Make Payments under Certain Consulting Contracts with McKinsey & Company, Inc. United States (the “**Application**”), filed in the above-captioned proceedings on September 17, 2019 (Dkt. 3919). This Declaration is based on my personal knowledge.

2. I am a non-party to this proceeding. I take no position on whether the Application should be granted, nor do I seek any relief from the Court. Rather, as noted above, the purpose of this Declaration is simply to correct and address certain misstatements made regarding myself and various litigation proceedings involving McKinsey.

I. Introduction

3. The Application asserts that McKinsey & Company, Inc. United States (“**McKinsey US**”) has performed and/or is performing certain services for the Debtors pursuant to

two pre-petition contracts and one post-petition contract. *See* Dkt. 3919 at 5-7. The Application asserts that McKinsey US has performed its services as an ordinary course professional and thus, under Sections 327(a) and 363(b) of the Bankruptcy Code, no Court approval is required for the Debtors to employ or pay McKinsey. *See id.* at 1. The Application appears to seek an order from the Court finding that McKinsey US is an ordinary course professional and that no disclosures are required. *See id.* at 13. The Application indicates that if such an order is not granted, McKinsey will file retention disclosures. *Id.*

4. At pages 11-12, the Application states:

As the Court may be aware, Jay Alix has pursued litigation against McKinsey in certain bankruptcy and non-bankruptcy courts unrelated to these Chapter 11 Cases. All courts to date have ruled in McKinsey's favor but the expectation is that this party will continue to pursue litigation against McKinsey, including possibly in this matter. For its part, McKinsey Recovery & Transformation Services U.S., LLC ('**McKinsey RTS**'), an affiliate of McKinsey, has developed and adopted a new protocol developed by Jan Baker and Paul Singerman for review of its connections in bankruptcy cases. Specifically, on February 21, 2019, the Westmoreland Court granted a joint motion of Westmoreland and McKinsey RTS to defer consideration of Westmoreland's application to retain McKinsey RTS while McKinsey RTS worked with an expert on developing the new disclosure protocol, applied the new protocol to its Rule 2014 disclosures, and filed Rule 2014 disclosures based on the new protocol.

The final proposed protocol, the Houston Disclosure Protocol, was filed with the Westmoreland Court on May 31, 2019 (the '**Protocol**'). On July 3, 2019, McKinsey RTS and certain of its affiliates filed a new retention application with updated Rule 2014 disclosures in accordance with the Protocol.

Dkt. 3919 at 11-12 (internal citations omitted).

5. The Application further states that "in light of the process that McKinsey recently undertook in *Westmoreland* to prepare and file its disclosures in accordance with the Protocol, McKinsey has indicated to the Debtors that it wishes to delay consideration of this Application

until such voluntary disclosures can be prepared and file its disclosures with the Protocol” and that “[t]hese are the same delayed retention procedures that the *Westmoreland* Court approved in connection with McKinsey RTS’s retention application under section 327(a) of the Bankruptcy Code.” Dkt. 3919 at 12 & n.4.

6. I am the beneficial owner of Mar-Bow Value Partners, LLC (“**Mar-Bow**”), an entity which is fully controlled by me.

7. For purposes of full disclosure, I am a minority shareholder and a member of the board of directors of AlixPartners LLP (“**AP**”), which has been hired as a professional in this case. However, I am neither an officer nor an employee of AP, and I have no involvement in the day-to-day operations of AP, including having no involvement in this case. All views expressed in this Declaration and the accompanying Statement are my personal views, not the views of AP.

8. All litigation that I have pursued against McKinsey, whether personally or through Mar-Bow, has been directed, controlled, and funded by me in my personal capacity, with no involvement by AP.

9. Since 2016, Mar-Bow, in the position of creditor or as a non-party seeking *amicus*, has litigated or is currently litigating against McKinsey in six Chapter 11 bankruptcy proceedings in which McKinsey has been approved to act as a bankruptcy professional under Section 327 of the United States Bankruptcy, 11 U.S.C. § 101, *et seq.* (the “**Bankruptcy Code**”) (or, in one instance, pursuant to Section 363 of the Bankruptcy Code):

- a. *In re Edison Mission Energy*, No. 12-BK-49219(JPC) (Bankr. N.D. Ill.) (“**Edison Mission**”);
- b. *In re NII Holdings, Inc.*, No. 14-BK-12611(SCC) (Bankr. S.D.N.Y.) (“**NII**”);
- c. *In re SRC Liquidation LLC*, No. 15-BK-10541(BLS) (Bankr. D. Del.) (“**Standard Register**”);

- d. *In re Alpha Natural Resources, Inc.*, No. 15-BK-33896(KRH) (E.D. Va.) (“**ANR**”);
- e. *In re SunEdison, Inc.*, No. 16-BK-10992(SMB) (Bankr. S.D.N.Y.) (“**SunEdison**”); and
- f. *In re Westmoreland Coal Co.*, No. 18-BK-35672(DRJ) (Bankr. S.D. Tex.) (“**Westmoreland**”).

10. Additionally, as assignee of AP, I have brought non-bankruptcy litigation against McKinsey and related individuals, alleging violations of the Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. §§ 1961, *et seq.* (“**RICO**”) as well as state claims, in an action captioned *Alix v. McKinsey & Co., Inc., et al.*, No. 18-CV-04141(JMF) (S.D.N.Y.) (the “**RICO Action**”).

II. CORRECTIONS TO THE APPLICATION’S STATEMENTS

A. The Nature of My Litigation with McKinsey

11. *First*, the Application suggests without any basis that I might seek to litigate against McKinsey in this case.¹ However, I have no intention to intervene in this case, nor have I ever indicated otherwise. As noted above, I take no position on whether the Application should be granted.

12. Moreover, none of the above-referenced litigation matters in which I have proceeded against McKinsey have involved work by McKinsey as an “ordinary course professional.” Rather, in each of the bankruptcy proceedings, McKinsey was hired (or, in the case of *Westmoreland*, is seeking to be hired) as a bankruptcy professional pursuant to Section 327 of the Bankruptcy Code or, in the case of *Standard Register*, was hired pursuant to Section 363 of

¹ See Dkt. 3919 at 11 (“Jay Alix has pursued litigation against McKinsey in certain bankruptcy and non-bankruptcy courts . . . the expectation is that this party will continue to pursue litigation against McKinsey, including possibly in this matter.”). While the Application refers to me as “this party,” I am, of course, not a party to these proceedings.

the Bankruptcy Code. And the sole non-bankruptcy case, the RICO Action, involves my RICO and state law claims against McKinsey.

B. The Results of My Litigation with McKinsey

13. *Second*, the Application states misleadingly that in all cases in which I have litigated against McKinsey, “[a]ll courts to date have ruled in McKinsey’s favor[.]” Dkt. 3919 at 11. In reality, no court has ruled against me or Mar-Bow on the merits. All rulings “in McKinsey’s favor” have been on technical grounds of standing in bankruptcy matters and the proximate cause standard under RICO. Several courts have, however, ruled against McKinsey or made statements on the record calling into question McKinsey’s bankruptcy disclosure practices. Those rulings are briefly summarized below.

i. ANR

14. In *ANR*, McKinsey’s initial Rule 2014 disclosures, as well as its first and second supplemental disclosures, failed to name a single connection between McKinsey and any of the interested parties in *ANR*. On May 3, 2016, after I brought deficiencies in McKinsey’s bankruptcy disclosures to the attention of the Office of the United States Trustee (the “**U.S. Trustee**”), the U.S. Trustee brought a motion to compel McKinsey to comply with the disclosure requirements of Federal Rule of Bankruptcy Procedure 2014 (“**Bankruptcy Rule 2014**” or “**Rule 2014**”) in the *ANR* bankruptcy.² In response to the U.S. Trustee’s motion to compel, McKinsey filed a third supplemental Rule 2014 declaration, naming 17 connections for the first time.³

² *ANR* Dkt. 2308 (Motion of the United States Trustee to Compel McKinsey Recovery & Transformation Services U.S. [LLC], Turnaround Advisor for the Debtors, to Comply with the Requirements of Bankruptcy Rule 2014). McKinsey Recovery & Transformation Services U.S., LLC (“**McKinsey RTS**”) is a wholly-owned subsidiary of McKinsey US.

³ *ANR* Dkt. 2464 (Third Supplemental Declaration of Kevin Carmody in Support of Application of the Debtors, Pursuant to Sections 327(a), 328(a) and 1107(b) of the Bankruptcy Code, Bankruptcy Rule 2014(a) and Local Bankruptcy Rule 2014-1, for an Order Authorizing Them to Retain and Employ McKinsey

15. On June 6, 2016, Mar-Bow, as an unsecured creditor in ANR, brought its own motion to compel McKinsey to comply with Bankruptcy Rule 2014.⁴ On July 1, 2016, after a hearing, the ANR Court ruled against McKinsey and **granted** Mar-Bow's motion to compel and required McKinsey to disclose, *inter alia*, 121 undisclosed connections; connections arising from McKinsey's captive investment firm MIO Partners, Inc. ("**MIO**"), and information concerning McKinsey's disclosure process.⁵ The ANR Court also ruled, over McKinsey's objections, that McKinsey, was indeed a bankruptcy professional just like a law firm, and was, therefore, a fiduciary for the estate.⁶

16. In 2018, Mar-Bow moved to re-open ANR after evidence emerged indicating McKinsey had reaped millions in profits from an undisclosed investment interest in the reorganized debtor.⁷ McKinsey failed to disclose that investment interest to the ANR Court despite a clear order requiring McKinsey do so *in camera* in July 2016.⁸ McKinsey held that investment through MIO, while at the same time concealing from the Court and the U.S. Trustee that

Recovery & Transformation Services U.S., LLC as Turnaround Advisor for the Debtors, Effective as of the Petition Date, filed May 9, 2016).

⁴ ANR Dkt. 2603 (Motion of Creditor Mar-Bow Value Partners, LLC to Compel McKinsey Recovery & Transformation Services U.S., LLC, Turnaround Advisor for the Debtors, to Comply with the Requirements of Bankruptcy Rule 2014).

⁵ ANR Dkt. 2895 (Order Compelling McKinsey Recovery & Transformation Services, U.S., LLC, Turnaround Advisor for the Debtors, to Comply with the Requirements of Bankruptcy Rule 2014).

⁶ See ANR Dkt. 2834 (6/29/2016 Hearing Tr.) at 158:11-13 (THE COURT: "Section 327 talks about professionals. McKinsey's a professional. Mr. Rhodes is exactly right. They're a fiduciary.").

⁷ See ANR Dkt. 4122 (Mar-Bow Value Partners, LLC's Motion to Reopen Case, filed Jul. 18, 2018); ANR Dkt. 4128 (Mar-Bow Value Partners, LLC's *Amended* Motion for Relief from Judgments and for Indicative Ruling *and* Reply to the United States Trustee's Response to (I) Motion to Reopen the Case and (II) Motion for Relief from Judgments and for Indicative Ruling, filed Aug. 9, 2018); *see also, e.g.*, Gretchen Morgenson & Tom Corrigan, McKinsey Investments Weren't Disclosed in Bankruptcy Cases, *Wall St. J.*, Jun. 19, 2018, available at <https://www.wsj.com/articles/mckinsey-investments-werent-disclosed-in-bankruptcy-cases-1529423138>.

⁸ See ANR Dkt. 2895 (Order); ANR Dkt. 4164 (Comments of United States Trustee Regarding McKinsey RTS's Opposition to Mar-Bow Partners, LLC's (I) Motion to Reopen Case and (II) Motion for Relief from Judgments and for Indicative Ruling, filed Nov. 30, 2018); ANR Dkt. 4182 (1/9/2019 Hearing Tr.) at 25:1-2.

McKinsey RTS's founder and President, Jon Garcia, was simultaneously on MIO's board of directors and a member of its Investment and Audit Committees from 2006 to 2017.⁹

17. Mar-Bow's motion to reopen ANR was **supported** by the U.S. Trustee, which asked the ANR Court to reopen the case and order McKinsey to disgorge the more than \$15 million it had received in fees.¹⁰ The U.S. Trustee concluded that McKinsey had misled it in both the ANR and SunEdison cases by claiming that MIO was a "blind trust," and stated that McKinsey had never answered the U.S. Trustee's questions regarding MIO in a forthright and satisfactory manner.¹¹

18. Calling the allegations against McKinsey "***some of the most serious allegations I've ever seen***," the ANR Court **reopened ANR**.¹²

19. McKinsey subsequently agreed to pay **\$15 million**, including \$5 million for the benefit of the ANR estate, to settle disputes with the U.S. Trustee over whether McKinsey had violated Bankruptcy Rule 2014 (the "**UST Settlement**").¹³ However, the settlement explicitly carved out any claims based on fraud, lack of disinterestedness under 11 U.S.C. § 327, **or for any criminal liability**.¹⁴

20. When the ANR Court later dismissed Mar-Bow for lack of standing, the Court made clear that he was not making any findings on the merits of "Mar-Bow's **very serious fraud allegations**" and noted that "***the United States Attorney retains the ability to institute an action [against McKinsey] under title 18 of the United States Code*** if so warranted."¹⁵

⁹ ANR Dkt. 4164 at 10 ¶ 15.

¹⁰ *Id.*

¹¹ *Id.* at 9 ¶ 13.

¹² ANR Dkt. 4182 (1/9/2019 Hearing Tr.) at 31:20-21 (emphasis added).

¹³ *In re Old ANR, LLC*, No. 19-302(KRH) (Bankr. E.D. Va.) ("**Old ANR**") Dkt. 45 (Corrected Order Approving Settlement Agreement Between United States Trustee Program and McKinsey & Company, Inc. and Certain of Its Affiliates, filed Apr. 19, 2019) at 2 ¶ 4.

¹⁴ *Id.* at 4-5 ¶ 6; *id.* at 6 ¶ 10.

¹⁵ *Old ANR* Dkt. 54 (Mem. Op.) at 12 (emphasis added).

ii. Westmoreland

21. The second case in which Mar-Bow appeared, *Westmoreland*, is the only case to date in which Mar-Bow has purchased a claim and filed an objection **before** approval of McKinsey's employment. Far from having been decided "in McKinsey's favor," McKinsey's employment still has not been approved in *Westmoreland*, despite the passage of nearly a year since the filing of the initial application to hire McKinsey and plan confirmation on March 2, 2019.

22. On November 30, 2018, after Mar-Bow filed an objection, the *Westmoreland* Court issued an Order *sua sponte*, stating:

The objection alleges **conduct by McKinsey in this case and at least one other case pending before the Court [GenOn] that, if true, could violate Title 18** and otherwise impugn the integrity of the bankruptcy process. The Court requests the United States Trustee to review the allegations set forth in the Mar-Bow objection and make a written recommendation to the Court on how best to proceed.

Westmoreland Dkt. 632 (Order) (emphasis added).

23. The U.S. Trustee followed with objections of its own.¹⁶ During a preliminary hearing, the Court again emphasized that the allegations against McKinsey "**clearly implicated certain sections of Title 18 applicable to bankruptcy cases**[.]"¹⁷

24. After both I and McKinsey's initial Rule 2014 declarant, Mark Hojnacki, were deposed on December 31, 2018, the *Westmoreland* Court called the transcript of Mr. Hojnacki's deposition "one of the most frustrating reads that I've had in a long time" and stated: "He

¹⁶ *Westmoreland* Dkt. 785 (Acting United States Trustee's (1) Objection to Debtors' Application for Entry of an Order Authorizing the Retention and Employment of McKinsey Recovery & Transformation Services U.S., LLC as Performance Improvement Advisors to the Debtors *Nunc Pro Tunc* to the Petition Date; and (2) Response to Court's Order Dated November 30, 2018, filed Dec. 14, 2018).

¹⁷ *Westmoreland* Dkt. 868 (12/18/2018 Hearing Tr.) at 164:15-18 (emphasis added).

[Hojnacki] won't do, on the stand, what he did in that deposition. I will get candor and I will get honesty.”¹⁸

25. In contrast, my deposition confirmed that my allegations were made in good faith and based on long, extensive research coupled with my first-hand knowledge obtained from four decades in the restructuring industry. Regarding my deposition, the Court stated that “unless he’s totally making some things up, he’s got a reason for thinking there’s something wrong.”¹⁹ The Court also stated: “***If what Mr. Alix alleges is true, then McKinsey has a Title 18 problem.***”²⁰

26. Although its employment has not been, and perhaps never will be, approved in *Westmoreland*, McKinsey agreed to pay **\$5 million** for the benefit of the *Westmoreland* estate in the UST Settlement, which explicitly carves out claims for fraud and lack of disinterestedness under Section 327 and for any criminal liability.²¹

27. On August 20, 2019, the U.S. Trustee filed an objection to McKinsey’s third and final attempt at disclosure in *Westmoreland*, stating: “***After multiple filings in aid of its employment, [McKinsey’s] employment must be denied.***”²²

28. On October 29, 2019, the *Westmoreland* Court will hold a hearing on whether it should deny the application to hire McKinsey in that case as a matter of law or whether the matter should proceed to discovery and trial.

¹⁸ *Westmoreland* Dkt. 981 (1/3/2019 Hearing Tr.) at 30:23-31:1.

¹⁹ *Id.* at 30:16-18.

²⁰ *Id.* at 28:6-7 (emphasis added).

²¹ *See Old ANR* Dkt. 45.

²² *Westmoreland* Dkt. 2273 (Acting United States Trustee’s Response to WLB Debtors’ Application for Entry of an Order (I) Authorizing the Retention and Employment of McKinsey Recovery & Transformation Services U.S., LLC and Certain of Its Affiliates as Performance Improvement Advisors for the WLB Debtors Effective *Nunc Pro Tunc* to the Petition Date and (II) Granting Related Relief (Dkt. 2119), filed Aug. 20, 2019) at 3 (emphasis added).

iii. SunEdison

29. In the third case in which Mar-Bow appeared, *SunEdison*, it was revealed after the fact that on December 27, 2018, McKinsey entered into a secret settlement in which it agreed to pay the SunEdison Litigation Trust **\$17.5 million – over \$2 million more than McKinsey received in fees** in that cases.²³

30. McKinsey also paid **another \$5 million** for the benefit of the SunEdison estate as part of the UST Settlement in February 2019, which, again, explicitly carves out fraud, issues of disinterestedness under Section 327, and any criminal liability.²⁴

31. In his opinion finding that Mar-Bow lacked standing, the *SunEdison* Court echoed the ANR and Westmoreland Courts, stating that “**the United States Attorney retains the ability to prosecute any crimes under title 18.**”²⁵

iv. NII

32. During a hearing in *NII*, the Court sought and obtained the U.S. Trustee’s assurances that it will investigate the allegations of McKinsey’s fraud on the court in that case and it “**will liaise, as [] appropriate, with other branches of the Department of Justice, including applicable US Attorneys’ offices[.]**”²⁶

v. Standard Register

33. In its opinion finding that Mar-Bow lacked standing, the Court in *Standard Register* noted that “the settlement between the UST and RTS contained a carve-out for fraud and the UST remains free to pursue those claims.”²⁷

²³ See *SunEdison* Dkt. 5884 at 4.

²⁴ See *Old ANR* Dkt. 45.

²⁵ *SunEdison* Dkt. 5999 at 24 (emphasis added).

²⁶ See *NII* Dkt. 1040 (7/31/2019 Hearing Tr.) at 53:13-55:4 (emphasis added).

²⁷ *Standard Register* Dkt. 2448 (9/12/2019 Op.) at 14.

vi. Edison Mission Energy

34. In *Edison Mission Energy*, the Court has not yet made any findings. A hearing is scheduled for November 6, 2019 on Mar-Bow's motion for leave to file as an *amicus* and Mar-Bow's motion to reopen that case.

vii. RICO Action.

35. In the RICO Action, in an opinion dismissing my RICO claims on proximate cause grounds, the Court stated: "***If Alix's allegations in this case are true*** (as the Court has assumed they are for purposes of this motion), ***they are certainly troubling***."²⁸ The Court further stated that I "***may well have good reason to be upset about Defendants' alleged misconduct and may indeed have genuinely public-spirited reasons for seeking to deter it going forward***."²⁹

C. McKinsey's "Houston Disclosure Protocol"

36. Finally, the Application emphasizes what it calls McKinsey's "Houston Disclosure Protocol." See Dkt. 3919 at 11-12. To be clear, however, McKinsey's protocol has not been approved or promoted by any court. Indeed, the *Westmoreland* Court has made clear that it will *not* approve McKinsey's protocol.³⁰ Another United States Bankruptcy Judge in the Southern District of Texas has described it as "really confusing" and stated: "No one's ever adopted that protocol. I'm not adopting it right now."³¹

²⁸ *RICO Action* Dkt. 104 (Op. and Order, filed Aug. 19, 2019) at 23 (emphasis added).

²⁹ *Id.* (emphasis added).

³⁰ See *Westmoreland* Dkt. 1762 (4/16/2019 Hearing Tr.) at 41:12-42:18.

³¹ *In re Legacy Reserves Inc.*, No. 19-BK-33395(MI) (Bankr. S.D. Tex.), 8/1/2019 Hearing Tr. at 55:13-16, 62:23; *id.* at 55:12-13.

Pursuant to 28 U.S.C. § 1746, I declare under penalty of perjury that the foregoing is true and correct.

Dated: October 23, 2019

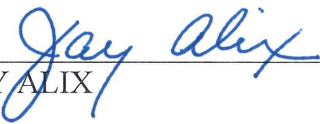

JAY ALIX

Exhibit A

HOUSTON DISCLOSURE PROTOCOL

Summary

The following Houston Disclosure Protocol addresses the complex legal and business issues surrounding the disclosure obligations arising from a Proposed Professional's retention under Section 327¹ in bankruptcy cases involving more than \$50 million in claims. The Protocol addresses Proposed Professionals of varying types, including law, accounting, financial advisory, and investment banking firms, that seek compensation from a bankrupt estate. A Schedule of Defined Terms immediately follows this Summary, and capitalized terms used in this Summary and in the Protocol have the meanings ascribed to them there. This Summary outlines the Protocol's disclosure recommendations and the means or process to satisfy them.

The Protocol focuses on a Proposed Professional's disclosure regarding Connections to parties that could affect the Proposed Professional's "disinterestedness" and contemplates that the debtor will create and maintain an Interested Party List to facilitate identification of Connections (Exhibit "A" to the Protocol addresses the IPL). The Protocol recommends that a Proposed Professional obtain the data to support disclosure of Connections by procedures that include, as applicable, a computerized search of client databases, distribution of a questionnaire (a proposed form of which is provided in Exhibit "B" to the Protocol), and inquiry of the Proposed Professional's AMAs (if any), as discussed below. While recognizing that a Proposed Professional bears the burden of adequate disclosure in its retention application and an Estate Professional bears that burden in all appropriate supplemental disclosures, the Protocol provides that disclosure of Connections should be based on a Proposed Professional's actual knowledge of them, including from the results of a computer search and questionnaire process, as applicable.

The Protocol distinguishes Connections arising from the different kinds of the Proposed Professional's affiliates, including: (a) Retained Affiliates, which the Protocol classifies as generating Direct Connections of the Proposed Professional, and (b) Unretained Affiliates (including AMAs), which the Protocol classifies as generating Indirect Connections. As set forth in the Protocol, the disclosure of known Connections and the process to obtain knowledge of them should vary in accordance with the characteristics of each Proposed Professional and its AMAs and other Unretained Affiliates.

The Protocol classifies AMAs into 4 Types and recommends a process to obtain and disclose information regarding Connections that varies based on the extent to which the AMA: (i) is subject to Securities Registration, Regulatory Oversight, and/or Independent Personnel and Management; (ii) refrains from investing directly in Named Issuers; and (iii) accepts investment funds from third parties rather than Related Investors. The Protocol recommends that: (a) Proposed Professionals that qualify as Type 1 Financial Organizations or have Type 1 AMAs disclose only Direct Connections known to the Proposed Professional without review of the IPL by an AMA; (b) Proposed Professionals with Type 2, 3 or 4 AMAs should also disclose Direct Connections known to the Proposed Professional; (c) Proposed Professionals with Type 2 AMAs should also disclose the names of IPL Parties with Indirect Connections known to the Type 2 AMA as reported by the Type 2 AMA to the Proposed Professional; (d) Proposed Professionals

¹ This Protocol does not address retention applications filed by claims and noticing agents under 28 U.S.C. § 156.

with Types 3 and /or 4 AMAs should disclose Indirect Connections known to the AMA(s) and reported to the Proposed Professional, including direct investments in Named Issuers that are IPL Parties, and (e) Proposed Professionals with Type 4 AMAs should make such additional disclosures, if any, as may be appropriate in the circumstances.

The Protocol recognizes that disclosure of Connections may vary in response to, *inter alia*, the size of the bankruptcy case and should exclude *de minimis* matters. The *de minimis* concept is applicable to both the IPL and the disclosure of Connections in a Proposed Professional's retention application. *De minimis* exclusions can be based, for example, on the small value of a claim, the small ownership percentage and value of an equity interest, or other, similar considerations. An IPL, and a Proposed Professional's disclosure of Connections in its retention application, should state the criteria applied in making *de minimis* exclusions.

DEFINED TERMS

AMA means an affiliate or division of a Proposed Professional that is actively engaged in managing or owning financial investments. For clarity, AMA does not refer either to assets that might be held through investment vehicles or to such investment vehicles, e.g., mutual funds, but does refer to the entity managing such investment vehicles, i.e., a mutual fund manager.

CFTC means the Commodities Futures Trading Commission.

Connection means, in the context of Section 327 and Rule 2014, an association or relationship with an IPL Party that a reasonable person might find bears on whether the Proposed Professional “holds or represents an interest adverse to the estate” and is “disinterested” under Section 327 and Section 101(14), based on the facts of a particular bankruptcy case.

De minimis means a matter too distant in time, remote in probability, or insignificant to warrant consideration in the context of a particular bankruptcy case.

Direct Connection means a known Connection between a Proposed Professional and an IPL Party (other than an Indirect Connection).

Estate Professional means a Proposed Professional whose retention has been approved by the Bankruptcy Court.

FINRA means the Financial Industry Regulatory Authority.

Immediate Indirect Connection means a known Connection between an IPL Party and a Proposed Professional’s Unretained Affiliate (including an AMA).

Independent Personnel and Management means, with respect to an AMA of a Proposed Professional, the employment or engagement of management, professional and other personnel separate from those of such Proposed Professional, (e.g., excluding the Proposed Professional’s active employees from the AMA’s management, so that only independent directors/managers or professionals that are not active employees of (or that have retired from) the related Proposed Professional serve on the AMA’s board of directors (or other equivalent governing body)).

Indirect Connection means an Immediate Indirect Connection or a Remote Indirect Connection.

Information Barriers means policies and procedures of a referenced entity (including but not limited to policies and procedures adopted in compliance with Rule 10b5-1) that seek reasonably to ensure that (a) such entity’s investment decisions not violate the laws prohibiting trading on the basis of MNPI, and (b) Proposed Professional Personnel have no participation in or knowledge concerning investment decisions made by the Proposed Professional or its affiliates.

Interested Party List or **IPL** means a list of parties with Connections to the debtor’s estate (other than *de minimis* connections).

IPL Parties means the persons or parties listed on an IPL.

MNPI means material non-public information.

Named Issuers means an issuer of debt or equity securities (including a municipality), including parties that could become a debtor in a bankruptcy case.

NFA means the National Futures Association.

Other Regulatory Oversight means examination by any federal, state or foreign regulatory authority regarding compliance with regulatory requirements, other than Regulatory Oversight.

Proposed Professional means a professional person or entity proposed to be retained in connection with a pending bankruptcy case under Section 327. As used in this Protocol, the term “Proposed Professional” includes Retained Affiliates.

Proposed Professional Personnel means the primary working group within a Proposed Professional entity that directly provides the services for which the Proposed Professional is retained in the particular bankruptcy case, and excludes personnel that only episodically provide such services.

Regulatory Oversight means periodic regulatory examinations by the SEC, FINRA, or the NFA.

Related Investors means, with respect to a Proposed Professional, the Proposed Professional’s current and former ultimate beneficial owners, employees and their immediate family members.

Remote Indirect Connection means a known Connection arising from a relationship between a Proposed Professional’s Unretained Affiliate (including an AMA) and a third party, which third party, in turn, has a Connection with an IPL Party.

Retained Affiliates means those affiliates of a Proposed Professional that employ professional personnel for whom the Proposed Professional will seek compensation pursuant to Section 330 of the Bankruptcy Code.

Rule 10b5-1 means 17 C.F.R. 240.10b-5.

Rule 2014 means Federal Rule of Bankruptcy Procedure 2014.

SEC means the United States Securities and Exchange Commission.

Section 101(14) means 11 U.S.C. § 101(14).

Section 327 means 11 U.S.C. § 327.

Securities Registration means, with respect to a referenced entity, such entity’s registration (and attendant regulation) as an investment advisor by the SEC, as a securities broker/dealer by FINRA, or under the requirements of the CFTC.

Survey means the Summary of Industry Affiliate Investment Disclosures. *In re: Westmoreland Coal Co.*, Case No. 18-35672 (Bankr. S.D. Tex.), ECF No. 1659-1 pp. 2-66.

Third-Party Managed Investments means investments (including through mutual funds and other investment vehicles) that are managed by third parties with delegated investment authority and discretion.

Type means one of the four (4) types of AMAs that are classified in this Protocol.

Type 1 AMA means an AMA that either:

- A. (i) employs Information Barriers, (ii) is subject to both Securities Registration and Regulatory Oversight, and (iii) obtains most or all of its assets under management from third parties (i.e., parties other than Related Investors); or
- B. qualifies under the criteria provided in subsections (A)(i) and (ii), above, but obtains most or all of its assets under management from Related Investors and not from third parties, and also insulates its personnel and management by means of Independent Personnel and Management.

Type 2 AMA means an AMA that: (i) qualifies under the criteria provided in subsections (A)(i) and (ii) in the definition of Type 1 AMA, above; (ii) obtains most or all of its assets under management from Related Investors and not from third parties; (iii) does not make direct investments in Named Issuers but only, if at all, holds investments in Named Issuers as Third-Party Managed Investments; and (iv) does not have Independent Personnel and Management.

Type 3 AMA means an AMA that: (i) employs Information Barriers; (ii) is subject to either: (A) Regulatory Oversight, or (B) Other Regulatory Oversight; (iii) obtains its assets under management from Related Investors or third parties; and (iv) may make direct investments in the debt or equity of Named Issuers, whether or not it also holds such investments as a result of Third-Party Managed Investments.

Type 4 AMA means an AMA not qualifying as a Type 1, Type 2 or Type 3 AMA.

Type 1 Financial Organization means a Proposed Professional, including an investment banking or similar institution (including a financial advisor affiliated with an investment bank), that has Information Barriers and other characteristics of and would therefore qualify as a Type 1 AMA. A Type 1 Financial Organization retains its classification as such even if it does not have assets under management. A Type 1 Financial Organization also retains its classification as such notwithstanding that it may include affiliates of other Types (e.g., Type 3 AMAs engaged in insurance activities, and Type 4 AMAs acting in various capacities in ownership and/or management of investment assets).

Unretained Affiliate means an affiliate of a Proposed Professional other than a Retained Affiliate.

Introduction

Rule 2014 requires disclosure of connections between a Proposed Professional and certain parties in interest in bankruptcy cases. None of Rule 2014, Section 327, or the decisional law construing any of them provides Proposed Professionals (and Estate Professionals) and in particular, those having an AMA, any clear guidance regarding adequate disclosure of their AMA's connections with parties in interest in a bankruptcy case. This Protocol: (a) suggests definitions for a Connection requiring disclosure and categorizes such Connections; (b) classifies AMAs within four Types; (c) differentiates the disclosure of Connections recommended for the four Types of AMAs; (d) discusses knowledge of Connections and the means to obtain it; and (e) addresses confidentiality concerns and requirements for updating disclosure of Connections.

This Protocol does not endeavor to and could not effectively provide definitive guidance to all Proposed Professionals in all circumstances. Proposed Professionals range from sole practitioners or single office practices to complex international firms with thousands of professionals and multiple AMAs of various Types. Proposed Professionals may similarly be subject to a wide range of regulation, including self-regulatory rules and standards governing legal and accounting professionals, and Securities Registration and/or Regulatory Oversight to which financial advisory and investment banking firms may be subject. Proposed Professionals also are subject to a broad range of consequences for violation of the respective rules, regulations and laws that govern them, including license suspension or loss, enforcement under Securities Registration and/or Regulatory Oversight, and potential civil and criminal liabilities for misuse of MNPI. This Protocol therefore provides general guidance regarding how Proposed Professionals may obtain information and make proper disclosures to support their retention in U.S. bankruptcy cases that are within the scope of this Protocol, but this Protocol does not provide specific guidance for all Proposed Professionals, regardless of their type, size and structure, or in all bankruptcy cases, regardless of their size, scope, or operative facts. This Protocol recognizes that a Proposed Professional may deviate from its suggested data gathering procedures and disclosure recommendations based upon its particular facts and circumstances. No such deviation, *per se*, however, should support a contention that a Proposed Professional is not disinterested or that its retention should not be approved.

A Proposed Professional bears the burden of making appropriate disclosure of Connections in its initial retention application and an Estate Professional bears a continuing burden to supplement that disclosure as appropriate in the circumstances. This Protocol proposes a framework for disclosure of Connections by Proposed Professionals, Estate Professionals, and their affiliates in bankruptcy cases involving more than \$50 million in liabilities.

Connection should be broadly defined to respect the term's ordinary meaning and accomplish the important purposes of Rule 2014 and Section 327 to ensure that a Proposed Professional is a "disinterested person" as defined in Section 101(14). Section 327's primary functions include: (a) allowing the estate to obtain and retain expertise to fulfill its essential functions; (b) requiring disclosure of matters that might affect Estate Professionals' performance of their duty of loyalty; and (c) maintaining the integrity of the bankruptcy process and promoting the parties' and the public's confidence in that integrity. Section 327 requires that Proposed Professionals "not hold or represent an interest adverse to the estate" and are "disinterested persons." Section 101(14)(c) requires that a disinterested person "not have an

interest materially adverse to the interest of the estate or of any class of creditors or equity security holders, by reason of any direct or indirect relationship to, connection with, or interest in the debtor, or for any other reason.” Rule 2014 disclosure is intended to provide the Bankruptcy Court and parties in interest in a bankruptcy case with information adequate to evaluate whether a Proposed Professional is a disinterested person and qualified to serve under Section 327.

The definition of Connection and Rule 2014’s related disclosure obligations should not impair an effective evaluation of disinterestedness by requiring disclosure of every possible connection, no matter how *de minimis*. Further, Rule 2014 disclosure should not impractically require disclosure of unknown information or ignore valid confidentiality concerns.

The formulation of this Protocol has been informed by the Survey. The Survey reflects that, in the absence of any definition of Connection and disclosure guidelines, Proposed Professionals have adopted widely disparate practices governing disclosure of Connections, even among similarly situated Proposed Professionals. This Protocol was further informed by the results of telephonic interviews conducted with representatives of more than a dozen separate professional firms with significant Chapter 11 experience, who expressed their willingness to discuss (for themselves and not as an expression of their firm’s policies or procedures), in a candid, off-the-record context and not for attribution in the Protocol, disclosure issues arising from the retention application process. This Protocol provides guidance to Proposed Professionals regarding such disclosures.

1. Description of Connections

a. **Requirement of Disclosure.** Rule 2014 requires disclosure of the Connections of the “person to be employed,” and Section 101(14) refers to “direct or indirect relationships,” but neither Rule 2014 nor related decisional law addresses whether Indirect Connections (i.e., Connections created by affiliates of a Proposed Professional) must be disclosed.

b. **Interested Parties and Interested Party List.** In order to facilitate a Proposed Professional’s disclosure of Connections, the debtor, in consultation with its outside restructuring counsel, should prepare and make an Interested Party List (or IPL) available to all Proposed Professionals. If a Proposed Professional believes that the then-current IPL should be amended, such Proposed Professional should so advise the debtor’s counsel. If no IPL has been prepared when a Proposed Professional files its retention application, the retention application should disclose that fact and explain how the Proposed Professional identified Connections. Exhibit “A” to this Protocol includes an IPL template, as well as guidelines for a debtor’s consideration in preparing an IPL in light of the particular facts and circumstances of a bankruptcy case.

c. **Retained Affiliates.** A Proposed Professional should: (i) seek retention (and include the identity) of Retained Affiliates in its retention application; and (ii) ensure that its retention application discloses all known Connections (other than *de minimis* connections) among IPL Parties and such Retained Affiliates.

d. **Protocol Organization.** Paragraph 2 provides for certain disclosures relating to Immediate Indirect Connections. Paragraph 6 addresses what constitutes knowledge in connection with preparing retention application disclosures. Paragraph 8 discusses confidential treatment for Connections and IPL Parties in certain circumstances.

e. ***De Minimis* Exclusions.** Effective disclosure in large bankruptcy cases requires reasonable exclusion of *de minimis* connections and parties that should not qualify as IPL Parties (e.g., small creditor, vendor, customer exclusions, and investments falling below a threshold), as described on Exhibit “A.” Section 101(14)(c)’s reference to “material” supports excluding *de minimis* connections. For instance, a Proposed Professional may determine that an equity investment in an IPL Party of less than 1% of the outstanding equity or debt (with a value the Proposed Professional determines to be *de minimis*) need not be disclosed. Each IPL and each Proposed Professional’s retention application that excludes *de minimis* parties or connections should state the criteria, based on the facts and circumstances of the case (commonly, a dollar and/or percentage amount) applied to make such exclusions from disclosure.

f. **Disclosure under this Protocol.** Subject to *de minimis* exclusions as set forth herein, this Protocol recommends:

(i) A Proposed Professional (including Retained Affiliates) should disclose all known Direct Connections, and also disclose all Indirect Connections known to its Unretained Affiliates (including AMAs) and reported to it. Except as otherwise provided in this Protocol (including in Paragraph 8 regarding confidentiality), disclosed Connections should be identified by name and adequately described.

(ii) A Proposed Professional should obtain knowledge of Connections through its new matter intake process, by computer database searches, questionnaires and otherwise as described in this Protocol.

(iii) A Proposed Professional should disclose whether it has any AMAs, and if it does, it should describe such AMAs’ classification by Type as provided for in this Protocol, including (as applicable) such AMAs’: (A) Information Barriers; (B) Related Investors; (C) practices regarding direct investments in Named Issuers and/or through Third-Party Managed Investments; (D) Independent Personnel and Management; and (E) Regulatory Oversight and/or Other Regulatory Oversight.

(iv) A Proposed Professional that does not qualify as a Type 1 Financial Organization or have a Type 1 AMA, and does have one or more Type 2, 3 and/or 4 AMAs, should provide the IPL to such Type 2, 3 and/or 4 AMAs and request the AMAs to report Indirect Connections to the Proposed Professional as provided in this Protocol (including enhanced disclosure for Type 3 and 4 AMAs).

2. Indirect Connections

a. **Requirement of Disclosure.** Immediate Indirect Connections should be disclosed, as bearing upon whether the Proposed Professional “holds or represents an interest adverse to the debtor,” including Immediate Indirect Connections of: (i) Unretained Affiliates (as disclosed pursuant to an applicable questionnaire process), and (ii) Type 2, 3 and 4 AMAs (as disclosed in response to the distribution of the IPL), all as discussed below.

b. **Remote Indirect Connection.** The Survey reflects that Remote Indirect Connections are not generally disclosed, likely because Proposed Professionals have no knowledge of them. This Protocol recommends disclosure of a Remote Indirect Connection (other than a *de minimis* connection) only if the Proposed Professional has knowledge thereof. A

Proposed Professional's retention application should disclose the potential existence of unknown Remote Indirect Connections with IPL Parties. A Proposed Professional is not required to conduct procedures other than those set forth in this Protocol to identify Remote Indirect Connections.

3. Indirect Connections through Asset Management Affiliates

a. **AMA Disclosure.** When a Proposed Professional (including, without limitation, a law, accounting, financial advisory or investment banking firm) has an Unretained Affiliate that is an AMA, additional disclosure may be required to explain the AMA's Connections and their impact, if any, on the Proposed Professional's disinterestedness. That additional disclosure should also describe whether the AMA accepts funds from third parties or Related Investors, and whether the AMA makes direct investments in the debt or equity securities (i.e., buys or sells short, long, option or other positions) of Named Issuers or holds investments in Named Issuers through Third-Party Managed Investments, or both. Based on the Survey, many Proposed Professionals do not identify such AMAs individually by name, but rather identify them descriptively and generically. This Protocol does not intend to change that practice. The description of such AMAs should categorize them by reference to the applicable "Types" described below. Most Proposed Professionals (in common with most employers) maintain 401(k) programs and support various other pension and/or other retirement account programs for their employees' benefit as Third-Party Managed Investments and without using an AMA; such arrangements do not trigger any requirement for analysis as an AMA under this Protocol.

b. **Material Non-Public Information; Regulation and Oversight.** Proposed Professionals, Estate Professionals and their respective AMAs frequently possess MNPI and often implement Information Barriers to address this. These entities may also be subject to regulation and oversight, including Securities Registration and/or Regulatory Oversight.

c. **AMA Classification.** This Protocol identifies four Types of AMAs (Types 1, 2, 3 and 4) and proposes corresponding disclosure requirements for each Type. If a Proposed Professional believes its AMA has characteristics of more than one Type, its retention application should discuss these characteristics and include disclosure applicable to the higher numbered Type (e.g., an AMA with characteristics of both a Type 3 and Type 4 AMA should make the disclosure required for a Type 4 AMA). If a Proposed Professional believes its AMA should be classified differently from these Types, its retention application should discuss this and include disclosure most appropriate to such AMA.

d. **Change in AMA Type.** An AMA's classification can change over time. For example: a Type 4 can qualify as a Type 3 by implementing Information Barriers and becoming subject to Regulatory Oversight or Other Regulatory Oversight; a Type 3 can qualify as a Type 2 by becoming subject to Securities Registration (and, if applicable, Regulatory Oversight rather than Other Regulatory Oversight) and holding investments in Named Issuers only as Third-Party Managed Investments; and a Type 2 can become a Type 1 by implementing Independent Personnel and Management. With respect to each bankruptcy case in which a Proposed Professional files a retention application, however, the Proposed Professional should classify its AMA(s) (as a Type 1, 2, 3 or 4) based on the AMA's characteristics when the Proposed Professional files its initial retention application in such case, and this classification should remain in effect throughout the course of such case (i.e., the same classification should apply to

an Estate Professional's updated retention application disclosures). Accordingly, the same AMA of a Proposed Professional may be classified differently in different bankruptcy cases, based on its characteristics at the time that the Proposed Professional files its initial retention application in the different bankruptcy cases.

4. Disclosures Relating to Type 1 Financial Organizations and Type 1 AMAs

a. **Present Type 1 Financial Organization and Type 1 AMA Disclosure.** The Survey indicates that a retention application for a Proposed Professional qualifying as a Type 1 Financial Organization or having an AMA that this Protocol categorizes as a Type 1 AMA commonly discloses only Direct Connections known to the Proposed Professional Personnel because its Information Barriers, Securities Registration and Regulatory Oversight fully protect MNPI, and insulate the Proposed Professional Personnel from any effects that MNPI could potentially create with respect to the Proposed Professional's disinterestedness. Such Proposed Professional Personnel generally have no knowledge of (and therefore the Proposed Professional does not disclose) debt or equity investments in IPL Parties because of the effectiveness of the Information Barriers applicable to communication and misuse of MNPI and insulating Proposed Professional Personnel from participation in or knowledge of investment decisions.

b. **Proposed Type 1 Financial Organization and Type I AMA Disclosure.** This Protocol proposes that the disclosures of Connections in a retention application of a Proposed Professional qualifying as a Type 1 Financial Organization or having a Type 1 AMA may properly be limited to identifying the names (subject to confidentiality considerations) of Direct Connections (other than *de minimis* connections) known to such Proposed Professional in reliance on the presumed effectiveness of Information Barriers. Such named entities should ordinarily be described as "a current or former client, but with respect to matters unrelated to the Debtor," absent facts or circumstances that require enhanced disclosure. Bankruptcy Courts have consistently approved retention applications based upon such disclosures.

5. Disclosures relating to Type 2, 3 and 4 AMAs

a. **Present Type 2, 3 and 4 AMA Disclosure.** The Survey indicates that retention applications for a Proposed Professional with an AMA that this Protocol categorizes as a Type 2, 3, or 4 AMA include increased disclosures because: (i) such a firm accepts most or all of its investments from Related Investors; (ii) a Type 3 AMA may be subject only to Other Regulatory Oversight (and may not be subject to any Securities Registration); (iii) a Type 4 AMA may not be subject to regulatory examinations or Securities Registration at all; and (iv) a Type 3 or 4 AMA may make direct investments in Named Issuers, rather than investing exclusively through Third-Party Managed Investments.

b. **Considerations for Type 2 AMA Disclosures.** A Proposed Professional with an AMA that this Protocol categorizes as a Type 2 AMA could credibly contend that its disclosure obligations in respect of its Type 2 AMA should be the same as the disclosure obligations in respect of Type 1 AMAs because its Type 2 AMA protects MNPI by means of the same Information Barriers enforced by the same Securities Registration and Regulatory Oversight as those that apply to Type 1 AMAs. In addition, a Type 2 AMA refrains from direct investments in Named Issuers, and a Type 1 AMA may make direct investments in Named Issuers. Nonetheless, this Protocol recommends increased disclosure by a Proposed Professional with a Type 2 AMA in order to advance the purposes of (i) protecting public confidence in the integrity

of the restructuring process, and (ii) ensuring an absence of self-dealing because a Type 2 AMA obtains most or all of its funds under management from Related Investors and may be managed and controlled by active professional personnel that also manage and control the related Proposed Professional (rather than utilizing Independent Personnel and Management).

c. **Proposed Type 2 AMA Disclosure.** A retention application for a Proposed Professional (other than a Type 1 Financial Organization) with a Type 2 AMA should disclose known (i) Direct Connections of the Proposed Professional, and (ii) Immediate Indirect Connections of its Type 2 AMA, in each case other than *de minimis* connections. Disclosure of known Immediate Indirect Connections (other than *de minimis* connections) of a Type 2 AMA will consist of identifying the IPL Parties, if any, to which the Type 2 AMA has Immediate Indirect Connections, if and as reported by the Type 2 AMA to its related Proposed Professional. A Proposed Professional with a Type 2 AMA should provide the IPL to its Type 2 AMA, and request its Type 2 AMA to inform it of known Immediate Indirect Connections (other than *de minimis* connections) to IPL Parties for potential disclosure in the Proposed Professional's retention application pursuant to this Protocol, including Paragraph 6, below, regarding knowledge.

d. **Proposed Type 3 AMA Disclosure.** A retention application for a Proposed Professional (other than a Type 1 Financial Organization) with a Type 3 AMA should contain enhanced disclosure that reflects (i) such AMA's Regulatory Oversight or Other Regulatory Oversight, as applicable; and (ii) the extent of any Securities Registration applicable to such AMA. Such retention application disclosure should also address how, if at all, these characteristics of its AMA could cause any potential impairment to the Proposed Professional's perceived or actual disinterestedness. Because Type 3 AMAs may make direct investments in Named Issuers, the disclosures required from such a Proposed Professional with a Type 3 AMA should disclose known Indirect Connections (other than *de minimis* connections) between the Type 3 AMA and IPL Parties including those arising from any such direct investments in Named Issuers that appear in the IPL, in each case as reported by the Type 3 AMA to its related Proposed Professional.

e. **Proposed Type 4 AMA Disclosure.** A retention application for a Proposed Professional (other than a Type 1 Financial Organization) with a Type 4 AMA should contain enhanced disclosure that sets forth the Securities Registration, Regulatory Oversight and/or Other Regulatory Oversight (or lack thereof) applicable to the Proposed Professional. Such retention application disclosure should also address how, if at all, these characteristics of its AMA could cause any potential impairment to the Proposed Professional's perceived or actual disinterestedness. If the applicable Type 4 AMA makes direct investments in Named Issuers, the disclosures required from such a Proposed Professional with such Type 4 AMA should disclose known Indirect Connections (other than *de minimis* connections) between the Type 4 AMA and IPL Parties, including those arising from any such direct investments in Named Issuers that appear in the IPL, in each case if and as reported by the Type 4 AMA to its related Proposed Professional. The disclosures required in a retention application of a Proposed Professional with a Type 4 AMA should be informed by the disclosure provided with respect to other categories of AMAs and supplemented as appropriate based on the facts and circumstances applicable to the particular AMA and bankruptcy case.

6. Disclosure Based on Actual Knowledge

The disclosure obligations of a Proposed Professional under this Protocol derive from the Proposed Professional's knowledge of Connections (other than *de minimis* connections), including the knowledge of Connections of a Proposed Professional's AMAs (if any) which the AMA may report to the Proposed Professional. In the case of Type 2, 3 and 4 AMAs with only Third-Party Managed Investments, disclosure of investments in Named Issuers included in the IPL Parties that such managers may make from time to time would be impractical because of, *inter alia*, the frequency of trading in such positions, and the AMA's limited knowledge thereof (if any). To be sure, Proposed Professionals cannot disclose unknown Connections, and this Protocol does not suggest that they do so. Instead, this Protocol provides procedures to obtain such knowledge. For purposes of this Protocol, a Proposed Professional's knowledge of Connections means actual knowledge derived from its new matter intake process and the results of the Proposed Professional's: (a) computer client database check (as described in Paragraph 7, below); (b) any applicable inquiry of its professional personnel (and Unretained Affiliates other than AMAs) by a questionnaire process or otherwise (also as described in Paragraph 7, below); (c) review of the report it receives of its AMA's (if applicable) check for conflicts and Connections (or any other applicable) process; and (d) review of any other process for its Unretained Affiliates (if any, and other than an AMA). All references to "knowledge" in this Protocol refer to actual knowledge. As discussed in Paragraph 7(e), below, if a Proposed Professional limits its retention application disclosure to the knowledge of Proposed Professional Personnel, that limitation should be disclosed in the retention application. A retention application of a Proposed Professional with knowledge of Direct Connections or Indirect Connections with IPL Parties (other than *de minimis* connections), should disclose all such Connections. In addition, if a Proposed Professional has knowledge of a Connection (other than a *de minimis* connection) with a person not included in the IPL, such Connection should be disclosed.

7. Determination of Whether a Connection Exists

Proposed Professionals should obtain knowledge of whether Connections exist generally by following the procedures discussed below, subject to adaptations to disclose particular circumstances affecting a particular Proposed Professional and bankruptcy case. Each retention application for a Proposed Professional should describe the process and procedures it utilized to obtain knowledge of Connections.

a. **Interested Party List.** Subject to Paragraph 6 of this Protocol regarding knowledge, Proposed Professionals can reasonably and in good faith rely on the list of IPL Parties, consistent with the description and template attached as Exhibit "A," prepared (and periodically updated, with information derived from the debtor's bankruptcy schedules and otherwise, as described in Exhibit "A" and in Paragraph 10, below) by the debtor.

b. **Process to Check for Conflicts and Connections.** Every Proposed Professional should perform (in connection with its other new matter intake procedures) a process to check such Proposed Professional's client databases for conflicts and Connections with IPL Parties. A Proposed Professional should utilize a process designed to identify Connections adequately in the context of the size and organizational complexity of the Proposed Professional. For entities

with a significant number of professionals, this process often utilizes computer software.¹ For Proposed Professionals with a large number of professionals, this Protocol recommends deployment of adequate software within a reasonable time. Pending such deployment, a Proposed Professional may retain an independent third party to assess the adequacy of the alternative procedures the Proposed Professional uses to identify and appropriately disclose Connections.

A Proposed Professional (other than a Type 1 Financial Organization or a Proposed Professional with Type 1 AMAs) should distribute the IPL to its Type 2, 3 and 4 AMAs, request them to report any Connections (other than *de minimis* connections) to the Proposed Professional, and disclose in its retention application all Connections so reported. In addition, a Proposed Professional should distribute the IPL to its Proposed Professional Personnel, request them to report any Connections (other than *de minimis* connections) to the Proposed Professional, and disclose in its retention application all Connections so reported.

c. **Questionnaires.** A Proposed Professional should disclose in its retention application the results from written inquiries of the Proposed Professional's professional personnel (as distinguished from staff, support or administrative personnel), and (to the extent, if any, appropriate) Unretained Affiliates (if any) controlled by the Proposed Professional regarding: (i) their known equity or debt investments in the debtor (e.g., excluding Third-Party Managed Investments); and (ii) other connections or relationships with the debtor (other than the Proposed Professional's proposed engagement), the Bankruptcy Court judges, or United States Trustee personnel. Exhibit "B" to this Protocol presents a sample questionnaire. Particularly for Proposed Professionals organized in complex global structures, Exhibit "B" may require substantial modification, or a different (or even no) approach to seeking this information from certain of its professional employees and affiliates may be appropriate.

d. **AMA's Report.** A Proposed Professional should set forth in its retention application the results reported to the Proposed Professional from its AMA's (if applicable) search with respect to IPL Parties (including any alternative processes or rationale for omission thereof).

e. **Type 1 Financial Organizations and Type 1 AMAs.** As discussed above, Type 1 Financial Organizations and Type 1 AMAs are subject to Information Barriers that not only protect against misuse of MNPI but also insulate Proposed Professional Personnel from participation in or knowledge concerning investment decisions. Accordingly, it may be appropriate for such Proposed Professionals to obtain knowledge of Connections from their new matter intake procedures and computer client database reviews and base their disclosures on the knowledge of their Proposed Professional Personnel derived therefrom, without using questionnaires (other than directed to its Proposed Professional Personnel) or other procedures.

8. Confidentiality Considerations

If a Connection (or the identity of an IPL Party) that should be disclosed under this Protocol is subject to confidentiality considerations and the Proposed Professional seeks not to disclose the Connection or the name of the IPL Party, the following steps should be taken:

¹ Law firms generally use proprietary software licensed from vendors, while financial advisory firms more typically develop such software themselves or through third-party consultants.

a. **Description in IPL.** The Connection (or IPL Party) should be described (but not identified) in sufficient detail to permit informed decisions concerning the Proposed Professional's "disinterestedness" (as defined in Section 101 (14));

b. **Identity Filed Under Seal.** The party seeking to preserve confidentiality with respect to IPL Parties or Connections may file a motion for leave to file the identity of the confidential party under seal under Rule 9018, Federal Rules of Bankruptcy Procedure, on notice to the Office of the U.S. Trustee, the Debtor, any official committee, the holders of the 20 largest claims against the Debtor, any party that has requested notice pursuant to Rule 2002, Federal Rules of Bankruptcy Procedure, any applicable local rule, and all other parties entitled to notice of motions of this type under orders of the Bankruptcy Court in the Debtor's bankruptcy case. If the Bankruptcy Court enters an order granting such relief, in whole or in part, the party obtaining such relief should proceed in accordance therewith; and

c. **Access to Sealed Information.** Subject to the provisions of any particular Bankruptcy Court's sealing order, any party in interest, including the United States Trustee, may ask the Bankruptcy Court for permission to review (or for their counsel to review) the sealed information, and the party seeking access to the information bears the burden of proof regarding such request. The Bankruptcy Court order granting such access may protect the information's continuing confidentiality. *See, e.g.,* Order Authorizing Evercore Group L.L.C. To File Under Seal Certain Confidential Information Related to Evercore's Retention Application, *In re: Jones Energy, Inc., et al.*, Case No. 19-32112 (Bankr. S. D. Tex.), ECF No.210.

9. Look-back Period and Diligence

a. **Time Period.** A Proposed Professional should disclose Connections during the three years preceding the commencement of the bankruptcy case unless the circumstances reasonably warrant a longer period. For example, if a Proposed Professional represented a party in interest in a leveraged buy-out of the debtor eight years before the petition date, the Connection should be disclosed. Conversely, if a Proposed Professional represented a creditor of the debtor in a matter unrelated to the debtor four years before the petition date, no disclosure of that connection should be required.

b. **Additional Processes.** A Proposed Professional (and AMAs and other Unretained Affiliates) may, but should not be required to, conduct a process or procedure to identify Connections in addition to those set forth in this Protocol.

10. Updates

A Proposed Professional, once retained, has ongoing disclosure obligations. The debtor has the continuing obligation to update the IPL. This Protocol recommends that a debtor update, file and serve the IPL in a manner that clearly identifies changes thereto from prior versions no less frequently than every 90 days, including in connection with the filing of the debtor's schedules and statements, the passage of the claims bar date, the commencement of adversary proceedings, and filings under Bankruptcy Rule 2019 or by prospective purchasers of the debtor's assets. Estate Professionals should supplement their Rule 2014 disclosures, to the extent necessary as a result of updated IPLs and other developments in the bankruptcy case, including by reason of newly discovered or inadvertently omitted Connections. Without limiting Estate Professionals' obligations relating to prompt disclosure of known Connections, Estate

Professionals may maintain continuing compliance with their supplemental disclosure obligations under Rule 2014 by updating their disclosures in accordance with this Protocol within a reasonable time after the debtor's filing of updated IPLs, to the extent required as a result thereof.

EXHIBIT A TO HOUSTON DISCLOSURE PROTOCOL³

³ Defined terms used and not otherwise defined in this Exhibit have the meanings ascribed to them in the Protocol.

GUIDELINES AND TEMPLATE FOR INTERESTED PARTY LIST

“Interested Parties List” or “IPL” means a list of people and entities, grouped into categories of their Connections, identified by name, and prepared to assist Proposed Professionals in complying with disclosure obligations under Rule 2014. The debtor, with the assistance of its outside restructuring counsel, should compile the initial IPL as part of due diligence leading up to the bankruptcy filing. An IPL categorizes each IPL Party in accordance with the nature of the Connection it has with the debtor, parties associated with the debtor (e.g., current directors, executive officers and debt and equity holders), and other IPL Parties (e.g., vendors, customers, contract, lease and litigation counterparties). Proposed Professionals rely on the IPL to provide the names of parties to review for possible Connections. In bankruptcy cases involving issuers of public debt or equity securities, it may be most efficient to construct the IPL using commercially available databases that offer exact legal names of entities and their affiliates.

An IPL may be both broader and narrower than the persons or entities the debtor lists in schedules and statements of financial affairs. An IPL (and updates to it as provided for in the Protocol) should include, without limitation, members of official committees, proposed purchasers of the debtor’s assets, and other Estate Professionals, none of which may appear in the debtor’s schedules and statements. An IPL may exclude *de minimis* potential IPL Parties that the debtor’s schedules and statements will include. Particularly in larger cases, the debtor’s schedules and statements may not be available before a Proposed Professional files its retention application. Accordingly, an IPL that the debtor makes available may form the best source of this information available to a Proposed Professional filing its retention application early in the bankruptcy case.

As set forth in the Protocol, a debtor should change and update the IPL during the course of a bankruptcy case, at intervals no less than 90 days, to reflect changing facts and circumstances in the case, including new developments, as well as to cure inadvertent omissions. Updates should reflect, among other things, the matters, events and circumstances addressed in the template provided below.

EXHIBIT “A”

IPL TEMPLATE

In its initial compilation of the IPL, the debtor should consider including the following categories of parties with Connections, as applicable:

- Debtor(s)
- Debtor affiliates and subsidiaries
- Current and former officers and directors (within the last 3 years)
- Affiliates of current and former officers and directors
- Significant equity holders (more than 5%)
- Prepetition lenders / noteholders
- Prepetition Indenture trustees / agents
- Initial DIP lenders
- U.S. Bankruptcy Court Judges serving in the District (as updated, only the Bankruptcy Judge presiding over the bankruptcy case will remain an IPL Party)
- U.S. District Court Judges for the applicable district
- U.S. Trustee (for the applicable region) and Staff Attorneys and Trial Attorneys in the District in which the case is filed
- Top 50 unsecured creditors
- Identified bankruptcy professionals
- Ordinary course professionals
- Contract counter-parties (other than *de minimis*)
- Vendors / suppliers (other than *de minimis*)
- Customers (other than *de minimis*)
- Competitors (other than *de minimis*)
- Landlords and lease counter-parties (other than *de minimis*)
- Licensees and licensors (including under intellectual property rights) (other than *de minimis*)
- Utility companies (other than *de minimis*)
- Litigation counter-parties (other than *de minimis*)
- Regulatory agencies / governmental bodies
- Taxing authorities (other than *de minimis*)
- Labor unions
- Depository banks (other than *de minimis*)
- L/C issuers
- Lien claimants
- Insurance providers and agents
- Surety bonds and surety providers
- Other IPL Parties significant to the bankruptcy case, and not included above.

The parameters for excluding *de minimis* parties from the IPL depend on the facts and circumstances of each particular bankruptcy case. In each category appropriate for *de minimis* exclusions, the debtor should consider a practical *de minimis* limitation so that category will contain only IPL Parties that bear on a Proposed Professional’s disinterestedness. The IPL should

disclose the dollar amount, percentage amount or other criteria (e.g., limiting equity holders to thresholds based on value and percentage interest) chosen for *de minimis* exclusions in each applicable category.

Updates

As set forth in the Protocol, the IPL is a dynamic document, and a debtor should change and update the IPL during the course of a bankruptcy case. The debtor should update the IPL no less frequently than every 90 days to reflect changing facts and circumstances, new developments, and information learned during the bankruptcy case, as well as to cure inadvertent omissions. After the filing of the bankruptcy case, the IPL should be updated to include additional IPL Parties identified in:

- The debtor's schedules and statements (including any amendments)
- Proofs of Claim
- Notices of appearance
- Adversary proceedings and other motions or applications
- Filings by prospective purchasers of debtor's assets, plan proponents and under Bankruptcy Rule 2019
- Appointments of official committees and retention of Estate Professionals

EXHIBIT B TO HOUSTON DISCLOSURE PROTOCOL

Exhibit B
Form of Questionnaire

Urgent Request for Information

THIS IS AN URGENT REQUEST FOR INFORMATION THAT REQUIRES YOUR IMMEDIATE ATTENTION AND RESPONSE IF YOU HAVE ANY INFORMATION TO REPORT OR MATTERS TO DISCLOSE. YOUR FAILURE TIMELY TO RESPOND WILL CONSTITUTE YOUR AFFIRMATION THAT YOU HAVE NO INFORMATION TO REPORT OR MATTERS TO DISCLOSE. IF YOU WOULD SELECT OPTION #1 TO EACH OF THE THREE QUESTIONS BELOW, YOU NEED NOT RESPOND TO THIS QUESTIONNAIRE. THANK YOU IN ADVANCE FOR YOUR PROMPT ASSISTANCE.

(Name of Proposed Professional) represents (or is applying for Bankruptcy Court authorization to represent) **(name of entity)** and its affiliates listed below (collectively, the “**Debtors**”) or (the Official Committee of Unsecured Creditors) (or other applicable official committee or party; as the case may be, the “Client”)) in their (recently filed) (contemplated) chapter 11 bankruptcy cases in the United States Bankruptcy Court for the _____ District of _____.

As an advisor to the Client, there are several types of disclosures that we must make in order for the Bankruptcy Court to approve retention of our firm. Most of the information required to be disclosed can be obtained from the databases and conflicts records our firm maintains. That process is underway. A limited amount of information, however, may most efficiently be obtained directly from professionals employed by our firm and affiliates of our firm who receive this Questionnaire (collectively, the “Questionnaire Recipients”). This request relates to the second type of material listed above, which is why you are being contacted. The specific disclosures that we are required to make are listed below.

First, we must disclose to the Bankruptcy Court presiding over the Debtors' cases any holdings by the Questionnaire Recipients in either the debt or equity securities of the Debtors (e.g., excluding any investments, whether held through mutual funds or other investment vehicles, that are managed by third parties with delegated investment authority and discretion; “Third-Party Managed Investments”), as well as the existence of any other claims against the Debtors held by any Questionnaire Recipient.

Second, we must disclose to the Bankruptcy Court whether any Questionnaire Recipient has any connections to the United State Trustee or any person employed in the Office of the United States Trustee for the _____ District of _____.

Third, we must disclose to the Bankruptcy Court whether any Questionnaire Recipient has any connections to any of the Bankruptcy Judges for the _____ District of _____.

Please respond to this email no later than [, 20] at noon EST:

1. Debt or Equity Securities, or Other Claims Against the Debtors.

Please indicate by replying to this email whether you, on or after [90 days prior to the date of this questionnaire] have owned or held a beneficial interest in any debt or equity securities (other than Third Party Managed Investments) of, or claims against, any of the Debtors. **To reply, review the options listed below and (electronically check the appropriate box) (select the appropriate button at the top of this message).**

Option #1 -- I have not held and do not hold debt or equity securities of, or other claims against, any of the Debtors.

Option #2 -- I have held but no longer hold debt or equity securities (other than Third-Party Managed Investments) of, or other claims against, any of the Debtors.

Option #3 -- I currently hold debt or equity securities (other than Third-Party Managed Investments) of, or other claims against, one or more of the Debtors. (If selecting this option, please describe in your reply the type of debt or equity securities that you hold, the name of the issuer, and/or the nature of any claim that you may hold or assert. To do this, select "Edit the response before sending" option to enter your comments.)

2. Connections to the United States Trustee or any Person Employed by the Office of the United States Trustee for the _____ District of _____.

The names of the United States Trustee and employees in the office of the United States Trustee for the _____ District of _____ are listed below.

To reply, review the options listed below and (electronically check the appropriate box) or (select the appropriate button at the top of this message).

Option #1 - I have no connections to the United States Trustee or to anyone employed in the office of the United States trustee for the _____ District of _____

Option #2 - I have the following connections to the United States trustee or to someone employed in the office of the United States Trustee for the _____ District of _____. (If selecting this option, please describe in your reply the connections that you have to the United States Trustee or to anyone employed in the office of the United States

Trustee for the _____ District of _____. To do this, select "Edit the response before sending" option to enter your comments.)

3. **Connections to any Bankruptcy Judges in the _____ District of _____.** The names of the Bankruptcy Judges in the _____ District of _____ are listed below.

To reply, review the options listed below and (electronically check the appropriate box) or (select the appropriate button at the top of this message).

Option #1 - I have no connections to any of the Bankruptcy Judges for the _____ District of _____.

Option #2 - I have the following connections to a Bankruptcy Judge for the _____ District of _____ (If selecting this option, please describe in your reply the connections that you have to a Bankruptcy Judge for the _____ District of _____). To do this, select "Edit the response before sending" to enter your comments).

(Insert "Edit Response Before Sending" option at appropriate point to facilitate electronic response)

If you have any questions concerning this urgent request for information, please call (_____) at (_____) - _____.

THANK YOU VERY MUCH FOR YOUR PROMPT ATTENTION TO THIS MATTER

List of [_____] Debtors:

(Each Debtor entity)

Bankruptcy, Receiverships and Cannabis Businesses

*And Oklahoma SB 532 Receivers for
Marijuana businesses*

Cannabis is Big Business

- Per the US Census data for 2018 Oklahoma's population was 3,943,000
- Per the Oklahoma Medical Marijuana Authority on 7/29/18 there had been issued
 - ❑ 170,404 patient licenses
 - ❑ 3,733 grow licenses
 - ❑ 1,708 dispensary licenses
 - ❑ 984 processor licenses
 - ❑ Total 6,425 MMJ businesses were started since September of 2018

Bankruptcy is not an Option for Marijuana Businesses

- The Tenth Circuit Bankruptcy Appellate Panel in *Arenas v. United States Trustee* (In re Arenas), 535 B.R. 845 (10th Cir. B.A.P. 2015), affirmed the dismissal of a chapter 7 debtors' case determined that a debtor in the marijuana business could not obtain relief in the federal bankruptcy court.
- In *In Re Basrah Custom Design, Inc.*, 2019 WL 2202742 (Bankr. E.D. Mich. May 21, 2019), the court dismissed a bankruptcy case filed by a company which was not in the marijuana business itself but whose principal had, in the name of the corporation, leased property he owned to a company which operated a medical marijuana dispensary. Such a business was legal under Michigan law but not federal law.
- Does this prohibition extend to hemp?

Cannabis, Hemp and Hemp products

- Cannabis is a genus of flowering plants, which consists of two primary species: *Cannabis sativa* and *Cannabis indica*. Within these two categories are hundreds of different strains
- While hemp and marijuana are regularly referred to as Cannabis, they actually very distinct.
- “*Hemp*” is Cannabis that contains THC delta 9 of less than 0.3% content by dry weight.



- “Marijuana” contains higher THC levels.



- Both hemp and marijuana are remarkably similar in look, smell and texture.
- But there is currently a legal distinction between the two plants.

Legislative Background

- The 2014 Farm Bill allowed the cultivation of hemp on a state by state basis through pilot programs administered by universities under the auspices of the state agricultural departments. There was an ongoing debate within the Justice Department as to whether hemp and hemp products, particularly, were still on schedule 1 of the CSA.
- On December 12, 2018, Congress passed the 2018 Farm Bill, which was signed into law by President Trump the following week. The 2018 US Farm Bill has now legalized the commercial production of hemp and removed it from the Controlled Substances Act as long as it met the definition of “hemp”.
- The 2018 Farm Bill defines hemp as the “plant cannabis sativa L. and any part of the plant with a delta-9 THC concentration of not more than 0.3 percent by dry weight”.
- The Farm Bill requires the US Department of Agriculture develop federal regulations for states that do not want to be the primary regulator.

Legislative Background

- For states that do want to be the primary regulators the Bill requires those states to submit a plan to the USDA which meets the minimum standards of the federal regulations.
- It authorizes the USDA to offer crop insurance.
- It is now legal to buy and sell hemp and hemp products in interstate commerce.
- The 2018 Farm Bill was designed to make the cultivation and processing of hemp legal just like any other farming operation.

Regulatory Guidance

- There is currently very little regulatory guidance for hemp farmers as the USDA has been slow to promulgate rules. Federal regulations are anticipated to be published in August
- The states are all waiting on the USDA to do their job before developing state plans.
- Consequently, the current hemp growers are operating under the old rules established by the 2014 Farm Bill under pilot programs.

Cannabis, Hemp and Hemp products

- Currently most of the famers and processors are growing and extracting CBD oil from hemp. CBD hemp can be very lucrative. A crop should produce about 10 percent CBD content, and should bring about \$25 to \$35 per pound. With a yield of about one pound per plant and up to 2,500 plants per acre, that's around \$60,000 per acre. Most large scale farms are growing 160 acres of hemp or more making the value of a crop nearly \$10,000,000.
- Additionally, there are many other products that can be made from hemp, including beer, milk, shoes, protein powder, tea, coffee, hamburgers, rope, clothes, yoga pants, sunglass frames, soap, concrete, automobiles and pens, just to name a few.

Acceptance of Hemp Businesses

- Banks are still reluctant to open accounts for Hemp businesses, however, that is slowly changing. Financial institutions are opening up to lending to farmers like any other crop and the federal government is working to develop federally backed loans to hemp farmers.
- There is still uncertainty of how the IRS is going to treat hemp businesses and whether they will treat them similarly to marijuana business and only allow deductions for cost of goods sold (IRC Section 280 (e))
- The 2018 Farm Bill allows for crop insurance but crop insurance for hemp will likely take years to develop because of uncertainty about yields and exceptions for destruction of crops at the direction of a regulatory body.

Bankruptcy for Hemp Businesses

- There is a great deal of uncertainty over whether bankruptcy courts will allow hemp businesses to file for bankruptcy protection.
 - After all...
 - Hemp and hemp products are not a scheduled drug under the CSA
 - It is legal to do business across state lines
 - It is federally legal in all 50 states
 - It is grown like any other crop

Challenges

- While hemp is legal under federal law and therefore like any other business that seeks bankruptcy court protection there may still be issues.
- Many farmers use feminized seeds and clones to maximize the CBD. Currently the gold standard is 10% of the plant contains CBD.
- This means that 90% of the plant contains other cannabinoids some of which may be THC delta 9.
- Producers generally want only the CBD so they process most if not all of the cannabinoids, including THC delta 9, out of the final product.

Challenges

- Some of these businesses sell the THC which has been processed out of the biomass, which would be illegal under federal law.
- Then there is the problem of whether a Chapter 12 debtor does not properly dispose of the hemp if any of the plant or biomass is “hot” i.e. more than .3% THC? Does this expose the Trustee to liability?
- Some states currently require a farmer, where there are a handful of hot plants, to cut down and dispose of the entire crop. What kind of impact would that have on a Chapter 12 plan?
- If bankruptcy is not an option then a hemp business would need to look to state law.
- Which brings me to receiverships.

Receiverships for a Cannabis Business

- All states have some form of a statutory scheme for receiverships
- But when it comes to receiverships for cannabis businesses its not always easy to have a receiver appointed
- Colorado
 - Allows receivers to be appointed to take over an run a marijuana business but they have to licensed by the State's regulatory body for overseeing marijuana. *Yates v Hartman*, 2018 COA 31, (Colo. App. 2018)

Receiverships for a Cannabis Business

- Many states have now made the appointment of a receiver much easier by providing for the right by a receiver to manage and operate a marijuana business without having to separately obtain a MM license from the state. For example-
- Oregon
 - Has adopted regulations which allow for the receiver to be appointed as long as the receiver meets some very simple standards.
 - Proof that the person is the legal trustee, receiver for the business; and
 - A written request for authority to operate as a trustee or receiver, listing the address and telephone number of the trustee, receiver or personal representative.

Oklahoma SB 532

- Andy Turner, a colleague of mine in Tulsa, drafted legislation for the appointment of a receiver for the purpose of making it simpler to have a receiver appointed for a medical marijuana business.
- Codified as 12 O.S. Section 1560 the new law allows for creditors of a medical marijuana business, be it a dispensary, grow operation or extraction company, to have receiver appointed to run the business during the pendency of the receivership.

Oklahoma SB 532

- In order to continue the operation of the MMJ business all the receiver has to do is submit to the Oklahoma Medical Marijuana Authority (“OMMA”) proof that he or she meets the requirements to hold a MMJ license under Oklahoma law.
- There are no additional fees for this transition other than the normal fees that OMMA charges.
- This same rules apply to persons that are deceased, who become insolvent or who file for bankruptcy.

Oklahoma MMJ Requirements

- Applicants must be 25 or older.
- Must be an Oklahoma resident.
- All owners must provide a background check; nonviolent felony convictions in the last two years and any other felony conviction in the last five years for any owner will disqualify the applicant.

Challenges for Receivers under the New Law

- When Oklahoma passed SQ 788 they passed one of the most liberal medical marijuana schemes in the country. The qualifications for who could or could not get a MMJ business license was extremely easy.
- This past legislative session Oklahoma passed the so-called Unity Bill which addressed some of the more wide open licensing requirements.
- In particular, the residency requirement went from proof that you lived in the state to a 2 year residency requirement.
- Finally, the law does not help hemp businesses since they operate under a different licensing scheme through the Oklahoma Department of Agriculture.

AMAZE AND DELIGHT YOUR FRIEND(LY
NEIGHBORHOOD BANKRUPTCY JUDGE)S:
UNREDACTED EFFECTIVE TRIAL TECHNIQUES

**Prepared for the Oklahoma Bar Association
Advanced Bankruptcy Seminar
Oklahoma City, Oklahoma
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Introduction¹

Before I became a judge, I practiced in a law firm that was split into sections. We had a bankruptcy/creditors' rights section (which is where I came from), and a litigation section, among others. As you all know, a bankruptcy practice is a litigation practice that includes a substantive area of expertise. The litigators in my firm didn't think so. Whenever they found out that I was getting ready to go to trial in bankruptcy court, I usually heard something like this:

"Why bother with the rules of evidence? They don't exist in bankruptcy court."

"When it comes to admitting evidence, the bankruptcy judge does what he or she pleases."

"The only rule of evidence in bankruptcy court is that everything comes in."

"Why worry? Isn't the judge asleep most days?"

It wasn't funny then, and, after more than 22 years on the bench, it still isn't funny. Getting the right evidence admitted matters to you if you want to win. Ruling on the basis of properly admitted evidence matters to me because: (1) I want to get the decision right; and (2) I really, *really*, *really* hate getting reversed.²

What follows are some observations on common evidence issues I have seen over the years, together with some suggestions on how to deal with them. They are based upon my experiences, both as an attorney and a judge, and war stories from my colleagues. Hopefully, at least one of these will come in handy for you during some hotly contested bankruptcy matter.

¹ If this looks familiar, it's because you attended the 2011 OBA Advanced Bankruptcy Seminar, where I presented a paper on presentation of evidence. This is an updated version of that paper. Before you complain about being fed leftovers, I was asked to talk about trial techniques in bankruptcy, and saw no need to reinvent the wheel.

² For a bankruptcy judge, "reversed" is the second most vile of all four letter words, trumped only by the most evil word ever uttered by an appellate court: "remanded." (Yes, I know both of these words have more than four letters, but cut me some poetic license, OK?)

Rule No. 1: “Just the facts, ma’am (or sir).” Leave the hostile courtroom tactics to the TV lawyers (or your partners in the litigation section).

Here are some things you probably already knew about bankruptcy judges:

1. Most of us are busy. Very busy.
2. Almost all of us like to get to the point. We want to know what is the real source of the dispute between your clients and deal with it. Quickly. Efficiently.
3. All of us hate to see lawyers bickering at each other in court, or behaving in court in a way that makes clear you don’t ever have a civil word between you outside of the courtroom. If we really want to see that stuff, there is more than enough reality TV to go around.

If there is really no dispute about a fact, don’t make the other side go to the ends of the earth to put on evidence to prove it.³

Rule No 2: Organization is a good thing.⁴

We have all seen the movies where the stumbling, bumbling lawyer comes in with a brief case full of loose papers, shuffling them around trying to find that silver bullet of a document that

³ The corollary to this rule is that if you have to make an objection, do so succinctly, with a basis under the Federal Rules of Evidence. Don’t find yourself in this situation:

Fletcher: Your honor, I object!

Judge: And why is that?

Fletcher: Because it’s devastating to my case!

Judge: Overruled.

Fletcher: Good call!

— *Liar Liar*, Universal Pictures/Imagine Entertainment, 1997.

⁴ Much of this rule is taken from my 2005 seminar paper entitled “How to Lose Your Case Without Really Trying.” Fourteen years and dozens of evidentiary hearings later, it seems that some of the lawyers who attended that seminar simply do not understand sarcasm.

will win his or her case. We all laugh at the stumbling and the bumbling, and laugh even louder as the judge's face gets redder and redder (think Joe Pesci and Fred Gwynne in "*My Cousin Vinnie*"). Only in the movies is it funny. Nothing antagonizes a court more than disorganization.

If you want to make it easy for the judge to follow your exhibits, organize them. Mark them. Number them as required by the local rules.⁵ If you really want to look good, provide your exhibits to the judge in an organized, tabbed notebook for easy review. Bring extra copies of exhibits for opposing counsel and the judge's law clerk.

Some of you work in courtrooms with digital evidence presentation systems. These systems allow attorneys to bring their evidence in electronic format (such as on their laptop computer using programs like Adobe Acrobat) and to plug the computer into the courtroom and have all of the exhibits easily accessible on a screen. The effect of this is to have exhibits that are well organized, easy to read, and easy to highlight for the benefit of the court and the witnesses.

Rule No. 3: Know what you have to prove before you step into the courtroom.

On more than one occasion I have stopped a lawyer dead in his or her tracks with this simple question: "What are the elements of your case?" If you don't know them, you can't figure out what evidence you need, let alone get it admitted. One of my former partners started every case the same way: with a big black notebook. In it, he kept a running summary of the facts as he came to know them. The first thing he put in that notebook were the causes of action he intended to advance (or was being asked to defend against), and the relevant jury instructions. Once he figured out what he needed to prove, he could determine the evidence that would be necessary to his case. Then he could

⁵ Many courts (ours included) require you to number each page of the exhibit (Ex. 1-1, 1-2, etc.). This makes it easy for everyone to get to the particular page you want to discuss.

focus upon making sure that evidence was presented to the court in admissible form.

When it comes to the elements of causes of action, here are some of the biggies:

Dischargeability of Debt under § 523(a)(2)(A)⁶

Statutory language:

A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt –

(2) for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by –

(A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition[.]

In order to prevail under this section, a creditor must establish each of the following elements by a preponderance of the evidence:

- (1) a representation was made by the debtor;
- (2) the representation was false;
- (3) the representation was made with the intent to deceive the creditor;
- (4) the creditor relied upon the representation;
- (5) such reliance was justifiable; and
- (6) as a result of such reliance; the creditor suffered loss.⁷

Unless all of these items are established by a preponderance of the evidence, the debt is dischargeable.⁸

⁶ All statutory references are to the United States Bankruptcy Code unless otherwise noted.

⁷ *AT&T v. Herrig (In re Herrig)*, 217 B.R. 891, 895 (Bankr. N.D. Okla. 1998).

⁸ Be aware that having a state court judgment for fraud (or other intentional tort found in § 523(a)(2)(4) or (6)) is not *res judicata* on a bankruptcy court, which has exclusive jurisdiction over dischargeability actions under those sections. If you don't believe me, consult *Brown v. Felson*, 442 U.S. 127 (1979).

Post-petition Financing Under § 364

§ 364(c) provides:

If the trustee [or debtor in possession] is unable to obtain unsecured credit allowable under section 503(b)(1) of this title as an administrative expense, the court, after notice and a hearing, may authorize the obtaining of credit or the incurring of debt –

- (1) with priority over any or all administrative expenses of the kind specified in section 503(b) or 507(b) of this title;
- (2) secured by a lien on property of the estate that is not otherwise subject to a lien; or
- (3) secured by a junior lien on property of the estate that is subject to a lien.⁹

There are few reported cases discussing the elements a debtor must prove in order to obtain post-petition financing under § 364(c). The United States Bankruptcy Court for Eastern District of Pennsylvania has held that a debtor seeking financing under § 364(c) has the burden of establishing the following three elements:

1. the debtor is unable to obtain unsecured credit by allowing a lender an administrative claim under § 503(b)(1)(A);
2. the credit transaction is necessary to preserve the assets of the estate; and
3. the terms of the transaction are fair, reasonable, and adequate, given the circumstances of the debtor-borrower and the proposed lender.¹⁰

A Colorado bankruptcy court has held that a debtor must prove the following four elements to obtain post-petition financing under § 364(c):

1. the proposed financing is an exercise of sound and reasonable business judgment;

⁹ § 364(c).

¹⁰ *In re Crouse Group, Inc.*, 71 B.R. 544, 549 (Bankr. E.D. Pa. 1987).

2. no alternative financing is available on any other basis;
3. the financing is in the best interests of the estate and its creditors; and
4. no better offers, bids, or timely proposals are before the court.¹¹

Remember, if you represent the debtor, the general rule is: no financing, no fees.

Approval of a Compromise

Federal Rule of Bankruptcy Procedure 9019 provides that “[o]n motion by the trustee and after notice and a hearing, the court may approve a compromise or settlement.”¹² In evaluating a proposed compromise or settlement, it is the court’s duty to make an “informed [decision] based upon an objective evaluation of developed facts.”¹³ Courts have developed factors for consideration in whether to approve settlements. In general, the court must determine whether the settlement is: (1) fair and equitable, and (2) in the best interest of the estate.¹⁴ Courts have held that in considering whether a settlement or compromise is fair and equitable and in the best interest of the estate, the court should consider these four factors:

- (1) the probable success of the underlying litigation on the merits;
- (2) the possible difficulty in collection of a judgment;
- (3) the complexity and expense of litigation; and

¹¹ *In re W. Pac. Airlines, Inc.*, 223 B.R. 567, 572 (Bankr. D. Colo. 1997).

¹² Fed. R. Bankr. P. 9019(a).

¹³ *Reiss v. Hagmann*, 881 F.2d 890, 892 (10th Cir. 1989).

¹⁴ *In re Kaiser Steel Corp.*, 105 B.R. 971, 976 (D. Colo. 1989).

(4) the interests of creditors in deference to their reasonable views.¹⁵

Generally, the court will lend deference to a trustee's judgment regarding the beneficial nature of a proposed settlement. The court should evaluate whether a trustee's actions are "within the universe of reasonable actions," and assess "whether the settlement falls below the lowest point in the range of reasonableness."¹⁶

Rule No. 4: Pleadings are your friend.

The easiest fact to prove is the fact that is already admitted. The operative rule is Federal Rule of Civil Procedure 8, made applicable in adversary proceedings by Federal Rule of Bankruptcy Procedure 7008. Rule 8(a)(2) requires the plaintiff to file a pleading containing "a short and plain statement of the claim showing that the pleader is entitled to relief."¹⁷ The next subdivision of the rule requires that a party answering the pleading must "admit or deny the allegations asserted against it by an opposing party."¹⁸ In addition, Rule 8(b)(6) states that an allegation that is not denied "is admitted if a responsive pleading is required and the allegation is not denied."¹⁹ Before you go to the ends of the earth trying to prove something or figuring out what you have to do to prove something, make sure it has not been admitted. Most judges (this one included) consider admitted

¹⁵ *In re Kopexa Realty Venture Co.*, 213 B.R. 1020, 1022 (10th Cir. BAP 1997). *See also Protective Comm. for Indep. Stockholders of TMT Trailer Ferry, Inc. v. Anderson*, 390 U.S. 414, 424–25 (1968).

¹⁶ *In re W.T. Grant, Co.*, 699 F.2d 599, 608 (2d Cir. 1983). *See also In re Dennett*, 449 B.R. 139, 145 (Bankr. D. Utah 2011).

¹⁷ Fed. R. Civ. P. 8(a)(2).

¹⁸ Fed. R. Civ. P. 8(b)(1)(B).

¹⁹ Fed. R. Civ. P. 8(b)(6).

facts as established for all purposes with respect to the contested matter or adversary proceeding at issue.

The corollary to this rule is to make sure that admitted facts are brought to the attention of the court. I learned this one the hard way. Early in my judicial career, I presided over a nondischargeability proceeding. The debtor was a party to a drug deal gone bad. In order to resolve the matter short of physical violence, the debtor allowed another party to take his car. The car had been pledged as collateral to a bank. The debtor filed bankruptcy and the bank came in claiming that the debtor's failure to maintain control of the car amounted to conversion.²⁰ I ruled in the bank's favor, finding that the terms of the security agreement prohibited unlawful disposition of the collateral. On appeal, I was reversed.²¹ The appellate court found that the record did not support my findings with respect to the security agreement, as the security agreement had not been introduced into evidence. Technically, the appellate court was correct; the security agreement had not been listed as an exhibit and offered and received into evidence. However, it had been attached to the complaint as an exhibit. Moreover, the answer admitted the execution of the security agreement and the validity of the copy attached to the complaint. The appellate court missed the issue because I didn't flag it. Do not make the same mistake.

Rule No. 5: The Pre-Trial Order is Your Friend.

This rule is just the logical extension of Rule No. 4. In virtually all of our adversary proceedings, and some of the more complicated contested matters, the submission of a proposed pre-

²⁰ The debtor candidly admitted that he chose to deal more favorably with the creditor that routinely carried a gun. Discretion remains the better part of valor.

²¹ See Note 1 *supra*.

trial order is required. Both judges in the Northern District have a form pre-trial order that we require the parties to use. Most courts do the same. The following sections may be of interest to you:

Admitted Facts

My pre-trial order requires counsel to complete a section under this heading: “***The following facts are admitted, and require no proof[.]***” Most other pre-trial orders contain a similar section. This is one of the first things I look at when I get a proposed pre-trial order. I want to know what you folks are really fighting over.²² The list of admitted facts are just that: facts that need no more time devoted to them at trial. It is by far the easiest way to get evidence into the record.

Exhibits

Most judges are picky about exhibits when it comes to pre-trial orders. Take a look at the form I use:

The exhibits to be offered at the trial, together with a statement of all admissions by and all issues between the parties with respect thereto, are as follows:

(Here (1) list all documents and things intended to be offered at the trial by each party, other than those to be used for impeachment, in the sequence proposed to be offered, with a (2) description of each sufficient for identification, and a (3) statement of all admissions by and all issues between any of the parties as to the genuineness thereof and the truth of relevant matters of fact set forth therein or in any legend affixed thereto, together with a (4) statement of objections reserved as to the admissibility in evidence thereof. **A list of exhibits which is general in nature [e.g., all financial records of debtor] will not be accepted. Exhibits must be numbered and identified**

²² This part of the pre-trial order also gives a judge some idea of whether counsel have put any effort into the pre-trial process. Speaking only for myself, few things are more disappointing than getting a pre-trial order containing one or two admitted facts, with the idea that everything else is to be left for trial. What most judges take from something like this is that the lawyers haven’t spent much time on this or simply don’t want to play nice (see Rule 1 *supra*).

in the same manner as they will be offered at trial.)

I am looking for two things here: (1) a list of exhibits in the same detail as the list you would present at trial; and (2) a list of all objections to the exhibits. From our standpoint, you should be ready to try the case when you finish the pre-trial order. Discovery is finished. The issues should have been framed for quite some time. There should be few or no surprises, for you or the court.

Under our form of pre-trial order, objections to exhibits not raised in the pre-trial order are waived.²³ Therefore, if an exhibit is listed in the pre-trial order with no objection from the opponent, it is automatically admitted if offered. Some of you out there are probably saying, “Hey, wait a minute. What about foundational objections? Why should I have to raise those now? If the other side forgets to bring a witness, that’s their problem!” The reason objections must be raised in the pre-trial order is so that if there is a true foundational objection, everyone knows about it well in advance of trial. If you raise the objection and the other side still ignores it, that’s their problem. I just don’t want any objections laying in the weeds. Leave the ambushes to the movie Westerns.

Pre-Trial Conferences

A quick word about pre-trial conferences. Take a look at Federal Rule of Civil Procedure 16(c). It gives the court some serious latitude. For example, at a pre-trial conference, the court is permitted to:

- “eliminat[e] frivolous claims or defenses.” (Rule 16(c)(2)(A))
- obtain “admissions and stipulations about facts and documents to avoid unnecessary proof.” (Rule 16(c)(2)(C))
- rule in advance on the admissibility of evidence. (Rule 16(c)(2)(C))

²³ Not all courts have such a policy. Be sure to know the rules where you practice. Don’t be proud. When in doubt, ask.

- limit the use of expert testimony. (Rule 16(c)(2)(D))

If there are issues of fact that should be agreed upon, but aren't, the pre-trial conference is the time to raise those issues. If there are issues regarding documentary evidence, the pre-trial conference is the time to iron those out.

Rule No. 6: The fact that you found it in a box in an office does not make it a “business record.”

In my experience, there is nothing so misunderstood as the business records exception to the hearsay rule. Time and time again, attorneys will offer a letter or other document that they received as part of a document production in order to prove the truth of the matter contained therein. Oftentimes, the document is a letter from an entity that is neither the opposing party nor the party whose records were produced. The offer is met with a hearsay objection. The response: “The business records exception applies. We got this document by going through the records of XYZ Business.”

Not so fast. Let's take a look at the rule in question:

Rule 803. Hearsay Exceptions; Availability of Declarant Immaterial

The following are not excluded by the hearsay rule, even though the declarant is available as a witness:

* * *

(6) Records of a Regularly Conducted Activity. A record of an act, event, condition, opinion, or diagnosis if:

(A) the record was made at or near the time by—or from information transmitted by—someone with knowledge;

(B) the record was kept in the course of a regularly conducted activity of a business, organization, occupation, or calling, whether or not for profit;

(C) making the record was a regular practice of that activity;

(D) all these conditions are shown by the testimony of the custodian or another qualified witness, or by a certification that complies with Rule 902(11) or (12) or with a statute permitting certification; and

(E) the opponent does not show that the source of information or the method or circumstances of preparation indicate a lack of trustworthiness.²⁴

The Tenth Circuit Court of Appeals has held that “[t]he rationale behind the business records exception is that such documents have a high degree of reliability because businesses have incentives to keep accurate records. ‘The business records exception is based on a presumption of accuracy, accorded because the information is part of a regularly conducted activity, kept by those trained in the habits of precision, and customarily checked for correctness, and because of the accuracy demanded in the conduct of the nation’s business.’”²⁵

Courts have held that in order for a document to be admitted as a business record, the proponent of the document must secure the testimony of the “custodian or other qualified witness” that:

1. It was the regular practice of the business to make the record in question;
2. The record was kept in the regular course of the business;
3. The record was made by a person with knowledge of the facts contained in the record; and
4. The record was made near or at the time of the event recorded.²⁶

²⁴ Fed. R. Evid. 803(6).

²⁵ *Timberlake Const. Co. v. U.S. Fid. & Guar. Co.*, 71 F.3d 335, 341 (10th Cir. 1995).

²⁶ *United States v. Blechman*, 657 F.3d 1052, 1065 (10th Cir. 2011).

It is easy to see that a lot of documents that were in the boxes handed over to you do not qualify as a business record under this rule. Correspondence from third parties doesn't fit.²⁷ Documents prepared in anticipation of litigation don't fit.²⁸

Even if the documents you want admitted fall within the business records exception, you have to lay the proper foundation. This means that you have to bring the custodian of the records to court with you.²⁹ The custodian need not be the person that prepared the record in question. However, the custodian must be able to testify as to each of the elements identified above, and must be able to establish that the document in question meets each of the four requirements. The exceptions to this rule involve documents created as part of a governmental activity, either domestic³⁰ or foreign,³¹ or where a statute permits certification.³² In those instances, you don't need a live witness. Instead, you may use a written declaration. Just make sure the declaration is given under penalty of perjury.

²⁷ *Cruz v. Aramark Servs., Inc.*, 213 Fed. Appx. 329 (5th Cir. 2007) (holding inadmissible third party letters contained in file, finding that letters were "unauthenticated").

²⁸ *Hertz v. Luzenac Am., Inc.*, 370 F.3d 1014, 1020 (10th Cir. 2004); *Timberlake Const. Co. v. U.S. Fid. & Guar. Co.*, 71 F.3d 335, 342 (10th Cir. 1995).

²⁹ Don't worry. You will know far in advance of trial whether you need to bring a witness, because the issue will be made plain in the pre-trial order. If your opponent objects to the exhibit, you know you need a witness. If there is no objection, the exhibit may be admitted. Isn't pre-trial practice wonderful?

³⁰ Fed. R. Evid. 902(11).

³¹ Fed. R. Evid. 902(12).

³² Fed. R. Evid. 803(6)(D).

Rule No. 7: The hearsay rule is second only to the rule against perpetuities in difficulty of understanding.

I debated whether to broach the subject of the hearsay rule in this paper because: the topic is endless. The rule seems simple: “‘Hearsay’ means a statement that: (1) the declarant does not make while testifying at the current trial or hearing; and (2) a party offers in evidence to prove the truth of the matter asserted in the statement.”³³ The principle behind the rule is equally simple: if you cannot test the veracity of the statement through cross-examination of the person making the statement, then you cannot consider the statement as proof of a fact.

The hearsay rule is replete with exceptions, most of which are found in Federal Rule of Evidence 803. The exceptions to the hearsay rule include:

- Prior statements by the witness, if made under oath or penalty of perjury (FRE 801(d)(1)).
- Admissions by a party-opponent (FRE 801(d)(2)).
- Statements reflecting a present sense impression (FRE 803(1)).
- Excited utterances (FRE 803(2)).
- Statements of declarant’s state of mind at the time of the utterance (FRE 803(3)).
- Statements for the purpose of medical diagnoses (FRE 803(4)).
- Recorded recollections of a witness (FRE 803(5)).
- Business records (FRE 803(6)) (we have already covered this).
- Public records (FRE 803(8)).
- Vital statistics (FRE 803(9)).
- Absence of a public record in order to establish that an event did not happen (FRE

³³ Fed. R. Evid. 801(c).

803(10)).

- Records kept by religious organizations (FRE 803(11)).
- Marriage and baptism certificates (FRE 803(12)).
- Family records (FRE 803(13)).
- Public records concerning real estate transactions (FRE 803(14)).
- Ancient documents (FRE 803(16)).
- Market reports and commercial publications (FRE 803(17)).
- Learned treatises, where it is established that experts commonly rely upon them (FRE 803(18)).
- Reputation (FRE 803(19, 20 and 21)).
- Judgments of prior conviction (FRE 803(22)).
- Judgments as proof of personal, family or general history, or as to legal boundaries (FRE 803(23)).

The common theme in these exceptions is one of reliability of the records at issue. The same concept underlies the “catch-all” exception found in Federal Rule of Evidence 807:

Rule 807. Residual Exception.

(a) In General. Under the following conditions, a hearsay statement is not excluded by the rule against hearsay **even if the statement is not admissible under a hearsay exception in Rule 803 or 804:**

(1) the statement is supported by sufficient guarantees of trustworthiness—after considering the totality of circumstances under which it was made and evidence, if any, corroborating the statement; and

(2) it is more probative on the point for which it is offered than any other evidence that the proponent can obtain through reasonable efforts.

(b) Notice. The statement is admissible only if the proponent gives an adverse party reasonable notice of the intent to offer the statement—including its substance and the

declarant's name—so that the party has a fair opportunity to meet it. The notice must be provided in writing before the trial or hearing—or in any form during the trial or hearing if the court, for good cause, excuses a lack of earlier notice.³⁴

This exception to the hearsay rule is kind of a last bastion of hope-sort of like § 105 of the Bankruptcy Code.³⁵ If it is all you have, focus on establishing the reliability of the evidence. Courts looking at the legislative history behind the rule note that “the residual exception is to be used very rarely, and only in exceptional circumstances.”³⁶ The rule is also not something that can be sprung on your opposition at the last minute—you have to provide advance notice of your intent to rely upon the rule.

By way of example, a statement by a bankruptcy judge in open court explaining the basis for his decision has been held admissible in a later district court action under Rule 807.³⁷ A plea agreement in a criminal action where a party admitted his involvement in and intent behind a Ponzi scheme has been admitted under Rule 807 as evidence of fraudulent intent in an adversary proceeding brought by a Chapter 11 trustee.³⁸ Rule 807 has also been invoked by at least one bankruptcy court to allow the admission of bank records where the party seeking to offer the records

³⁴ Fed. R. Evid. 807 (emphasis added).

³⁵ We all know the argument: “Gee, judge, we know there is no statutory or case law authority for what we want you to do, but (at least in the eyes of our client), it is the only fair and equitable result, and § 105 of the Code demands it.” Hey, when all else fails, . . . this probably will too.

³⁶ *In re Katzburg*, 326 B.R. 603, 605 (Bankr. D.S.C. 2004) (citations omitted).

³⁷ *Mountain Highlands, LLC v. Hendricks*, 616 F.3d 1167 (10th Cir. 2010).

³⁸ *In re Slatkin*, 525 F.3d 805 (9th Cir. 2008). I know you were all hoping for Bernie Madoff. Sorry.

failed to provide the foundation required under the business records exception to the hearsay rule.³⁹ One of my colleagues in Utah refused to apply Rule 807 to allow the admission of statements made by the owner and manager of a debtor corporation where the record contained nothing to show that the party seeking to offer the admission made any attempt to depose the owner (and thus obtain easily admissible evidence) prior to trial.⁴⁰

Rule No. 8: It's a trial, not a discovery deposition.

In my experience, examination of witnesses in bankruptcy cases is the most problematic area for most attorneys. Maybe it's because most bankruptcy lawyers don't do a lot of it-they spend most of their time negotiating settlements rather than preparing for litigation. Maybe it is a function of economics-many cases just don't have the dollars at issue to justify pre-trial depositions. I don't know. What I do know is that far too many cross-examinations of witnesses in bankruptcy cases take on the tenor of a discovery deposition. They cover every conceivable topic, and drone on for far too long.⁴¹

Treating the examination of a witness like a discovery deposition is a very dangerous practice. It causes all parties (including the judge) to lose the forest for the trees. No less an authority than Irving Younger advised that "[y]ou should never try to make more than three points

³⁹ *Beale v. Kurtz*, 381 B.R. 727 (S.D. Ind. 2008). I don't recommend this approach except as a last resort. It is just too risky.

⁴⁰ *In re Bedrock Mktg., LLC*, 404 B.R. 929 (Bankr. D. Utah 2009).

⁴¹ To those who take issue with my characterization of discovery depositions, I ask one simple question: how many of you go out and read discovery depositions for the pure fun of it? I thought so.

on cross-examination. Two points are better than three and one point is better than two.”⁴² He is right. By and large, cross-examination in a bankruptcy case should be surgical. Make your point (or two or three at the most) and sit down.

I think that the desire to break this rule in bankruptcy cases has its origin in one of two areas. Perhaps this is the attorney’s first chance to examine the witness since the case was filed.⁴³ Everybody is there, the witness is under oath, and the court reporter is free. Why not just go for it? This leads to an examination that covers the waterfront when all that is presently before the court is a narrow issue (such as an offer of adequate protection). Everybody gets lost, except maybe the judge. He or she just gets frustrated. The second reason for overly broad examinations is that the attorney never knows what he or she will find out. The answer to the next question may reveal the “smoking gun” that tilts the entire case in your favor. Resist that urge. Professor Younger was right. “Cross is not a fishing expedition in which you uncover new facts or new surprises at the trial.”⁴⁴ You should never ask a question on cross-examination that you don’t already know (or at least have a very good idea of) the answer to. Far more often than not, the answer hurts you rather than helps you.

⁴² Irving Younger, *The Art of Cross-Examination*, 1976 A.B.A. Section on Litigation, Monograph Series No. 1. I have attached Professor Younger’s “Ten Commandments of Cross-Examination” as an appendix to this paper. They are as valuable today as they were in 1976.

⁴³ Amazingly (at least to me), this seems to happen with unsettling regularity in my court on direct examination as well as cross. Counsel will seem shocked by the answers to questions given by their own client. It is like watching an episode of “Kids Say the Darndest Things,” without any of the cuteness and with much higher stakes.

⁴⁴ Younger’s Commandment No. 4.

Conclusion

The Federal Rules of Evidence are alive and well in bankruptcy courts across America. In order to get your evidence admitted, you need to follow them. In order to have the best chance to win your case, you need to know what you need to prove. You need to know what your witnesses will say and have a pretty darn good idea of what the other side's witnesses will say when you ask them questions. You need to have your documentary evidence organized and know what avenue you intend to use for its admission. You need to meaningfully participate in the pre-trial process. In other words, if the case is worth trying (and worth winning), you need to prepare, prepare, prepare. The more things change, the more they stay the same.

APPENDIX

IRVING YOUNGER'S 10 COMMANDMENTS OF CROSS EXAMINATION

1. Be Brief

Be brief, short and succinct. Why?

Reason 1: Chances are you are screwing up. The shorter the time spent, the less you will screw up.

Reason 2: A simple cross that restates the important part of the story in your terms is more easily absorbed and understood by the jury.

You should never try to make more than 3 points on cross-examination. Two points are better than three and one point is better than two.

2. Use Plain Words

The jury can understand short questions and plain words. Drop the 50 dollar word in favor of the 2 dollar word. "Drive your car" instead of "operate your vehicle."

3. Use Only Leading Questions

The law forbids questions on direct examination that suggest the answer. The lawyer is not competent to testify. On cross-examination the law permits questions that suggest the answer and allows the attorney to put his words in the witnesses' mouth. Cross-examination, therefore, specifically permits you to take control of the witness, take him where you want to go, and tell your important point to the jury through the witness. Not asking controlled leading questions leaves too much wiggle room.

What happened next?

I would like to clear up a couple of points you made on direct.

These questions are the antithesis of an effective cross-examination. Any questions that permit the witness to restate, explain or clarify the direct examination is a mistake. You should put the witness on autopilot so that all of the answers are a series of yes, yes, yes!

4. Be Prepared

Never ask a question that you do not know the answer to. Cross is not a fishing expedition in which you uncover new facts or new surprises at the trial.

5. Listen

Listen to the answer. For some, cross-examination of an important witness causes stage fright; it confuses the mind and panic sets in. You have a hard time just getting the first question out, and you're generally thinking about the next question and not listening to the answer.

6. Do Not Quarrel

Do not quarrel with the witness on cross-examination. When the answer to your question is absurd, false, irrational, contradictory or the like; Stop, sit down. Resist the temptation to respond with "how can you say that, or how dare you make such an outrageous claim?" The answer to the question often elicits a response, which explains away the absurdity and rehabilitates the witness.

7. Avoid Repetition

Never allow a witness to repeat on cross-examination what he said on direct examination. Why? The more times it is repeated, the more likely the jury is to believe it. Cross-examination should involve questions that have nothing to do with the direct examination. The examination should not follow the script of the direct examination.

8. Disallow Witness Explanation

Never permit the witness to explain anything on cross-examination. That is for your adversary to do.

9. Limit Questioning

Don't ask the one question too many. Stop when you have made your point. Leave the argument for the jury.

10. Save for Summation

Save the ultimate point for summation. A prepared, clear and simple leading cross-examination that does not argue the case can best be brought together in final summation.

Summarized from The Art of Cross-Examination by Irving Younger. The Section of Litigation Monograph Series, No. 1, published by the American Bar Association Section on Litigation, from a speech given by Irving Younger at the ABA Annual Meeting in Montreal Canada in August of 1975.

**UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF OKLAHOMA
LOCAL RULES**

RULE 5010-1 REOPENING CASES

Reopening of a case shall be effective only upon both entry of an order and payment of any applicable fees. Requests to reopen a case must be made by motion filed and served pursuant to Local Rules 9007-1 and 9013-1. Should the motion be contested, Local Rules 9014-1 and 9017-1 shall apply. It shall not be necessary to reopen a closed case in order to redact personally identifiable information therein. **If applicable, all orders reopening chapter 7, 12 and 13 cases shall state whether the moving party requests that the United States Trustee appoint a trustee.**

RULE 9013-1 MOTIONS

F. Hearings. Hearings on requests for relief may not be conducted routinely unless requested or unless required by an applicable Bankruptcy Rule. **When applicable, notice of a hearing may be combined in one Document with the request for relief, provided that the title of the Document indicates that such notice is contained therein.** If the Court orders a hearing, the party requesting the relief is responsible for serving notice of the hearing date and time on all other interested parties and filing a certificate of service in compliance with Local Rule 9007-1.D. Any request for continuance of a hearing or trial must be made in writing and, unless otherwise allowed by a judge, filed with the Court at least twenty-four (24) hours prior to the scheduled date of the hearing or trial.

RULE 9014-1 CONTESTED MATTERS

Unless otherwise provided in an order of the Court, any party wishing to present evidence at a scheduled hearing on a contested matter must file and serve on all parties in interest, pursuant to Local Rule 9007-1, a notice listing: a brief description of the exhibits to be offered; the names of all witnesses intended to be called; and an estimated length of time to present the evidence and argument. **Such notice must be filed no later than twenty (20) days prior to the scheduled hearing date or no later than three (3) days after a notice of hearing is issued by the Court if the notice is issued less than twenty-three (23) days prior to the scheduled hearing.** Upon review of this notice, the Court may schedule a pre-hearing conference and direct any rules governing adversary proceedings to be applied to the matter. Presentation of exhibits is further subject to Local Rule 9017. Failure to comply with this Rule may result in exclusion of the evidence or such other sanction as the Court deems appropriate in the circumstances. See also Rule 9017-1 for further obligations regarding evidence.

RULE 9017-1 EVIDENCE

C. Marking and Disclosure of Exhibits. All exhibits which are intended to be offered in evidence at a trial or hearing must be marked for identification and provided to opposing counsel and two (2) copies to the Court at least five (5) business days prior to the trial or hearing, or as may otherwise be ordered by the Court. Exhibits must be contained in a notebook or notebooks and be sequentially numbered in the lower right corner. The notebook(s) must be labeled with the case name and number and the respective party's name and the exhibit numbers contained therein. The notebooks(s) shall also contain an index of the exhibits contained therein.