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Contents

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AN OVERVIEW OF THE IMPACT OF BANKRUPTCY ON STATE COURT LITIGATION

By

Mark G. Ledwin, Esq.

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WILSON, ELSER, MOSKOWITZ, EDELMAN & DICKER LLP
3 Gannett Drive, White Plains, New York 10604
Tel: (914) 323-7000 Fax: (914) 323-7001

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AN OVERVIEW OF THE IMPACT OF BANKRUPTCY ON STATE COURT LITIGATION[1]

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Mark G. Ledwin, Esq.

I. INTRODUCTION

In 2001, over 1,490,000 bankruptcy petitions were filed across the United States setting a record for the most bankruptcy petitions ever filed in one calendar year. 69,000 of those petitions were filed within the State of New York. Calendar year 2002 is on pace to eclipse the record set in 2001. Through the first quarter, approximately 379,000 bankruptcy petitions have been filed nationwide, with about 17,000 of those petitions being filed in New York. Notwithstanding the proposed "bankruptcy reforms" being debated in the United States Congress, there is no sign that the record pace of bankruptcy filings will let up any time soon.[2]

Not surprisingly, many of the hundreds of thousands of persons and entities who seek bankruptcy relief each year are already involved in litigation in the state courts, be it a consumer collection action, a personal injury claim or a complex contractual dispute. The purpose of this article is to discuss some fundamental bankruptcy concepts which impact upon pending or future litigation in state court involving a party (either plaintiff or defendant) who has sought relief under the federal bankruptcy laws. In addition to the obvious issues which arise upon the imposition of the automatic bankruptcy stay and the subsequent entry of a discharge order, this article also explores related issues such as the granting of relief from the automatic stay to allow state court litigation to continue, exceptions to the discharge of certain debts which may be pursued in state court notwithstanding a bankruptcy filing, the effect of bankruptcy on state statutes of limitations, and the removal of state court actions to bankruptcy court.

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[1] This Article is intended to be for informational purposes only.

[2] See the addendum of bankruptcy statistics annexed hereto.

II. THE BASIC BANKRUPTCY CASES: CHAPTERS 7, 13 AND 11

In order to understand the impact of bankruptcy upon state court litigation, it is helpful to understand the fundamental concepts behind the three most common types of bankruptcy cases: the Chapter 7 liquidation, the Chapter 13 consumer bankruptcy and the Chapter 11 reorganization.

A. Chapter 7

A bankruptcy case commenced under Chapter 7 of the Bankruptcy Code (*i.e.*, Title 11 of the United States Code) is known as a liquidation proceeding or "straight bankruptcy." With certain statutory exceptions (notably, railroads, insurance companies and banks), almost any person or entity can be a Chapter 7 debtor, including a corporation or partnership. See 11 U.S.C. § 109(b). The Chapter 7 case may be commenced voluntarily by the debtor, or involuntarily by the debtor's creditors. See 11 U.S.C. §§ 301 and 303. Immediately upon the filing of the Chapter 7 case, an interim trustee will be appointed by the Office of the United States Trustee. 11 U.S.C. § 701. The debtor's creditors can then elect a trustee of their own choosing. If none is elected by the creditors, the interim trustee will become the permanent trustee. 11 U.S.C. § 702. The trustee will in effect oust any existing management of a corporate debtor, including its directors and officers, and assume control of the debtor's assets and operations, if any. The fundamental duty of a Chapter 7 trustee is to collect and liquidate the debtor's non-exempt assets, and then equitably distribute those assets among the debtor's creditors in an expeditious manner. 11 U.S.C. § 704.

Chapter 7 is perhaps the most common form of relief for debtors experiencing financial difficulty. One of the principal reasons for filing a Chapter 7 bankruptcy petition, and one of the salient advantages bankruptcy relief offers a debtor that non-bankruptcy remedies are not able to provide, is the benefit associated with a discharge. In a Chapter 7 case, only individuals can receive a discharge. The discharge of a debtor's financial obligations is viewed as granting the debtor a "fresh start" which enables the debtor to proceed unhampered by the financial burdens of the past. Under Chapter 7, a corporation becomes defunct. It is not granted a discharge. It will cease to operate although it may continue to have legal standing under a state's corporation laws.

A bankruptcy discharge thus (i) relieves a debtor of virtually all of his pre-bankruptcy obligations (with some important exceptions), (ii) permanently enjoins any action to enforce discharged debts, and (iii) protects a debtor against discriminatory treatment by a governmental unit or private employer based

solely on the debtor's bankruptcy. 11 U.S.C. §§ 524-525. Under Chapter 7, all of a debtor's non-exempt assets are distributed to his creditors. Thus, if a debtor has little in the way of assets, his creditors receive relatively little, if anything, by way of a distribution. A discharged Chapter 7 debtor is allowed to retain his future earnings.

Creditors can, however, object to the discharge of a debtor, either in full or with respect to an individual claim. See 11 U.S.C. §§ 523 and 727. Grounds for objecting to the dischargeability of a specific debt include money or property obtained through the use of false pretenses, fraud, embezzlement and materially false financial statements; debts founded upon a willful and malicious injury by the debtor to another or the property of another; fines and penalties owed to the government; and death or personal injury caused by drunk driving. An objection to the dischargeability of a debt based upon fraud and certain other criteria must be commenced as an adversary proceeding and must be filed within 60 days of the debtor's § 341 "meeting of creditors." Objections to the discharge of all debts must be similarly filed. Grounds for objecting to a complete discharge include fraudulently conveying or concealing assets, falsifying records, and the making of a false oath in the debtor's petition and schedules.

B. Chapter 13

Chapter 13 of the Bankruptcy Code is designed for individuals with regular income who desire to pay their creditors but are currently unable to do so. Under court supervision and protection, a Chapter 13 debtor can establish a repayment plan pursuant to which creditors are paid in full or in part over an extended period of time up to five years. Chapter 13 is only for individuals (not corporations or partnerships), can only be commenced voluntarily by the debtor (not involuntarily by creditors), and is subject to certain secured and unsecured debt limits (presently no more than $871,550 in secured debt and $290,525 in unsecured debt).

Upon the filing of a Chapter 13 petition, an impartial trustee is appointed to administer the case. 11 U.S.C. § 1302. A primary role of the Chapter 13 trustee is to serve as a disbursing agent, collecting payments from the debtor and making distributions to creditors. Upon the successful completion of the repayment plan, the debtor will receive a discharge. In certain limited circumstances, a Chapter 13 debtor may still receive what is known as a "hardship discharge" even though the debtor did not completely satisfy the repayment plan. 11 U.S.C. § 1328(b).

One of the significant distinctions which separates Chapter 13 from a Chapter 7 or 11 case is that Chapter 13 provides for a stay of all collection activity on a "consumer debt" which could be brought against the debtor and any other persons liable with the debtor for the consumer debt, even if such persons have not themselves filed for bankruptcy relief. 11 U.S.C. § 1301. This extended injunction is generally known as the Chapter 13 "co-debtor stay." See In re Jones, 106 B.R. 33 (Bankr. W.D.N.Y. 1989). Additionally, the types of debts which may be discharged under Chapter 13 are significantly broader than under Chapters 7 or 11.

C. Chapter 11

A case filed under Chapter 11 of the Bankruptcy Code is known as a reorganization proceeding. The goal of Chapter 11 is to rehabilitate the debtor's operations through a "plan of reorganization" approved by the debtor's creditors. This chapter is generally used by an operating business whose going concern value is greater than its liquidation value. A Chapter 11 case may also be commenced either voluntarily by the debtor, or involuntarily by creditors. 11 U.S.C. §§ 301 and 303. Although known as a reorganization, Chapter 11 is frequently used to undertake a controlled liquidation of the debtor's operating assets so as to maximize their value. A Chapter 11 "liquidating plan" thus tries to avoid the "fire sale" which often occurs in Chapter 7.

1. The Debtor-In-Possession

One of the most significant distinctions between a Chapter 7 case and a Chapter 11 case is that, under Chapter 11, a trustee is not automatically appointed to take control of the debtor's assets. Rather, the entity filing for bankruptcy protection is deemed a "debtor-in-possession" or "DIP". A Chapter 11 debtor thus remains in possession of its assets and its current management retains control over its business operations. 11 U.S.C. §§ 1107 and 1108. A debtor-in-possession, however, assumes almost all of the same duties and powers as would a Chapter 7 trustee. 11 U.S.C. § 1106.

The debtor-in-possession may use, sell or lease property of its estate in the ordinary course of business. 11 U.S.C. §363(c)(1). The debtor-in-possession may act in the ordinary course of business without notice to the bankruptcy court or to creditors. Notice is required and a hearing may be requested by a party in interest if the debtor's proposed use, lease, or sale of its property is not in the debtor's ordinary course of business. 11 U.S.C. §363(b)(1). A debtor may not use "cash collateral," which consists primarily of cash equivalents in which another party has an interest (for example, a lien on accounts

receivable), without authorization and only upon notice and a hearing given to the interested party. 11 U.S.C. §363(c)(2). Although the debtor in possession may pay its post-petition debts, it may not pay any pre-petition claims outside of the scope of its proposed plan or without prior court authorization.

2. Creditors' Committees

The fundamental mechanism provided by the Bankruptcy Code for policing a debtor-in-possession is the appointment by the United States Trustee of a committee of unsecured creditors to represent the interests of all of the debtor's unsecured creditors. 11 U.S.C. § 1102. A creditors' committee is authorized to retain its own attorneys and accountants. 11 U.S.C. § 1103. Committees can also be appointed for other large creditor constituencies, such as tort claimants, or for equity security holders.

The bulk of the negotiations that occur in a Chapter 11 case take place between the creditors' committees and the debtor. The committees are designed to deal with the debtor in a more manageable way than could the entire body of creditors. They are construed as representative bodies that must act for groups of creditors with similar interests. Creditors' committees are an integral part of the reorganization process and are needed to formulate a plan as well as to conduct the business of the debtor.

The Bankruptcy Code does not set forth any specific criteria for the appointment of a creditors' committee except to say that the committee "shall ordinarily consist of the persons, willing to serve, that hold the seven largest claims against the debtor of the kinds represented on such committee ...." 11 U.S.C. § 1102(b)(1). Creditors' committees are given a broad range of powers under the Code. 11 U.S.C. §1103. The committee may select and authorize the employment of attorneys, accountants, or other agents to represent or perform services for the committee. 11 U.S.C. § 1103(a).

The Bankruptcy Code provides that a trustee, examiner, counsel for a debtor, or any professional person employed by the trustee, debtor, or a committee, must apply to the Court for compensation. 11 U.S.C. § 331. Thus, in a Chapter 11 reorganization case, the debtor-in-possession must bear not only its own expenses for its professionals, but must also bear the expenses of the professionals employed by a creditors' committee.

3. *Appointment of a Chapter 11 Operating Trustee, Dismissal of the Chapter 11 Case, and Conversion to Chapter 7*

As a Chapter 11 debtor-in-possession, the debtor-corporation's pre-bankruptcy management will remain in control of the debtor's properties and the management of its business affairs, including any pending litigations (albeit, subject to certain fiduciary duties). See 11 U.S.C. § 1107 (rights, powers and duties of debtor in possession); 11 U.S.C. § 1108 (authorization to operate business). In the event current management refuses to engage in the good faith prosecution or settlement of litigation, it is not uncommon for the debtor's adversaries to seek to have current management displaced through the appointment of a Chapter 11 operating trustee, or a chapter 7 trustee upon the conversion of the Chapter 11 case to a Chapter 7 liquidation.

Thus, notwithstanding the general right of a debtor's management team to remain in control as a debtor-in-possession, under Bankruptcy Code § 1104, the bankruptcy court is given broad discretion to appoint a chapter 11 operating trustee at any time after the commencement of the case, but prior to confirmation of a plan, on request of a party in interest "for cause." Under § 1104(a)(1), cause is defined to include "fraud, dishonesty, incompetence, or gross neglect, either before or after the commencement of the case ...." Generally, the paramount concern is what is in the best interest of the creditors and the estate. See In re Ionosphere Clubs, Inc., 113 B.R. 164 (Bankr. S.D.N.Y. 1990).

Bankruptcy Code § 1112(b) further provides the bankruptcy court with broad discretion to determine whether a chapter 11 case should be dismissed or converted to a case under chapter 7. Upon the request of a party in interest, the bankruptcy court can convert a chapter 11 case "for cause," including: (i) the "continuing loss to or diminution of the estate and absence of a reasonable likelihood of rehabilitation" [§ 1112(b)(1)]; (ii) "inability to effectuate a plan" [§ 1112(b)(2)]; and (iii) unreasonable delay by the debtor that is prejudicial to the creditors" [§ 1112(b)(3)]. The list provided in § 1112(b) is not exhaustive, and thus the bankruptcy courts can consider other factors as well, including those found in § 1104 for the appointment of an operating trustee.

The most common ground for conversion or dismissal is § 1112(b)(1) -- continuing loss to or diminution of the estate and the absence of a reasonable likelihood of rehabilitation. In construing this provision, the courts have not required proof of a significant loss or diminution to the estate. Rather, all that is needed is some diminution or loss. In re Rundlett, 136 B.R. 376, 380 (Bankr. S.D.N.Y. 1992). Furthermore, the need to show a continuing loss or diminution to the estate is relaxed where "the absence of significant loss is because 'there is no operation of any business.'" In re Sal Caruso Cheese, Inc., 107

B.R. 808, 820 (Bankr. N.D.N.Y. 1989), quoting, In re Tracey Service Co., Inc., 17 B.R. 405, 409 (Bankr. E.D. Pa. 1982).

Similarly, for purposes of § 1112(b)(1), rehabilitation is defined as "something more than 'reorganization' ... rehabilitation means to put back into good condition; to reestablish on a firm, sound basis." In re Minnesota Alpha Foundation, 122 B.R. 89, 93 (Bankr. D. Minn 1990) (citation omitted). See also In re D & F Meat Corp., 68 B.R. 39, 41 (Bankr. S.D.N.Y. 1986). Thus, "rehabilitation contemplates the successful maintenance or reestablishment of the debtor's business operations, subject to internal reorganization as to the nature, scope and intensity of particular forms of economic activity." Minnesota Alpha, 122 B.R. at 93. The reasonable likelihood of rehabilitation test is thus fundamentally one of feasibility. Absent a feasible chance at rehabilitation, conversion or dismissal may be appropriate. In re Schriock Constr., Inc., 167 B.R. 569, 576 (Bankr. N.D. 1994).

4. The Chapter 11 Plan of Reorganization

A successful Chapter 11 bankruptcy case will result in the implementation of a plan of reorganization. The Code provides that the debtor is given an exclusive one hundred twenty (120) day period from the date of the order of relief (i.e., the petition date in a voluntary case) during which it may submit its plan of reorganization. 11 U.S.C. § 1121(b). If the debtor is a small business, it has an exclusive one hundred (100) day period from the date of the order for relief during which it may submit its plan of reorganization. 11 U.S.C. § 1121(e). A small business debtor is defined as a person engaged in commercial or business activities (excluding a person whose primary activity is owning and operating real property), who does not have aggregate non-contingent liquidated secured and unsecured debts exceeding $2,000,000. See 11 U.S.C. § 101(51C). The debtor's exclusivity period may be (and frequently is) extended on request of a party in interest for additional periods of time. 11 U.S.C. § 1121(d). In the event that the debtor loses its exclusive right to file a plan, any party in interest, including the debtor, the trustee, a creditors' committee, an equity security holders' committee, a creditor, or any other interested party, may file a plan. 11 U.S.C. § 1121(c).

The required contents of a plan are specified in the Bankruptcy Code. 11 U.S.C. § 1123(a). The Code does not set forth the exclusive provisions for the contents of a plan, but does provide for certain minimum standards. The Bankruptcy Code requires a plan to classify all claims and interests in a substantially similar manner. A plan may designate a separate class of claims consisting only of unsecured claims that are less than or reduced to an amount that the Court approves as reasonable and

necessary for administrative convenience. 11 U.S.C. § 1122. This provision permits nominal claims to be addressed separately and more expeditiously than would otherwise be the case.

5. The Disclosure Statement and Plan Solicitation

An acceptance or rejection of a reorganization plan may not be solicited after the commencement of the case absent prior court authorization. At the time of or before such solicitation, there is transmitted to the holder of a claim, the plan or a summary of the plan, and a written disclosure statement approved, after notice and hearing, by the Bankruptcy Court as containing adequate information. 11 U.S.C. § 1125(b). Adequate information is defined as information of a kind and in sufficient detail as is reasonably practicable, in light of the nature and history of the debtor and the condition of the debtor's books and records, that would enable a hypothetical, reasonable investor typical of holders of claims or interests of the relevant class to make an informed judgment about the plan. Adequate information is not deemed to include information about any other possible or proposed plan. 11 U.S.C. § 1125(a)(1). The Code directs that the same disclosure statement shall be transmitted to each holder of a claim or interest of a particular class, but there may be transmitted different disclosure statements, differing in amount, detail, or kind of information, as between classes of claimants. 11 U.S.C. § 1125(c).

Once the disclosure statement has been approved by the Court, the plan, disclosure statement and solicitations may be sent to all classes of claims and interests. The plan is accepted or rejected by voting on a ballot. Only the holders of a claim or interest allowed under the Code may accept or reject a plan. 11 U.S.C. § 1126.

Although post-petition solicitation for a plan is prohibited unless a disclosure statement has been approved by the bankruptcy court after notice and hearing, pre-petition solicitation, that is solicitation from creditors and holders of interests, is permitted provided that such acceptances were solicited in good faith and with a clear statement of the purpose for which the acceptance would be used. In the so-called "prepackaged bankruptcy," a debtor and its creditors may negotiate with one another and draft a plan for which solicitations are made before the time that the debtor files its petition for relief under Chapter 11. If agreements and acceptances can be made, the debtor files its plan promptly after the order for relief is entered and a confirmation of the plan can be entered shortly after the filing.

6. *Plan Confirmation*

Once the ballots have been received, after notice, the bankruptcy court holds a hearing to consider confirmation of the plan. A party in interest may object to plan confirmation on the grounds, for example, of improper solicitation, fraud, misconduct, feasibility, lack of adequate funding, etc. 11 U.S.C. § 1128. The Bankruptcy Code provides a lengthy list of criteria to which a court must adhere before it may confirm a plan. 11 U.S.C. § 1129.

The Bankruptcy Code provides that a class of claims has accepted a plan if the plan has been accepted by at least two-thirds in amount and more than one-half in number of the allowed claims of such class held by creditors that have accepted or rejected such plan. 11 U.S.C. § 1126(c). Similarly, a class of interests is deemed to have accepted a plan if at least two-thirds in amount of the allowed interests of such class have accepted or rejected such plan. 11 U.S.C. § 1126(d).

It is important to note, however, that a class of creditors or interests which is not impaired under a plan are conclusively presumed to have accepted the plan, and solicitation of acceptances with respect to such class is not required. 11 U.S.C. § 1126(f).

The Bankruptcy Code permits the Court to confirm a plan notwithstanding the failure of the plan to obtain the necessary votes. 11 U.S.C. § 1129(b). In order to obtain such a "cram-down," the plan must comply with all other paragraphs of sub-section (a) and must meet certain standards of fairness to dissenting creditors or equity security holders. The bankruptcy court is permitted to confirm a plan notwithstanding non-acceptance by an impaired class if that class, and all classes below it in priority, are treated according to the absolute priority rule. That is, the dissenting class must be paid in full (per its allowed claim) before any junior class may share under the plan. If it is paid in full, then junior classes may share. Treatment of classes of secured creditors are slightly different, because they do not fall in the priority ladder, but the principle is the same. In order to obtain a cram-down, the plan proponent must specifically request it in the plan itself. The bankruptcy court may not re-write the plan.

7. *Effect of a Confirmed Plan*

The provisions of a confirmed plan bind the debtor, any entity issuing securities or acquiring property under the plan, and any creditor, equity security holder or general partner. 11 U.S.C. § 1141(a). Thus, it is well settled that an order confirming a Chapter 11 plan is entitled to res judicata effect. See, e.g., Sure-Snap Corp. v. State Street Bank & Trust Co., 948 F.2d 869, 873-75 (2d Cir. 1991); Matter of

Howe, 913 F.2d 1138, 1143-47 (5th Cir. 1990). The confirmation of the plan also vests all other property of the estate back in the debtor or in some new entity created by the debtor. 11 U.S.C. § 1141(b). Thus, after confirmation, except with certain limitations, the property dealt with by the plan is free and clear of all interests of creditors, equity security holders and the general partners of the debtor. 11 U.S.C. § 1141(c).

The confirmation of a plan discharges the debtor from any debt that arose before the date of the confirmation whether or not a proof of claim was filed, the claim was allowed, or the holder of such claim has accepted the plan. 11 U.S.C. § 1141(d). The confirmation of a plan does not discharge an individual debtor from any debt excepted from discharge under § 523 of the Code. 11 U.S.C. § 1141(d)(2).

The confirmation of a plan also will not discharge a debtor if:

(a) The plan provides for the liquidation of all or substantially all of the property of the estate;

(b) The debtor does not engage in business after confirmation of the plan; and

(c) The debtor would be denied a discharge under Bankruptcy Code § 727(a) if the case were a case under Chapter 7.

11 U.S.C. § 1141(d)(3).

The confirmation of a plan does not terminate the jurisdiction of the bankruptcy court. The bankruptcy court's jurisdiction continues post-confirmation to protect the confirmation decree, and to implement the provisions of the plan. Fed.R.Bankr.P. 3020(d). Confirmation of the plan is thus one step in the administration of the debtor's estate and the bankruptcy court remains responsible for overseeing the execution of the plan. Generally, the plan expressly provides that the bankruptcy court retains jurisdiction in the post-confirmation period, but jurisdiction is limited to that which is necessary to effectuate the confirmed plan.

III. PROPERTY OF THE ESTATE AND AUTOMATIC STAY ISSUES

The automatic stay is probably the bankruptcy concept most widely recognized by non-bankruptcy practitioners. Indeed, it is one of the most fundamental and important protections afforded to a debtor filing for bankruptcy. The scope of the automatic stay is extremely broad. With certain statutory exceptions, the stay encompasses virtually any act taken against a debtor or its property. The phrase "property of the estate" is often mentioned in the same breath as the automatic stay, and for good reason. One of the primary goals of the automatic stay is to prevent a "chaotic and uncontrolled scramble for the debtor's assets in a variety of uncoordinated proceedings in different courts." In re Holtkamp, 669 F.2d 505, 508 (7th Cir. 1982). The following section discusses the impact of the creation of the bankruptcy estate and the imposition of the automatic stay upon a debtor's creditors.

A. Property of the Estate

Immediately upon the filing of a voluntary bankruptcy petition, whether under Chapter 7, 11 or 13, an estate is created by operation of law comprised of all the debtor's property, wherever located and by whomever held. See 11 U.S.C. § 541. The phrase "property of the estate" is a term of art in bankruptcy. Other than certain statutory exceptions, it has been generally interpreted in its broadest sense to include virtually any kind of legal or equitable interest which the debtor may have in tangible or intangible property, including realty, personalty, contract rights, and causes of action, as well as any proceeds or profits obtained therefrom.

1. Standing to Assert Claims which are Property of the Estate

As noted above, once a bankruptcy petition is filed, all of the property rights of the debtor become assets of its estate. Under the broad and expansive provisions of Bankruptcy Code § 541(a)(1), property of the estate encompasses all of the "legal and equitable interests of the debtor in property as of the commencement of the case." 11 U.S.C. § 541(a)(a). This includes causes of action which belong to the debtor pre-petition, including tort claims. In re Folks, 211 B.R. 378, 384 (9th Cir. BAP 1997). As property of the estate, the only party with the right to assert such causes of action post-petition is the trustee or a debtor-in-possession acting in its capacity as a quasi-trustee. Id.; citing Pepper v. Litton, 308 U.S. 295, 307-08, 60 S.Ct. 238, 245-46 (1939). Although certain damages resulting from a debtor's causes of action may be exempt from the reach of a debtor's creditors (namely, up to $15,000 for personal

bodily injury; see 11 U.S.C. § 522(c)(11)), the right to bring the action is initially vested solely in the trustee unless and until the claim is abandoned to the debtor.

Occasionally, a debtor will fail to list on his or her bankruptcy schedules (either intentionally or unintentionally) a pending or potential cause of action. Under Bankruptcy Code § 521(1), debtors have a statutory obligation to file a schedule listing all of their assets. 11 U.S.C. § 521(1). "By operation of 11 U.S.C. § 554(c) and (d), any asset not scheduled pursuant to 11 U.S.C. § 521(1) remains property of the bankruptcy estate, and the debtor loses all rights to enforce it in his own name." In re Drexel Burnham Lambert Group, Inc., 160 B.R. 508, 514 (S.D.N.Y.).

The federal and state courts within New York have dismissed such undisclosed post-bankruptcy claims on the grounds that the debtor lacks standing to pursue such claims in his own right, or the debtor is judicially estopped from prosecuting such undisclosed claims. See In re Drexel Burnham Lambert, 160 B.R. at 514 ("[Plaintiff] cannot be allowed to defraud his creditors by consciously omitting reference to these claims in his own bankruptcy, and then, upon emerging from bankruptcy, attempt to reclaim them. Because [Plaintiff] lacks ownership of and standing to pursue the Additional Claims, the Bankruptcy Court appropriately granted summary judgment in favor of Drexel."); Robinson v. J.A. Wiertel Construction, 185 A.D.2d 664, 586 N.Y.S.2d 59, 60 (4th Dep't 1992) ("Having failed to list a personal injury cause of action against [defendant] on his schedule of assets, plaintiff is precluded from pursuing the claim."); DeLarco v. DeWitt, 136 A.D.2d 406, 527 N.Y.S.2d 615, 616 (same).

B. The Automatic Stay

Together with the creation of an estate, immediately upon the filing of a bankruptcy petition, an automatic stay is imposed by operation of law under Bankruptcy Code § 362(a) which prevents (with certain statutory exceptions), inter alia: (i) the commencement or continuation of any judicial action or proceeding against the debtor [§ 362(a)(1)]; (ii) any acts to obtain possession of, or to exercise control over, property of the estate [§ 362(a)(3)]; and (iii) any acts to collect on any pre-petition debts of the debtor [§ 362(a)(6)].

Generally, the rule is that acts taken in violation of the automatic stay are voidab initio, and not merely voidable. More significantly, however, a willful violation of the automatic stay may result in a claim for actual damages by an injured party (not just the debtor), including an award of costs and attorneys' fees incurred in remedying the violation, and, in appropriate circumstances, punitive damages.

See 11 U.S.C. § 362(h). A "willful" violation of the stay will generally be found if the party knew of the automatic stay and the party's actions which violated the stay were intentional. Thus, whether the party believed in good faith that its actions were not in violation of the stay is not relevant for a determination that the party acted "willfully," although the good faith intentions of the party may be relevant to a determination that punitive damages should not be imposed.

1. Actions Brought Against the Debtor

Under the express provisions of Bankruptcy Code § 362(a)(1), the automatic stay precludes, without qualification, "the commencement or continuation ... of a judicial, administrative or other action against the debtor ...." The purpose behind this provision of the automatic stay is in part to protect the debtor from expending its scarce resources in defending multiple litigation claims outside the bankruptcy court, which resources can otherwise be used in working towards a successful reorganization. As a result, absent an express statutory exception, all litigation pending in any court, state or federal, against a person or entity that has filed a bankruptcy petition is automatically stayed and enjoined immediately upon the filing of the bankruptcy petition and without the need for any affirmative act by the bankruptcy court.

It should be noted, however, that whereas litigation, including discovery, brought against a defendant which files for bankruptcy is arguably automatically stayed, some courts have held that a debtor is still obligated to provide discovery in litigation which pertains to the claims and defenses of other parties, or in litigation in which it is not a named party, unless such discovery obligations have a materially adverse impact on the debtor's bankruptcy proceedings. See In re Miller, 262 B.R. 499, 504-07 (9th Cir. BAP 2001).

2. Exceptions to the Automatic Stay: Police and Regulatory Powers

Section 362(b) of the Bankruptcy Code contains a list of 18 exceptions to the automatic stay, that is, certain activities which a creditor is not precluded from undertaking merely because of the debtor's bankruptcy filing. Most of these exceptions are founded in some public policy propounded in favor of a variety of special interest groups. A frequently invoked exception which may impact on pending state court litigation, especially for environmental liabilities, is the police powers exception.

Bankruptcy Code § 362(b)(4) provides an express statutory exception to the automatic stay for the "commencement or continuation of an action or proceeding by a governmental unit to enforce such governmental unit's police or regulatory powers." Bankruptcy Code § 362(b)(5) further provides that the

"enforcement of a judgment, other than a money judgment, obtained in an action or proceeding by a governmental unit" to enforce its police or regulatory powers will not be subject to the automatic stay. The legislative history of the section 362(b)(4) exception expressly references environmental protection actions. See S. Rep. No. 95-989, 95th Cong., 2d Sess. 51-2 (1978); H.R. Rep. No. 95-595, 95th Cong., 1st Sess. 342-3 (1977).

In Penn Terra Ltd. v. Dept. of Environmental Resources, 733 F.2d 267 (3d Cir. 1984), the Third Circuit held that an action to compel a debtor's compliance with its reclamation obligations under the Surface Mining Control and Reclamation Act fell squarely within § 362(b)(5) and thus was not subject to the automatic stay. Similarly, numerous Federal Circuit Courts have held that a CERCLA action seeking to fix a debtor's liability for past response costs is not stayed since the CERCLA action fell within the § 362(b)(5) exception to the automatic stay. City of New York v. Exxon Corp., 932 F.2d 1020 (2d Cir. 1991); United States v. Nicolet, Inc., 857 F.2d 202 (3d Cir. 1988). See also In re Commonwealth Oil Ref. Co., 805 F.2d 1175, 1186-88 (5th Cir. 1986) (action seeking compliance with RCRA not stayed); United States v. Jones & Laughlin Steel Corp., 804 F.2d 348 (6th Cir. 1986) (proceeding brought under Clear Water Act and Clean Air Act not stayed).

An overwhelming majority of courts have defined "money judgment" narrowly and permitted the enforcement of pre-petition orders requiring cleanup, even where a debtor would be forced to expend a substantial part of its assets for the cleanup. See In re Commonwealth Oil Ref. Co., 805 F.2d 1175, 1186-88 (5th Cir. 1986); Penn Terra Ltd. v. Department of Envtl. Resources, 733 F.2d 267 (3d Cir. 1984). Nevertheless, other courts have broadened the definition of "money judgment" and held that a debtors compliance with a clean-up order is the equivalent of the enforcement a money judgment. For example, in United States v. Johns-Manville Sales Corp., 18 Env't Rep. Cas. (BNA) 1177, 1188, 13 Envt'l L. Rep. 20310 (D.N.H. 1982), the court held that an EPA order requiring a debtor to remove asbestos contamination was subject to the automatic stay since it required substantial expenditure of assets of the estate and was therefore equivalent to enforcement of a money judgment.

It should also be noted that the "police and regulatory powers" exception only applies to actions brought by "governmental units." Therefore, even where environmental law grants a private citizen the authority to bring an action as a "private attorney general," such an action is subject to the automatic stay. In re Chateauguy Corp., 118 B.R. 19 (Bankr. S.D.N.Y. 1990).

In summary, a government's environmental actions against a debtor will not be stayed and can continue, although the government generally will be precluded from executing on any money judgment entered therein absent relief from the automatic stay.

3. *Obtaining Relief From the Automatic Stay to Commence or Continue an Action Against a Debtor*

Simply because a debtor has filed for bankruptcy, however, does not mean that all persons are forever precluded from commencing or continuing with an action against the debtor. The Bankruptcy Code does provide a mechanism for obtaining relief from the stay.

Bankruptcy Code § 362(d)(1) provides that, upon motion, the court may grant relief from the automatic stay "for cause." In the case of In re Sonnax Industries, Inc., 907 F.2d 1280, 1286 (2d Cir. 1990), the Second Circuit weighed twelve factors in determining whether to lift the automatic stay to allow a party to continue litigation with a debtor pending in a forum other than the bankruptcy court. Among those factors are: (1) the impact of the stay on the parties and the balance of harms; (2) the interests of judicial economy and the expeditious and economical resolution of the litigation; (3) the advanced status of the litigation and its proximity to trial; (4) whether relief would result in a complete resolution of the issues; (5) lack of interference with the bankruptcy case; and (6) whether the bankruptcy petition was filed in bad faith. Id.

Aside from a bad faith bankruptcy filing, the two Sonnax factors that are often given the most weight by the bankruptcy courts are: "(1) the interests of judicial economy and the expeditious and economical resolution of the litigation; and (2) the proximity of trial in the other proceeding." In re Fischer, 202 B.R. 341, 355 (E.D.N.Y. 1996).

If a state court action is pending at the time of the debtor's bankruptcy filing, chances are good that the bankruptcy court will grant relief from the automatic stay to allow the action to continue for at least two reasons. First, the issues to be resolved in the action likely will be governed by state law, not federal bankruptcy law. Second, if the action has been pending for any length of time, the bankruptcy court will likely not want to duplicate activities already undertaken by another court and thus will defer to the other court for reasons of judicial economy.

4. Actions Brought By The Debtor

By its express terms, the automatic stay applies only to judicial actions or proceedings brought against the debtor. It does not apply to actions or proceedings brought by the debtor. See 11 U.S.C. § 362(a)(1); In re Berry Estates, Inc., 812 F.2d 67, 71 (2d Cir. 1987); Carley Capital Group v. Fireman's Fund Ins. Co., 889 F.2d 1126, 1127 (D.C. Cir. 1989) (per curiam) (appeal in action initially brought by debtor pre-petition for breach of contract not stayed); Maritime Elec. Co. v. United Jersey Bank, 959 F.2d 1194, 1205 (3d Cir. 1991). Whether an action is brought by a debtor, as opposed to against a debtor, is "determined by the status of the debtor at the time the action was begun, not by who was ahead at the time the bankruptcy petition was filed." Berry Estates, 812 F.2d at 71.

Notwithstanding the apparent one-way application of the automatic stay, a party against whom a debtor in bankruptcy has commenced an action is by no means expected to sit idly by due to the automatic stay. In other words, the debtor cannot use the automatic stay as a shield and a sword to gain an unfair litigation advantage. Thus, it is largely held that the automatic stay "does not prevent entities against whom the debtor proceeds in an offensive posture -- for example by initiating a judicial or adversarial proceeding -- from 'protecting their legal rights.'" In re Financial News Network, 158 B.R. 570, 573 (S.D.N.Y. 1993), quoting, Martin-Trigona v. Champion Federal Savings and Loan Ass'n, 892 F.2d 575, 577 (7th Cir. 1989).

Accordingly, a defendant will not be violating the automatic stay if it asserts affirmative defenses in an action commenced by a debtor. Counterclaims by the defendant, however, which seek an affirmative award of money damages will still be subject to the automatic stay and thus cannot be asserted absent first obtaining relief from the stay. For reasons of judicial economy and avoiding inconsistent results, the bankruptcy court is likely to grant such relief, provided that the defendant, if successful, agrees not to enforce any monetary award outside of the bankruptcy proceedings.

5. Actions Against Non-Debtor Co-Defendants

The basic horn book rule is that the automatic stay only applies to the debtor in bankruptcy and its property interests and not to non-debtor parties and their property interests. See L. King, 3 Collier on Bankruptcy, ¶ 362.03[3][d], at p. 362-17 (15th Rev. Ed. 1998) ("The stay of litigation does not protect nondebtor parties who may be subjected to litigation for transactions or events involving the debtor"). See also Lynch v. Johns-Manville Sales Corp., 710 F.2d 1194, 1196-97 (6th Cir. 1983) (the automatic

stay does not apply to non-debtor, co-defendants); Teachers Ins. and Annuity Ass'n of America v. Butler, 803 F.2d 61, 65 (2d Cir. 1986) (citing cases).. Accordingly, non-debtor co-defendants, such as employees and related corporations who have not themselves filed for bankruptcy relief, will generally not be entitled to invoke the automatic stay.[3]

6. *Extending The Automatic Stay To Protect Non-Debtor Co-Defendants*

Although the general rule is that the automatic stay does not apply to actions brought against non-debtor co-defendants, several decisions have held that a bankruptcy court is nevertheless empowered to "extend" the automatic stay under the catch-all provisions of Bankruptcy Code § 105(a), and thus enjoin third-party actions brought against a debtor's related parties, namely its corporate parents and subsidiaries or its directors and officers. See, e.g., A.H. Robbins Co., Inc. v. Piccinin, 788 F.2d 994 (4th Cir. 1986) (Dalkon-Shield litigation); In re Johns-Manville Corp., 26 B.R. 420 (Bankr. S.D.N.Y. 1983) (asbestos litigation). The rationale underlying these cases is that the debtor's present directors and officers should not be thwarted in their efforts to reorganize the debtor by defending numerous third-party suits. The recent trend among the reported decisions, however, is to limit the holdings of cases such as A.H. Robbins and Johns-Manville to the truly "unusual circumstances" presented, i.e. mass product liability claims brought against both the debtor and its directors and officers which were the primary impetus for the bankruptcy filing. Indeed, the recent decisions from the New York bankruptcy courts have expressly declined to invoke the A.H. Robbins and Johns-Manville line of cases absent proof that the action commenced against non-debtor parties would thwart or frustrate the debtor's reorganization. See In re American Media Distributors, LLC, 216 B.R. 486, 489 (Bankr. E.D.N.Y. 1998); In re United Health Care Organization, 210 B.R. 228, 232-33 (Bankr. S.D.N.Y. 1997); In re Granite Partners, L.P., 194 B.R. 318, 335-38 (Bankr. S.D.N.Y. 1996).

7. *State Law Authority to Stay Litigation Involving Debtor and Non-Debtor Parties*

Generally, upon the bankruptcy of one of several co-defendants, the New York courts may sever the debtor-defendant from the action under CPLR § 603 as a result of the imposition of the automatic stay. Notwithstanding the general rule that the automatic stay only applies to a debtor and not to non-

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[3] As discussed above, the primary exception to this black-letter rule is the Chapter 13 co-debtor stay for consumer debts.

debtor co-defendants, there is authority under New York law for a court to nevertheless stay the entire action under CPLR § 2201 as a result of the primary defendant's bankruptcy filing. Rosenbaum v. Dane & Murphy, Inc., 189 A.D.2d 760, 592 N.Y.S.2d 391, 392 (2d Dep't 1993). Such relief, however, is entered sparingly given the obvious inequities which may befall upon a plaintiff who is precluded from pursuing an otherwise solvent co-defendant with potential joint and several liability. Id.

8. *Effect of the Automatic Stay on Tort Claims Covered by a Debtor's Insurance Policies*

The scope of the automatic stay is certainly broad enough to cover property damage or tort claims against a debtor, even if the debtor has insurance which would indemnify it for such claims. Immediately upon the filing of the bankruptcy petition, all such pending claims will be automatically stayed from proceeding further, and to the extent any such claims have not already been filed, the tort claimants will be precluded from doing so absent obtaining relief from the stay. Notwithstanding the foregoing, the bankruptcy courts will generally allow tort claims to proceed against a debtor/insured despite the automatic stay to the extent that the tort claim is covered by insurance. Under these circumstances, because the debtor-insured will not be required to expend its own assets for defense costs or indemnity payments, the bankruptcy courts will allow the claim to continue in state court. In other words, an insurer generally will not be allowed to take advantage of the automatic stay imposed upon claims against its insured.

Although the debtor is generally shielded by the automatic stay and the discharge injunction from suits, it is well settled that the automatic stay and discharge injunction will only apply to a debtor and not to third-parties who are co-obligors such as a debtor's guarantors, sureties or insurers. See 11 U.S.C. § 524(e) ("discharge of a debt of the debtor does not affect the liability of any other entity on, or the property of any other entity for, such debt").[4] The courts thus routinely lift the stay to allow claimants to proceed against a debtor nominally to the extent of seeking a recovery from the debtor's liability policy which falls above a deductible or self-insured retention ("SIR"). See, e.g., In re Jet Florida Systems, Inc.,

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[4] One exception to this general rule is found in Section 524(g) of the Bankruptcy Code which provides for the creation of a trust in asbestos cases. See, e.g., In re Eagle-Pitcher Industries, Inc., 203 B.R. 256 (S.D. Ohio 1996). Another exception is the so-called "channeling injunction" imposed pursuant to Section 105(a) of the Code in non-asbestos mass tort cases. See In re Down Corning Corp., 280 F.3d 648, 658 (6th Cir. 2002). Under these types of plans, non-debtor entities such as a debtor's parent or subsidiary entities and their insurers can receive the benefit of the debtor's discharge. Naturally, certain stringent criteria are required to be met before entering such relief.

883 F.2d 970 (11th Cir. 1989); In re Fernstrom Storage and Van Co., 938 F.2d 731 (7th Cir. 1991); Green v. Welsh, 956 F.2d 30 (2d Cir. 1992). However, if the debtor will have to fund the defense of the suit due to a large deductible or SIR, the courts will generally not lift the stay to allow the suit to proceed against the debtor. See In re Columbia Gas Transmission Corp., 219 B.R. 716, 720 (S.D.W.V. 1998); In re UNR Industries, Inc., 54 B.R. 266, 269-70 (court indicated that stay would not be lifted if there were a large deductible). Additionally, if the debtor's tort liabilities far exceed its available insurance assets, the courts will be reluctant to lift the automatic stay to allow any one claimant to gain an unfair advantage over other claimants.

9. *The Effect of the Automatic Stay on Tolling of Claims under State Law Statutes of Limitations*

The automatic stay may have the effect of tolling claims against a debtor. Although a debtor's bankruptcy may have the effect of discharging personal liability on the claim, as discussed more fully later in this Article, the debtor's discharge may not apply to all claims and it may not relieve other parties from responsibility, including the obligations of an insurer to defend and indemnify a debtor-insured. Thus, whether or not a claim is time barred or tolled may be of critical importance. Generally, many states' laws provide for the tolling of claims which are the subject of a mandatory stay such as the automatic bankruptcy stay. For example, under New York Law, Section 204 of the Civil Practice Law and Rules tolls any applicable statute of limitations during bankruptcy proceedings. In the context of the automatic stay, the toll operates from the filing of the bankruptcy case until such time as the automatic stay is terminated. See, e.g., Zuckerman v. 234-6 West 22nd Street Corp., 167 Misc. 2d 198, 645 N.Y.S.2d 967, 969-71 (Sup. Ct. N.Y. Cty. 1996). See also Zuckerman v. 234-6 West 22nd Street Corp., 699 N.Y.S.2d 284 (1st Dep't 1999) (later proceeding).

The Bankruptcy Code also contains a provision which extends (but does not toll) the statute of limitations for claims subject to the automatic stay. 11 U.S.C. §108(c). Section 108(c) states in relevant part:

> [I]f applicable nonbankruptcy law, an order entered in a nonbankruptcy proceeding, or an agreement fixes a period for commencing or continuing a civil action in a court other than a bankruptcy court on a claim against the debtor ..., and such period has not expired before the date of the filing of the petition, then such period does not expire until the later of--(1) the end of such period, including any suspension of such period occurring on or after the commencement of the case; or (2) 30 days after notice of the termination or expiration of the stay

> under section 362, 922, 1201, or 1301 of this title, as the case may be, with respect to such claim.

11 U.S.C. §108(c).

In short, if the statute of limitations has not run prior to the bankruptcy filing, under the Bankruptcy Code the claimant has until the later of the end of the statute of limitations period (which is not tolled or extended by federal law, but may be tolled or extended as a matter of state law) or 60 days from the termination of the automatic stay (which is a federal law extension regardless of any state law tolling) to timely commence an action.

10. Extension of Time for Debtor or Trustee to Report Notice of a Claim

It is also important to note that there is a provision in the Bankruptcy Code which may briefly extend a debtor's time to provide its insurer with notice of a claim. Upon filing for bankruptcy, the debtor is allowed 60 days to provide notices or file proofs of claim or loss under any agreement which fixes a time period for providing such notices, so long as such notice period has not expired prior to bankruptcy. See 11 U.S.C. § 108(b). This provision has been held to apply to the reporting of claims under insurance policies. In re Donald Sheldon & Co., Inc., 186 B.R. 364 (S.D.N.Y. 1995). As a result, if a claims made and reported policy period has not expired upon the insured's bankruptcy filing (or expires shortly thereafter), § 108(b) may provide a debtor/insured with additional time to provide notice of the claim to the insurer.

IV. THE BANKRUPTCY DISCHARGE

The goal of every debtor that files for bankruptcy is to obtain a discharge. The bankruptcy discharge varies depending on the type of case a debtor files, *i.e.* Chapter 7, 11 or 13. Generally, the discharge acts a release of the debtor form personal liability for certain debts. The discharge order operates as a permanent injunction (think of the automatic stay as a preliminary injunction) which precludes the debtor's creditors from taking any actions to collect on a discharged debt. Unless there is litigation involving the debtor's discharge (whether as to the over-all discharge for all debts or the dischargeability of a specific debt), the granting of a discharge is automatic. Nevertheless, it is important to note that although a debtor may receive a discharge of personal liability, a valid lien on the debtor's property, such as a mortgage on the debtor's real property or a security interest in the debtor's personal property, will remain after the bankruptcy case unless the lien was avoided during the bankruptcy.

A. Exceptions to Discharge

Not all debts are discharged in bankruptcy. The debts discharged vary under each Chapter of the Bankruptcy Code. Section 523(a) of the Code specifically excepts various categories of debts from the discharge granted to individual debtors. Therefore, the debtor must still repay those debts after bankruptcy. Congress has determined that these types of debts are not dischargeable for public policy reasons (based either on the nature of the debt or the fact that the debts were incurred due to improper behavior of the debtor, such as the debtor's drunken driving). There are 18 categories of debt excepted from discharge under Chapters 7 and 11. See 11 U.S.C. §§ 523(a)(1)-(18). A more limited list of exceptions applies to cases under Chapter 13. See 11 U.S.C. § 1328(a).

Generally speaking, the exceptions to discharge apply automatically if the language prescribed by Section 523(a) applies. The most common types of non-dischargeable debts are certain types of tax claims, debts not set forth by the debtor on the lists and schedules the debtor must file with the court, debts for spousal or child support or alimony, debts for willful and malicious injuries to person or property, debts to governmental units for fines and penalties, debts for most government funded or guaranteed educational loans or benefit overpayments, debts for personal injury caused by the debtor's operation of a motor vehicle while intoxicated, and debts for certain condominium or cooperative housing fees.

The types of debts described in Sections 523(a)(2), (4), (6), and (15) (obligations affected by fraud or maliciousness or certain debts incurred in connection with property settlements arising out of a separation agreement or divorce decree) are not automatically excepted from discharge. Rather, creditors must affirmatively file an adversary proceeding and ask the bankruptcy court to determine that these debts are excepted from discharge. See Fed.R.Bankr.P. 7001(6). In the absence of an affirmative request by the creditor and subsequent granting of the request by the court, the types of debts set out in Sections 523(a)(2), (4), (6), and (15) will be discharged.

A broader discharge of debts is available to a debtor in a Chapter13 case than a Chapter 7 case. As a general rule, the Chapter 13 debtor is discharged from all debts provided for by the plan except certain long-term obligations (such as a home mortgage), debts for alimony or child support, debts for most government funded or guaranteed educational loans or benefit overpayments, debts arising from death or personal injury caused by driving while intoxicated or under the influence of drugs, and debts for

restitution or a criminal fine included in a sentence upon a debtor's criminal conviction. See 11 U.S.C. § 1328(a).

B. Limitations on Successive Discharges

A discharge will be denied in a later Chapter 7 case if the debtor has been granted a discharge under Chapter 7 or Chapter 11 in a case filed within six years before the second petition is filed. 11 U.S.C. § 727(a)(8). The debtor will also be denied a Chapter 7 discharge if he or she previously was granted a discharge in a Chapter 13 case filed within six years before the date of the filing of the second case unless (1) all the "allowed unsecured" claims in the earlier case were paid in full, or (2) payments under the plan in the earlier case totaled at least 70% of the allowed unsecured claims and the debtor's plan was proposed in good faith and the payments represented the debtor's best effort. 11 U.S.C. § 727(a)(9).

C. Revocation of a Discharge

A discharge can be revoked under certain circumstances. See, e.g., 11 U.S.C. § 727(d). For instance, a trustee, creditor, or the United States trustee may request that the court revoke the debtor's discharge in a Chapter 7 case based on allegations that the debtor obtained the discharge fraudulently; the debtor failed to disclose the fact that he or she acquired or became entitled to acquire property that would constitute property of the bankruptcy estate; or the debtor committed one of several acts of impropriety described in Section 727(a)(6) of the Bankruptcy Code. Typically, a request to revoke the debtor's discharge must be filed within one year after the granting of the discharge or, in some cases, before the date that the case is closed. It is up to the bankruptcy court to determine whether such allegations are true and, if so, to revoke the discharge. In a Chapter 13 case, if confirmation of a plan or the discharge is obtained through fraud, the court can revoke the order of confirmation or discharge. 11 U.S.C. § 1328(e).

D. Voluntary Payments of a Discharged Debt

A debtor who has received a discharge may *voluntarily* repay any discharged debt even though it can no longer be legally enforced. Sometimes a debtor agrees to repay a debt because it is owed to a family member or because it represents an obligation to an individual for whom the debtor's reputation is important, such as a family doctor. 11 U.S.C. § 524(f).

E. Bankruptcy Discrimination

The Bankruptcy Code provides express prohibitions against discriminatory treatment of debtors by both governmental units and private employers. See 11 U.S.C. § 525. A governmental unit or private employer may not discriminate against a person *solely* because the person was a debtor, was insolvent before or during the case, or has not paid a debt that was discharged in the case. The law prohibits the following forms or governmental discrimination: terminating an employee; discriminating with respect to hiring; or denying, revoking, suspending, or declining to renew a license, franchise, or similar privilege. A private employer may not discriminate with respect to employment if the discrimination is based solely upon the bankruptcy filing.

V. BANKRUPTCY JURISDICTION ISSUES

Although this article is not intended to be an exhaustive discourse on the intricacies of bankruptcy jurisdiction (which itself is a rather complex, heavily litigated topic), issues do arise as to whether the bankruptcy court has jurisdiction to hear various traditional state court disputes, and if so, whether that jurisdiction is exclusive. We briefly discuss herein the fundamentals of bankruptcy jurisdiction and how it impacts upon state court litigation.

A. Core v. Non-Core

The present bankruptcy jurisdiction statutes are found in 28 U.S.C. §§ 1334, 157 and 158. They have somewhat of a tortured history. By way of background, it is helpful to note that the present state of bankruptcy jurisdiction was largely driven by the U.S. Supreme Court's decision in Northern Pipeline Constr. Co. v. Marathon Pipeline Co., 102 S.Ct. 2858 (1982), which held that the complete vesting of bankruptcy and related jurisdiction in the bankruptcy courts (which are Article I courts) rather than in the district courts (which are Article III courts) violated the Constitution's separation of powers.

In response to Marathon, in 1984 Congress enacted the Bankruptcy Amendments and Federal Judgeship Act. As it presently exists, under 28 U.S.C. § 1334(a) and (b), the United States District Courts are granted "original and exclusive jurisdiction" over all cases under title 11 [the Bankruptcy Code], and "original but not exclusive jurisdiction" over all civil proceedings arising under title 11, or arising in or related to cases under title 11. Furthermore, 28 U.S.C. § 1334(e) provides that the district court in which a bankruptcy case is pending "shall have exclusive jurisdiction of all the property, wherever located, of the debtor as of the commencement of the case, and of property of the estate." As § 1334 makes clear,

therefore, the initial grant of bankruptcy jurisdiction is vested in the district courts and not the bankruptcy courts.

Under 28 U.S.C. § 157(a), however, each district court may provide that "any and all cases under title 11 and any or all proceedings arising under title 11 or arising in or related to a case under title 11 shall be referred to the bankruptcy judges for the district." Every district court in the country has exercised its authority under section 157(a) and ordered that all bankruptcy cases, as well as all matters arising under the Bankruptcy Code, or arising under some other law but related to the bankruptcy case, be automatically referred to the bankruptcy courts.

Although § 157(a) permits the automatic referral of all matters arising directly out of or related to a bankruptcy case to the bankruptcy courts, 28 U.S.C. §§ 157(b) and (c) restrict the power of the bankruptcy courts to enter final judgments and orders in certain matters. In this regard, § 157(b)(1) provides that the bankruptcy judges may enter final orders and judgments in a bankruptcy case (such as a Chapter 7 discharge, or the confirmation of a Chapter 11 plan). Furthermore, a bankruptcy judge is empowered to enter final judgments and orders in all "core" proceedings arising in the bankruptcy case (such as motions for relief from stay, objections to claims, or preference and fraudulent conveyance actions). See 28 U.S.C. § 157(b)(2) (definition of "core proceedings"); In the Matter of Pied Piper Casuals, Inc., 65 B.R. 780, 781 (S.D.N.Y. 1986) ("core proceedings" are essentially those matters which directly concern the administration of the bankruptcy estate or which would otherwise not exist absent the bankruptcy proceeding). Under 28 U.S.C. § 158(a), these final judgments and orders are subject to normal appellate review by the district courts, and then by the circuit courts of appeal.

As to non-core matters which are "related to" a bankruptcy case, but which are not dependent upon the bankruptcy case for their creation and survival (such as a garden variety pre-petition breach of contract claim), the bankruptcy courts have slightly less authority. Under 28 U.S.C. § 157(c)(1), a bankruptcy judge "may hear a proceeding that is not a core proceeding but that is otherwise related to a case under title 11." A non-core, related to proceeding is generally defined as one whose outcome could conceivably have any effect (either positively or negatively) upon the estate being administered in bankruptcy. See Pacor v. Higgins, 743 F.2d 984, 994 (3d Cir. 1984). "In such a proceeding, the bankruptcy judge shall submit proposed findings of fact and conclusions of law to the district court, and any final order or judgment shall be entered by the district judge after considering the bankruptcy judge's proposed findings and conclusions and after reviewing de novo those matters to which any party has timely and specifically objected." 11 U.S.C. § 157(c)(1). Pursuant to 28 U.S.C. § 157(c)(2), with the

consent of all the parties, the bankruptcy court may enter final judgments and orders in a non-core, related to proceeding which will then be subject to regular appellate review by the district court and court of appeals. In a non-core, related to matter, therefore, a bankruptcy judge is essentially akin to a U.S. magistrate judge.

B. Withdrawal of the Reference and Jury Trial Issues

In recognition of the initial grant of primary bankruptcy jurisdiction to the district courts, 28 U.S.C. § 157(d) provides for the permissive (and in certain cases mandatory) withdrawal of a referred proceeding from the bankruptcy court to the district court. A district court can withdraw any matter referred to the bankruptcy court, regardless of whether it is core or non-core. The motion to withdraw the reference is made to the district court, not the bankruptcy court. See 28 U.S.C. § 157(d) ("The district court may withdraw, in whole or in part, any case or proceeding referred under this section, on its own motion or on timely motion of any party, for cause shown.")

In deciding whether cause exists for withdrawal of the reference, the district courts generally consider the following factors: (i) the efficient use of judicial resources; (ii) delay and costs to the parties; (iii) uniformity of bankruptcy administration; (iv) the prevention of forum shopping; (v) whether the proceeding is core or non-core; (vi) whether a jury trial is involved; and (vii) any other related concerns. See In re Orion Pictures Corp., 4 F.3d 1095, 1101 (2d Cir. 1993).

The most common reason for withdrawing the reference is the right to a jury trial asserted in a non-core matter. It is generally well accepted that a bankruptcy court cannot conduct a jury trial in a non-core proceeding. Because the jury verdict would be subject to de novo review, a second jury trial by the district court may be required. And, because such a procedure would be cumbersome, time consuming and a violation of the Seventh Amendment's prohibition against reexamining a jury's findings of fact, the courts have generally held that a bankruptcy judge cannot conduct a jury trial in a non-core matter unless the parties consent. Beard v. Braunstein, 914 F.2d 434, 443 (3d Cir. 1990).[5]

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[5] There is some debate, however, as to whether a bankruptcy judge can conduct a jury trial in a core proceeding. Because there is no de novo review in a core proceeding, but only regular appellate review, the Seventh Amendment's prohibition is not implicated. The Second Circuit has held that the bankruptcy courts are empowered to conduct jury trials in core matters. See In re Ben Cooper, Inc., 896 (continued . . .)

28 U.S.C. § 157(b)(3) provides that the bankruptcy judge is to determine whether a proceeding is core or non-core either on motion of a party or on its own motion. Thus, before a motion to withdraw the reference is made to the district court, arguably the moving party should first seek a ruling from the bankruptcy court that the matter is non-core. Nevertheless, district courts can decide this issue on their own, especially where the non-core status of the matter appears self-evident. See Harley Hotels, 57 B.R. at 776-77.

In a non-core proceeding involving a right to a jury trial, the generally accepted view is that the district court should withdraw the reference to the bankruptcy court. See Civic Center Cleaning Co. v. Reginella Corp., 140 B.R. 374 (W.D. Pa. 1992); In re New York City Shoes, Inc., 122 B.R. 668, 673 (E.D. Pa. 1990). Thus, presuming that the subject adversary proceeding is non-core, the success of a motion to the district court to withdraw the reference will be greatly enhanced if the party has a right to a jury trial.

The U.S. Supreme Court has established essentially a two part test for determining whether a party has a right to a jury trial. First, the court compares the subject action to 18th century actions brought in the courts of England prior to the merger of law and equity. Second, the court examines the remedy sought to determine whether it is legal or equitable. Granfinanciera, S.A. v. Nordberg, 492 U.S. 33, 42 (1989); Tull v. United States, 481 U.S. 412, 417-18 (1987). See also In re Pasquariello, 16 F.3d 525, 529 (3d Cir. 1994). The Court has made clear that the second prong of this analysis is more important than the first. Id.

The right to a jury trial is not easily impinged. The mere fact that a legal claim has been joined with an equitable claim will not destroy the Constitutional right to a jury trial. Tull v. United States, 481 U.S. at 425; Curtis v. Loether, 415 U.S. 189, 196 n.11 (1974). Even if the equitable claims clearly outweigh the legal claims, the right to a jury trial still controls and all common questions of fact must be submitted to a jury before the court decides the equitable claims. Curtis, 415 U.S. at 196 n.11; Dairy Queen, Inc. v. Wood, 369 U.S. 469, 473 n.8 (1962). Similarly, a right to a jury trial will not be lost merely because a legal action is interposed in a court of equity, such as by a trustee in the bankruptcy court. In re Globe Parcel Service, Inc., 75 B.R. 381, 383 (E.D. Pa. 1987). Further, the assertion of a

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(. . . continued)
F.2d 1394 (2d Cir. 1990) (bankruptcy court could conduct jury trial in action for breach of post-petition insurance contract) (subsequent case history omitted). Other courts have disagreed.

compulsory counterclaim in response to a debtor's equitable claim will not waive a right to a jury trial if the counterclaim is legal in nature. Amoco Oil Co. v. Torcomian, 722 F.2d 1099, 1104 (3d Cir. 1983).[6]

Finally, it should be noted that even in a non-core proceeding with a clear right to a jury trial, a district court may be reluctant to withdraw the reference to the bankruptcy court until the case is actually trial ready. Frequently, the district courts will utilize a bankruptcy judge similar to a magistrate judge and thus allow the bankruptcy court to preside over all non-dispositive, pre-trial matters, and may even further require a report and recommendation on any dispositive motions.

C. Abstention

Even if a bankruptcy court has jurisdiction over a traditional state law action, the court could still decline to rule on the state law issues raised in the action under 28 U.S.C. § 1334(c) which provides that a bankruptcy or district court may abstain from hearing a non-core, related to matter. Section 1334(c) provides for both mandatory and permissive abstention. Under § 1334(c)(1), the bankruptcy court may abstain from hearing a non-core, state law issue if it is deemed "in the interests of justice, or in the interests of comity with State courts or respect for State law ...." Under § 1334(c)(2), the bankruptcy court must abstain from hearing a non-core, state law matter upon the "timely motion of a party" if it is found that the matter could not have been commenced in the bankruptcy court absent the bankruptcy jurisdiction statute [28 U.S.C. § 1334(a) and (b)], and the matter "can be timely adjudicated, in a State forum of appropriate jurisdiction." Section 1334(c) abstention thus presupposes that there is a pending state court action.

Similar to the standards governing withdrawal of the reference, in deciding whether permissive abstention is appropriate, the bankruptcy courts can consider a variety of factors, including:

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[6] The right to a jury trial in bankruptcy is far from ironclad. A party who files a proof of claim in a bankruptcy case waives any right to a jury trial since, by filing the claim, the party is deemed to submit to the equitable jurisdiction of the bankruptcy court to resolve all matters relating to that claim, including counterclaims by the debtor or trustee. Katchen v. Landy, 382 U.S. 323, 327-28 (1966); Ganfinanciera v. Nordberg, 492 U.S. at 58-59. Further, a right to a jury trial does not attach to a legal defense; there must be an affirmative counterclaim. Owens-Illinois, Inc. v. Lake Shore Land Co., 610 F.2d 1185, 1191 (3d Cir. 1979). Also, there is some question as to whether a party retains a right to a jury trial on a permissive, as opposed to a compulsory, counterclaim which is voluntarily filed in the bankruptcy court. See Beard v. Braunstein, 914 F.2d at 442; Baldwin-United Corp. v. Thompson, 48 B.R. 49, 54-55 (Bankr. S.D. Ohio 1985).

(a) The extent to which state law issues predominate over bankruptcy issues;

(b) The difficulty or unsettled nature of state law;

(c) The effect of abstention on the administration of the bankruptcy estate;

(d) Whether the underlying issues are core or non-core;

(e) The existence of a right to a jury trial; and

(f) The involvement of non-debtor parties.

See Civic Center Cleaning Co. v. Reginella Corp., 140 B.R. 374, 375-76 (W.D. Pa. 1992); Gilbert v. Ben Franklin Hotel Associates, 1995 U.S. Dist. LEXIS 14752 (E.D. Pa. Oct. 10, 1995).

The most important factors relied upon by the courts are whether there are unsettled issues of state law (not merely state law issues), whether there is a pending action and whether abstention will delay resolution of the bankruptcy case. Id. See also Harley Hotels, Inc. v. Rain's Int'l, Ltd., 57 B.R. 773, 781-82 (M.D. Pa. 1985); Ronix Corp. v. City of Philadelphia, 82 B.R. 19, 20 (E.D. Pa. 1988). Absent a withdrawal of the reference, an abstention motion must necessarily be brought before the bankruptcy court.

D. Removal of Claims to the Bankruptcy Court

28 U.S.C. § 1452(a) provides that a "party may remove any claim or cause of action in a civil action other than ... a civil action by a governmental unit to enforce such governmental unit's police or regulatory power, to the district court for the district where such action is pending, if such district court has jurisdiction over such claim or cause of action under [28 U.S.C. § 1334 -- the bankruptcy jurisdiction statute]." Bankruptcy Rule 9027(a)(2) generally provides that a notice of removal for a pending action must be filed within 90 days of the filing of the bankruptcy petition.

Under § 1452(a), therefore, any party named in a state court action could remove the action, or any claim asserted therein, as of right to the federal district court in which the action is pending provided that a bankruptcy court could have jurisdiction over that action as a non-core matter related to a bankruptcy case. Unlike the federal removal statute (28 U.S.C. § 1441), the bankruptcy removal statute provides for the removal of individual claims (not just actions) by any party (not just the defendants).

Thus, there is no need for all defendants to consent to the removal. Creasy v. Coleman Furniture Corp., 736 F.2d 656, 660-61 (4th Cir. 1985).

Upon removal to federal district court, the action would be automatically referred to the bankruptcy court if the related bankruptcy case is pending in that same district. If the action is pending in another district, upon removal, the district court would likely either transfer venue to the district in which the bankruptcy case is pending, or remand the matter back to state court. As to the former, 28 U.S.C. § 1409(a) (venue of adversary proceedings) clearly provides that the district in which the bankruptcy case is pending is an appropriate venue for an action once removed. Similarly, 28 U.S.C. § 1412 (change of venue) provides that a district court may change the venue of an adversary proceeding to any other district "in the interest of justice or for the convenience of the parties." If transferred to the same district in which the bankruptcy case is pending, the action will be automatically referred to the bankruptcy court and treated as an adversary proceeding under Part VII of the Bankruptcy Rules. See Fed.R.Bankr.P. 9027(e) and (g).

Absent a transfer of venue under 28 U.S.C. § 1452(b), the federal court could remand a removed action back to state court. The standard for remand as provided in § 1452(b) is "any equitable ground." The types of considerations which are generally included within this rather amorphous and wholly discretionary standard include: (i) judicial economy; (ii) federal/state comity and respect for state law and state courts; (iii) the predominance of state law issues and non-debtor parties; (iv) the nexus of the removed action to the administration of the bankruptcy case; (v) the effect of remand upon the pending bankruptcy case; and (vi) the prejudice to the other parties to the action. See Western Helicopters, Inc. v. Hiller Aviation, Inc., 97 B.R. 1 (E.D. Cal. 1988). Obviously, as to most actions, arguments can often be made on both sides concerning the appropriateness of a remand.

E. Bankruptcy Court Jurisdiction Over Wrongful Death and Personal Injury Claims

Under 28 U.S.C. § 157(b)(5), all personal injury claims asserted in a bankruptcy case must be tried by the United States district courts. Such claims may be "referred" to the bankruptcy court for purposes of liquidation, but if the claims are to be tried, then the reference is withdrawn to the district court. In the district court trial, the personal injury or wrongful death claimant will retain the right to a jury trial, notwithstanding having filed a proof of claim in the bankruptcy proceedings which is normally viewed as a waiver of any jury trial rights. See 28 U.S.C. § 1411. This means that bankruptcy courts are generally without authority to enter final orders regarding personal injury tort and wrongful death claims.

Alternatively, the bankruptcy court can vacate the automatic stay and allow personal injury claims against a debtor/insured to be tried in the state courts. However, the bankruptcy court cannot itself conduct a personal injury trial.

The district court for the district in which the debtor's bankruptcy case is pending is authorized to determine the venue for all personal injury or wrongful death claims against the debtor. The district court may either retain the claims for trial or transfer venue to the district in which the claim arose. 28 U.S.C. § 157(b)(5). Several circuit courts in mass tort bankruptcy cases have entered decisions favoring the centralization of all personal injury trials in the district in which the bankruptcy case is pending, even if those trials will include non-debtor co-defendants. See A.H. Robbins v. Piccinin, 788 F.2d 994 (1986); In re Dow Corning Corp., 86 F.3d 482 (6th Cir. 1996) and 113 F.3d 565 (6th Cir. 1997). Frequently, however, personal injury or wrongful death claims against a debtor are permitted to proceed in state court upon a lifting of the automatic stay, especially where the debtor has insurance providing coverage for the claim.

VI. SETTLEMENT OF DISPUTES IN BANKRUPTCY

Even if the bankruptcy court lifts the automatic stay to allow a pending state court action to continue, any settlement of that action may still require the approval of the bankruptcy court before it can become final.

A. The Rule 9019(a) Settlement Motion

There are essentially two ways to have a settlement with a debtor in bankruptcy approved by the bankruptcy court. The first way is through a motion on notice to all creditors under Bankruptcy Rule 9019(a). Generally, only a debtor-in-possession or a trustee has standing to bring a Rule 9019(a) motion. Obviously, this means that in order to utilize Bankruptcy Rule 9019(a), the party must reach a settlement which includes either the debtor or a trustee appointed for the debtor. Generally, a settlement approved pursuant to a Rule 9019(a) motion will be binding upon all parties receiving notice of the motion. See In re Lift Equipment Service, Inc., 816 F.2d 1013, 1018 (5th Cir. 1987) (creditor was bound by settlement approved by bankruptcy court after notice and a hearing); 10 Collier on Bankruptcy, ¶ 9019.02, at p. 9019-5 (15th Ed. Rev. 1997) ("A compromise effected with the approval of the court is conclusive on the parties and on the creditors of the estate as well."). Accordingly, a settlement which encompasses the debtor and is approved by the bankruptcy court will provide a measure of finality to the settling parties.

Additionally, at least one circuit has held that a bankruptcy court is empowered under 11 U.S.C. § 105(a) and Bankruptcy Rule 9019(a) to enter an injunction in connection with the approval of a settlement of an action between the debtor and one of several co-defendants (funded with the proceeds of the settling defendant's professional liability insurance policy), which precluded the non-settling co-defendants from pursuing contribution or indemnification claims against the settling defendant. See Matter of Munford, Inc., 97 F.3d 449 (11th Cir. 1996). Critical to this holding was the fact that the settlement contained a dollar-for-dollar reduction of the settlement amount from any future judgment obtained by the debtor against the non-settling co-defendants. Id. at 455. Any settlement approved by a bankruptcy court could thus be forced upon other parties and even non-parties to the litigation.

B. Settlements Incorporated into a Confirmed Plan of Reorganization

The second way to obtain approval of a settlement in bankruptcy is through the confirmation of a plan of reorganization. Bankruptcy Code § 1123(b)(3) provides that a plan may include "the settlement or adjustment of any claim or interest belonging to the debtor or to the estate ...." Upon confirmation by the bankruptcy court, Bankruptcy Code § 1141(a) provides that the plan will be binding upon the debtor, any entity acquiring property under the plan, and any creditor, regardless of whether the creditor's claim is impaired under the plan, and regardless of whether the creditor voted in favor of the plan. Thus, it is well settled that an order confirming a Chapter 11 plan is entitled to res judicata effect. See, e.g., Sure-Snap Corp. v. State Street Bank & Trust Co., 948 F.2d 869, 873-75 (2d Cir. 1991); Matter of Howe, 913 F.2d 1138, 1143-47 (5th Cir. 1990). Again, the approval of a litigation settlement through a confirmed plan should provide the parties with a reasonable degree of finality.

C. The Standard for Approving a Bankruptcy Settlement

The standard for approving a settlement, either in a confirmed Chapter 11 plan or in a stand-alone Rule 9019 motion, is whether the settlement is "fair and equitable" and in the best interests of the estate. The decision to approve the settlement rests within the sound discretion of the bankruptcy court. See In re Texaco, Inc., 84 B.R. 893 (S.D.N.Y. 1985). To determine whether a proposed settlement is fair and equitable, a bankruptcy court is expected to inform itself of all facts necessary for an intelligent and objective decision on the matter. See Protective Committee for Independent Stockholders of TMT Trailer Ferry, Inc. v. Anderson, 390 U.S. 414, 424-25 (1968). In doing so, the bankruptcy court considers the complexity of the litigation and all other factors essential to making an informed decision as to the wisdom of the proposed settlement. Id. at 424.

In deciding whether to approve a settlement, a court will usually consider five factors affecting the litigation, namely, (i) the likelihood of success of the litigation, (ii) the difficulties associated with collection, (iii) the complexity of the litigation, (iv) the expense and inconvenience of attending to the litigation, and (v) the creditors' interests. Id. at 424-25. In short, the bankruptcy court determines whether the settlement is reasonable under the circumstances.

Generally, it is presumed that the bankruptcy court has considered all relevant factors in approving or denying a proposed settlement. An approved bankruptcy settlement, therefore, is generally entitled to the same status as a final judgment on the merits and is thus entitled to res judicata effect. In re Medomak Canning, 922 F.2d 895, 900 (1st Cir. 1991). "Under res judicata, a final judgment on the merits precludes the parties or their privies from relitigating issues that were or could have been raised in that action." Allen v. McCurry, 449 U.S. 90, 94 (1980) (emphasis added). Such an order is binding and enforceable as a matter of law, and may have the effect of precluding other claims involving a debtor pending in state courts.

VII. CONCLUSION

When a party to a state court litigation files for bankruptcy, there are a multitude of potential impacts which can occur in that litigation as a result of the bankruptcy filing. Aside for the immediate impact of the automatic stay, any number of things can happen. The automatic stay may be lifted for cause and the action allowed to continue in state court. The debtor defendant may be granted a discharge thereby bringing the state court action to its end, or the debtor may be denied a discharge or have its bankruptcy case dismissed in which case the state court action will be revived. The action may also be removed to bankruptcy court as to the remaining non-debtor parties, and possibly remanded back to the state court on abstention grounds. Or the action may remain in state court and nevertheless be stayed as to both debtor and non-debtor parties. If the action had not yet been commenced as of the bankruptcy filing, the bankruptcy may have an impact on whether or not the claims asserted are time barred. Given that almost 1.5 million bankruptcy cases are filed nationally each year, invariably bankruptcy issues are bound to appear in state court litigation. A working knowledge of the fundamental bankruptcy concepts, therefore, is not only helpful, it is practically essential for today's judges and lawyers.

About the Author:

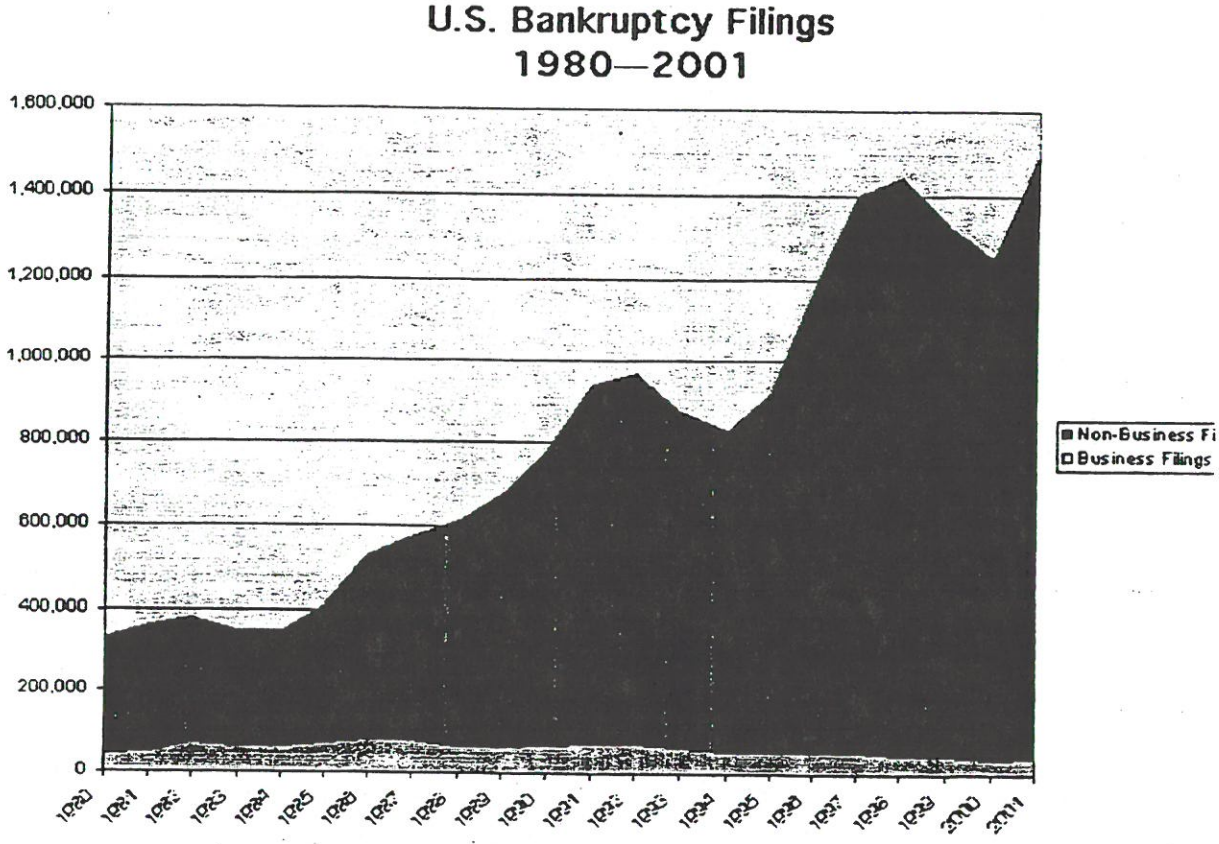
Mark G. Ledwin is a resident partner in the White Plains, New York office of Wilson, Elser, Moskowitz, Edelman & Dicker LLP. Mark practices in the general areas of bankruptcy, creditors' rights and commercial litigation. He also specializes in the litigation and resolution of insurance disputes in the bankruptcy courts, including bankruptcy cases involving environmental, mass tort and directors and officers liabilities. Mark also has experience with insurance company insolvency, rehabilitation and liquidation proceedings.

Mark received his J.D. degree, with high distinction, from Ohio Northern University, where he also served as an associate editor of the law review. He is a former law clerk to the Honorable George E. Woods of the United States District Court for the Eastern District of Michigan, and has been with Wilson Elser for the past eleven years. Mark is admitted to practice in all federal and state courts in New York, and frequently appears in bankruptcy and other actions pending in courts across the country.

Mark is the author of several articles discussing bankruptcy and insurance issues, including: *The Treatment of Retrospectively Rated Insurance Policies in Bankruptcy*, Vol. 16, No. 1 of the Bankruptcy Developments Journal of Emory University; and *An Overview of the Impact of Bankruptcy on a Directors and Officers Insurance Policy*, Professional Liability Underwriting Society (PLUS) Journal, December 2001 and January 2002. Mark also frequently lectures on bankruptcy issues.

Mark is most honored to be invited as a participant in the 2002 New York Judicial Seminar.

Mark G. Ledwin, Esq.
WILSON, ELSER, MOSKOWITZ, EDELMAN & DICKER LLP
3 Gannett Drive
White Plains, New York 10604
Tel: (914) 323-7000
Fax: (914) 323-7001
E-mail: LedwinM@wemed.com


U.S. Bankruptcy Filings
1980—2001
1,600,000
1,400,000
1,200,000
1,000,000
800,000
600,000
400,000
200,000
0
Non-Business Fi
Business Filings

U.S. Bankruptcy Filings 1980-2001 (Business, Non-Business, Total)

ABI World

Year	Totals Filings	Business Filings	Non-Business Filings	Consumer Filings as a Percentage of Total Filings
1980	331,264	43,694	287,570	86.81%
1981	363,943	48,125	315,818	86.78%
1982	380,251	69,300	310,951	81.78%
1983	348,880	62,436	286,444	82.10%
1984	348,521	64,004	284,517	81.64%
1985	412,510	71,277	341,233	82.72%
1986	530,438	81,235	449,203	84.69%
1987	577,999	82,446	495,553	85.74%
1988	613,465	63,853	549,612	89.59%
1989	679,461	63,235	616,226	90.69%
1990	782,960	64,853	718,107	91.72%
1991	943,987	71,549	872,438	92.42%
1992	971,517	70,643	900,874	92.73%
1993	875,202	62,304	812,898	92.88%
1994	832,829	52,374	780,455	93.71%
1995	926,601	51,959	874,642	94.39%
1996	1,178,555	53,549	1,125,006	95.46%
1997	1,404,145	54,027	1,350,118	96.15%
1998	1,442,549	44,367	1,398,182	96.92%
1999	1,319,465	44,367	1,281,581	97.12%
2000	1,253,444	35,472	1,217,972	97.17%
2001	1,492,129	40,099	1,452,030	97.31%

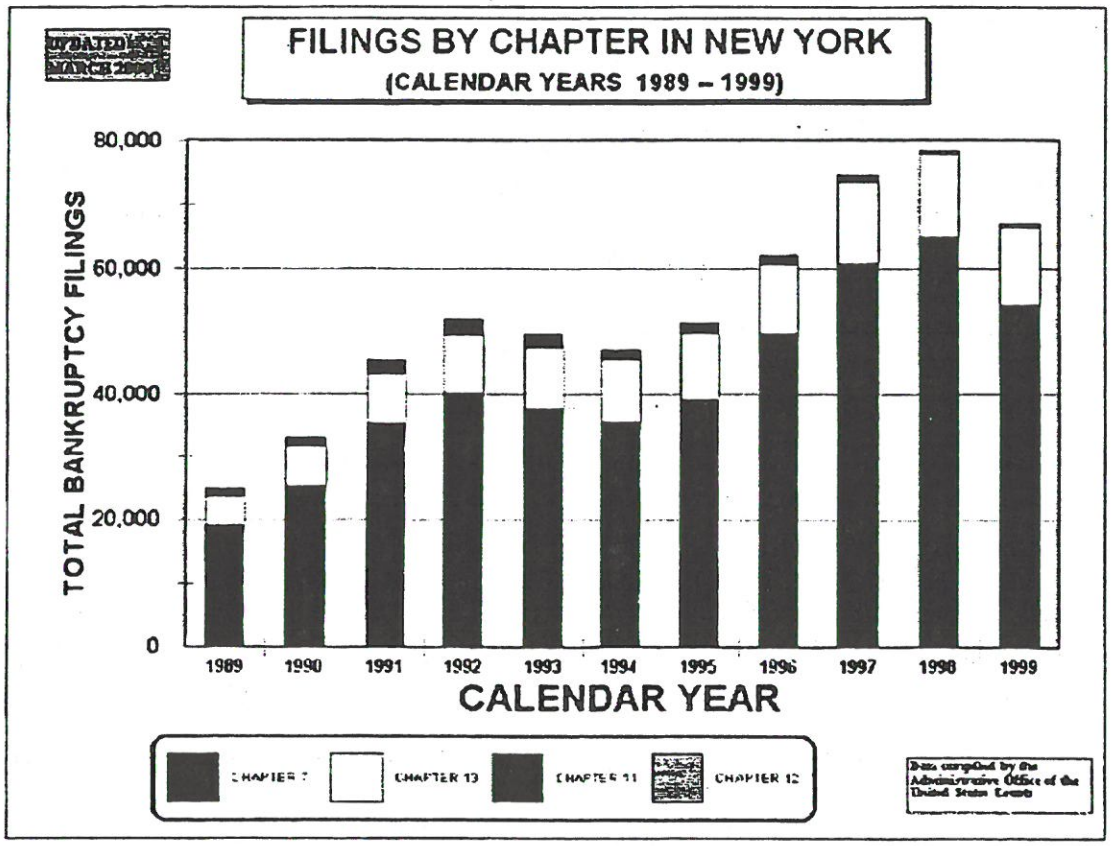
Annual U.S. Bankruptcy Filings by State 2000 - 2001

ABI World

	2000				2001			
State Code	Total Filings	Business Filings	Non-Business Filings	Percent Consumer	Total Filings	Business Filings	Non-Business Filings	Percent Consumer
AK	1,419	118	1,301	91.68%	1,473	104	1,369	92.93%
AL	38,849	428	38,421	98.89%	38,849	428	38,421	98.89%
AR	16,784	261	16,523	98.44%	21,484	290	21,194	98.65%
AZ	20,955	765	20,190	96.35%	25,489	753	24,736	97.04%
CA	142,719	4,595	138,124	96.78%	153,659	5,238	148,421	96.59%
CO	15,558	373	15,185	97.60%	18,800	467	18,333	97.51%
CT	10,643	139	10,504	98.69%	11,613	156	11,457	98.65%
DC	2,346	58	2,288	97.53%	2,559	49	2,510	98.08%
DE	4,695	2,320	2,375	50.59%	4,259	1,374	2,885	67.73%
FL	72,731	1,447	71,284	98.01%	87,112	1,896	85,216	97.82%
GA	59,927	1,012	58,915	98.31%	70,095	1,162	68,933	98.34%
GU	155	31	124	80.00%	288	27	261	90.62%
HI	4,549	63	4,486	98.62%	5,039	68	4,971	98.65%
IA	8,293	214	8,079	97.42%	11,076	289	10,787	97.39%
ID	7,119	269	6,850	96.22%	8,265	303	7,962	96.33%
IL	61,162	1,270	59,892	97.92%	74,583	1,547	73,036	97.92%
IN	37,524	398	37,126	98.94%	48,066	604	47,462	98.74%
KS	11,315	169	11,146	98.51%	13,937	220	13,717	98.42%
KY	21,018	355	20,663	98.31%	26,183	474	25,709	98.18%
LA	23,135	619	22,516	97.32%	27,019	716	26,303	97.35%
MA	15,601	393	15,208	97.48%	17,654	427	17,227	97.58%
MD	30,335	677	29,658	97.77%	35,388	758	34,630	97.85%
ME	4,042	162	3,880	95.99%	4,548	151	4,397	96.67%
MI	36,412	577	35,835	98.42%	46,826	688	46,136	98.52%
MN	15,314	1,492	13,822	90.26%	8,660	620	8,040	92.84%
MO	26,020	369	25,651	98.58%	30,704	505	30,199	98.35%
MS	18,458	203	18,255	98.90%	22,116	289	21,827	98.69%
MT	3,336	141	3,195	95.77%	4,002	149	3,853	96.27%
NC	27,091	445	26,646	98.36%	33,712	613	33,009	98.18%
ND	1,933	92	1,841	95.24%	2,232	115	2,117	94.84%
NE	5,629	115	5,514	97.96%	7,702	144	7,058	91.63%
NH	3,615	302	3,313	91.65%	3,931	334	3,597	99.50%
NJ	37,305	660	36,645	98.23%	41,484	730	40,754	98.24%
NM	7,032	513	6,519	92.70%	8,660	620	8,040	92.84%
NMI	15	6	9	60.00%	26	8	18	69.23%
NV	14,010	332	13,678	97.63%	18,102	419	17,683	97.68%
NY	59,170	1,960	57,210	96.69%	69,060	2,432	66,628	96.47%
OH	54,184	1,471	52,713	97.29%	71,086	1,794	69,292	97.47%

OK	19,279	876	18,403	95.46%	23,504	941	22,563	95.99%
OR	18,227	1,453	16,774	92.03%	23,038	1,389	21,649	93.97%
PA	43,970	1,455	42,515	96.69%	51,938	1,541	50,397	97.03%
PR	14,919	209	14,710	98.60%	14,346	333	14,013	97.67%
RI	4,457	74	4,383	98.34%	4,883	64	4,819	98.68%
SC	11,958	138	11,820	98.85%	14,149	147	14,002	98.96%
SD	2,706	164	2,542	93.93%	2,706	164	2,542	93.93%
TN	49,236	641	48,595	98.70%	60,340	886	59,454	98.53%
TX	62,121	2,592	59,529	95.83%	77,021	3,155	58,056	75.37%
UT	15,192	451	14,741	97.03%	19,411	475	18,936	97.55%
VA	36,191	815	35,376	97.75%	51,986	1,246	50,800	97.71%
VI	56	7	49	87.50%	65	12	53	81.53%
VT	1,492	71	1,421	95.24%	1,748	97	1,651	94.45%
WA	31,131	717	30,414	97.70%	37,135	642	36,493	98.22%
WI	17,849	685	17,164	96.16%	22,081	734	21,347	96.67%
WV	8,646	277	8,369	96.80%	10,223	322	9,901	96.85%
WY	2,078	47	2,031	97.74%	2,493	45	2,448	98.19%

United States Trustee Program
Bankruptcy Filings



This bar chart shows filings in New York by chapter for calendar years 1989 through 1999. Nearly all of the bankruptcy cases in the state are filed under chapter 7 or chapter 13.

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Page Last Updated on Wed., April 19, 2000

SUPREME COURT OF THE STATE OF NEW YORK
NEW YORK COUNTY

IN RE: NEW YORK CITY
ASBESTOS LITIGATION

ANTHONY TANCREDI and CONSTANCE TANCREDI,

Plaintiffs,

-against-

A.C.&S., Inc., et al.,

Defendants.

Index No. 120136/00

IAS Part 39
(Freedman, J)

HELEN E. FREEDMAN, J.:

These motions and cross-motion seeking declaratory relief[1] in four asbestos-related personal injury and wrongful death lawsuits[2] raise a critical issue about judgment molding[3] that affects not only these four actions, but the tens of thousands of cases now pending before me in the New York City Asbestos Litigation ("NYCAL").[4] The question is whether, under Article 16

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[1]Moving for summary judgment, the parties in essence ask for declarations to issue. But the pleadings do not contain any claims for declaratory relief. Pursuant to CPLR § 103(c), however, the pleadings are deemed amended so as to set forth such claims. *See infra* pp. 6-7.

[2] *Mazura v. ACandS, Inc.*, index no. 113954/01 (Sup. Ct. N.Y. Co.), *Tancredi v. ACandS, Inc.*, index no. 120136/00 (Sup. Ct. N.Y. Co.), *Lopez v. ACandS, Inc.*, index no. 120594/00 (Sup. Ct. N.Y. Co.), and *Powers v. ACandS, Inc.*, index no.119824/01 (Sup. Ct. N.Y. Co.) The motions in these actions are consolidated for joint disposition.

[3]The cross-motion by plaintiffs raises a corollary issue that only applies to product liability actions, and shall be addressed after the main issue. *See infra* p. 16.

[4]The NYCAL parties estimate that there are now about 30,000 filed cases before me. An exact figure is unavailable, because our courts have no information about the subject matter of a given case until the plaintiff files a Request for Judicial Intervention ("RJI"). As of October 18, 2002, there were 1,607 cases on the NYCAL docket. But pursuant to the Case Management Order governing NYCAL (the "CMO"), plaintiffs are not required to file RJI's for most filed

of the CPLR, a solvent tortfeasor in a personal-injury or wrongful death lawsuit whose percentage of fault is less than fifty percent must absorb the liability for non-economic losses of a tortfeasor that has filed for bankruptcy.

Statutory Framework

Article 16, enacted in 1986, partially abrogates New York's common-law, under which any joint tortfeasor, whatever its share of fault, could be held jointly and severally liable for the entire judgment. *Rangolan v. Co. of Nassau*, 96 N.Y.2d 42, 46 (2001). The statute, CPLR 1601(1), limits a joint tortfeasor's liability for the plaintiff's noneconomic losses to its proportionate share, provided that the tortfeasor is found 50% or less at fault. If a defendant is found more than 50% culpable, however, it cannot benefit from the statute and remains liable as a joint and several tortfeasor.[5]

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cases until just before they are clustered and assigned.

Given the importance of these motions for all NYCAL litigants, the Court invited interested non-parties to submit *amicus curaie* briefs. On behalf of the moving defendants, non-parties Minnesota Mining & Manufacturing, the New York State Trial Lawyers Association, and (jointly) Conrail, CSX, NS, and American Premier Underwriters submitted papers. Congoleum Corp. and Tishman Liquidating Corp, who are defendants in other asbestos lawsuits, but not the four under consideration, purportedly "moved' in their cases, without filing formal motions, for the same relief that moving defendants seek; the Court will deem their papers as *amicus curaie* briefs for these motions. On behalf of plaintiffs, the law firms of Weitz & Luxenberg, Wilentz, Goldman & Spitzer, Levy Phillips & Konigsberg, LLP, and Early & Strauss submitted briefs.

[5]An illustration: In a personal injury action, it is found that Defendant A is 30% at fault and Defendant B is 70% at fault for the plaintiff's non-economic loss of $ 100,000. Under Article 16, Defendant A, whose share of fault is less than fifty percent, is liable for no more than $30,000 of the loss (30% of $ 100,000), while Defendant B, whose share exceeds 50 percent, is liable for the entire $ 100,000.

The first proviso in CPLR 1601(1)[6] states that, if a plaintiff in an action can prove that it could not with due diligence obtain jurisdiction over a tortfeasor and join it as a defendant, then that non-party tortfeasor's share of fault will not be considered when calculating the party-defendants' percentages of fault under Article 16.[7]

Issue and Contentions

The issue here is whether, under the CPLR 1601(1) proviso, a plaintiff is "unable to obtain jurisdiction" over a tortfeasor simply because it has filed for bankruptcy, triggering the automatic stay of prosecution under 11 USC § 362(a). Defendants contend that, as a matter of law, a bankruptcy filing by a tortfeasor does not divest a plaintiff of jurisdiction that it might otherwise obtain over the bankrupt, and accordingly the bankrupt's share of fault should be

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[6]The second proviso in the statute applies to actions that implicate the Workers' Compensation Law; it is irrelevant here.

[7]"[T]he culpable conduct of any person not a party to [an] action shall not be considered in determining any equitable share [pursuant to CPLR 1601(1)] if the claimant proves that with due diligence he or she was unable to obtain jurisdiction over such person in said action ...."

Another illustration: Plaintiff P sues tortfeasors A and B in a personal injury action. P also diligently tries to join tortfeasor C, a non-domiciliary of New York, but is unable to obtain jurisdiction over C. P is found to have non-economic damages of $ 100,000. As to liability, defendant A is found to be 30% at fault, defendant B to be 50% at fault, and non-party C to be 20% at fault. A's and B's liability to P is calculated as follows: pursuant to the proviso in CPLR(1601(1), C's share of the total fault (20%) is not considered in determining A's and B's liability shares. Deducting 20% from 100% leaves 80%, which is used to determine the limit of A and B's exposure pursuant to CPLR 1601(1). Thus A's share is adjusted from 30/100 to 30/80, or 37.5%; since 37.5% is less than 50%, A's exposure is capped at 37.5% of $ 100,000, or $37,500. As for B, its share of fault is adjusted from 50/100 to 50/80, or 62.5%, which exceeds 50%; accordingly, B is jointly and severally liable for the entire $ 100,000. It is worth noting that, once the shares of culpability have been adjusted, A's exposure rises significantly (from $ 30,000 to $ 37,500), and B's exposure doubles (from $ 50,000 to $ 100,000.)

included when calculating the defendants' exposure under Article 16. Plaintiffs argue that, because the automatic stay afforded by a bankruptcy filing precludes a plaintiff from obtaining "effective jurisdiction" over the bankrupt tortfeasor, the bankrupt tortfeasor's shares should be excluded from the calculation, which will cause the culpable defendants' shares of liability to increase. If the adjustment causes a defendant's liability to rise to above fifty percent, the severally liable defendant would become jointly liable for the plaintiff's entire non-economic loss.[8]

Effect on Asbestos Litigation

This issue is relevant to any personal injury action with more than one tortfeasor, in which a bankrupt entity has been assigned liability. But its impact on asbestos litigation is especially pronounced, because of the large number of potentially culpable parties that have filed for bankruptcy. Most of these companies claim to have been driven into bankruptcy by the "elephantine mass of asbestos cases"[9] in state and federal courts throughout the country.[10]

Since 1982, at least sixty-two companies that mined asbestos, or manufactured or used asbestos-containing products, have filed for bankruptcy.[11] The bankruptcy rate is accelerating:

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[8]*See supra* n.7..

[9]*Ortiz v. Fibreboard Corp.*, 527 U.S. 815, 821 (1999).

[10]By the end of 2000, more than 600,000 people in the United States had filed claims for asbestos-related personal injuries. Stephen J. Carroll et al., *Asbestos Litig. Costs & Compen.* 40-41 (RAND Inst. for J. 2002).

[11]UNR Industries, Inc. (filed in 1982), Johns-Manville Co. (1982), Amatex Corp. (1982), Waterman Steamship Corp. (1983), Wallace & Gale Co. (1984), Forty-Eight Insulations, Inc. (1985), PACOR (1986), Prudential Lines, Inc. (1986), Standard Insulations, Inc. (1986), U.S.

The first three companies filed in 1982, followed by thirteen more in the rest of the 1980's. In the 1990's, there were eighteen filings. And since January 1, 2000, in a period of less than three years, twenty-six companies filed pursuant to Chapter 11. Carroll et al., *Asbestos Litig. Costs & Compen.* at 71.

There are noteworthy differences between the bankrupt defendants and those that are still solvent. As a group, the bankrupt corporations can be characterized as "traditional" asbestos defendants: they either mined asbestos, or manufactured, sold, distributed or required asbestos-containing products, including insulation, fireproofing, construction materials, and boilers. Until recently, these "traditional" defendants were the plaintiffs' primary targets.

Many of the remaining defendants are "downstream" users or distributors of asbestos-containing products, or manufacturers of products in which asbestos was jacketed or

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Lines (1986), Nicolet, Inc. (1987), Gatke Corp. (1987), Todd Shipyards (1987), Chemetron Corp. (1988) Raytech (1989), Delaware Insulations (1989), Celotex Corp. (1990), Hillsborough Holdings (1990), National Gypsum Co. (1990), Standard Asbestos Mfg. & Insul. (1990), Eagle-Picher (1991), H.K. Porter Co. (1991), Cassiar Mines (1992), Kentile Floors (1992), Keene Corp. (1993), American Shipbuilding, Inc. (1993), Lykes Brothers Steamship (1995), Rock Wool Mfg. (1996), SGL Carbon (1998), M.H. Detrick (1998), Brunswick Fabricators (1998), Fuller-Austin Insul. (1998), Harnischfeger Corp. (1999), Joy Technologies (1999), Rutland Fire & Clay (1999), Babcock & Wilcox (2000), Pittsburgh Corning (2000), Burns & Roe Enterprises (2000), E.J. Bartells (2000), Owens Corning (2000), Armstrong World Industries (2000), G-1 Holdings (GAF Corp.) (2001), W.R. Grace (2001), Skinner Engine Co. (2001), USG (US Gypsum) Corp. (2001), Federal Mogul (2001), Eastco Industrial Safety Corp. (2001), Washington Group Int'l, Inc. (2001), Bethlehem Steel (2001), North American Refractories (NARCO) (2002), Kaiser Aluminum (2002), Plibrico Refractories (2002), Porter-Hayden (2002), American Club (2002), Huxley Development Corp. (2002), Harbison-Walker Refractories Co. (2002), Continental Producers Corp. (2002), A.P. Green Indus. (2002), Shook & Fletcher (2002), Atra Group, Inc. (Synkoloid) (2002), and ACandS, Inc. (2002).

All these corporations filed bankruptcy petitions indicating that asbestos litigation was the primary cause of their insolvency. Carroll et al., *Asbestos Litig. Costs & Compen.* at 71.

encapsulated.[12] These defendants include premises owners, heavy and light equipment manufacturers (whose products incorporated some asbestos), brake, gasket, and sealant manufacturers, and general construction contractors. For example, moving defendant American Standard, Inc. manufactured boilers for use in buildings that required asbestos insulation or contained jacketed asbestos, joint movants Ford Motor Co., Inc., DaimlerChrysler Corp., and General Motors Corp. made and sold vehicle brakes, moving defendant Treadwell Corp. was a general construction contractor, and *amicus curaie* Congoleum Corporation manufactured floor tiles.

In asbestos litigation, the bankrupt tortfeasors' shares of liability, which the plaintiffs claim that the solvent defendants must absorb, can comprise much or most of a large verdict. For example: In August 1993, multi-million dollar verdicts were returned in four consolidated cases, in which the plaintiffs were exposed to asbestos-containing pipe covering, cement, spray and tile in the 1940s and 1950s. Fault percentages were apportioned among the tortfeasors. If the four cases were decided today, the percentages attributable to now-bankrupt defendants would be 45% (of non–economic damages of $ 11.3 million), 67% (of $ 14 million), 74% (of $ 4.4 million), and 74% (of $ 8.2 million). *See In re N.Y. Asbestos Litig.*, 847 F.Supp. 1086, 1116, 1118, 1120, 1124-25, 1128, 1131, 1134 & 1137 (S.D.N.Y. 1994).

Nature of Relief Sought

Before the merits are reached, two threshold matters need to be addressed. First, the

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[12]It is claimed by certain defendants that, in some of these products, the asbestos was encapsulated or otherwise contained so as to emit relatively few respirable asbestos fibers under normal use.

nature of the relief sought here must be clarified. By these motions and cross-motions, the parties raise only a question of law. They ask this Court to construe Article 16, because they want to establish the extent to which the solvent defendants may be liable to the plaintiffs before verdicts are rendered. In other words, the parties seek an advance declaratory judgment interpreting the statute. *See Morgenthau v. Erlbaum*, 59 N.Y.2d 143, 150 (1983) (noting that declaratory judgment is "an appropriate vehicle" for statutory construction.).

But the parties do not assert any claims for declaratory relief in their affirmative pleadings; they only seek coercive relief. However, they plead general allegations and defenses about how Article 16 applies to the cases, pursuant to CPLR 1603: the complaints include allegations that defendants are jointly and severally liable because Article 16 exemptions apply, and the answers include defenses denying that exemptions apply and alleging that the defendants may take advantage of the limited liability rule.

Under these circumstances, pursuant to CPLR 103(c) any defects of form in the pleadings will be disregarded, and the parties are deemed to seek declaratory as well as coercive relief. This will not prejudice the parties, who have proceeded as if the actions sought declaratory relief, and who fully briefed the issues at hand. Moreover, all the parties to the NYCAL were given full opportunity to appear on behalf of these motions. *See supra* n. 4.

Accordingly, the pleadings are deemed amended so as to set forth the claims for declaratory relief that are addressed here.

Ripeness

The second threshold issue is whether these motions are premature. Plaintiffs contend

that they are not ripe for determination because a verdict has not been rendered in any of the four cases. Until both the movants and non-party bankrupts are found liable for a plaintiff's non-economic injuries, according to plaintiffs, the issue raised in these motions will not affect the parties. Plaintiffs also note that a declaration that bankrupt tortfeasors' shares are to be included when calculating a plaintiff's liability under Article 16 would not affect what a plaintiff could recover from a moving defendant if (a) the defendant has been found more than 50% culpable, and thus unable to benefit from CPLR § 1601(1), or (b) the defendant cannot benefit from Article 16 because it falls within one of the exclusions set forth in CPLR 1602. Under the present circumstances, plaintiffs argue, if this Court were to determine the legal issue that defendants' raise in their motions, the Court would improperly be issuing an advisory opinion on a matter that may never occur. *See Cuomo v. Long Island Lighting Co.*, 71 N.Y.2d 349, 354 (1988).

But plaintiffs fail to acknowledge that, whether or not a verdict is ever rendered in the four cases at hand, a declaration at this time that fixes the parties' rights under Article 16 will very likely have an immediate and powerful effect on the plaintiffs and defendants as they weigh the risks and benefits of litigating these four cases, as well as the entire docket of asbestos personal-injury lawsuits statewide. A court may in its discretion render a declaratory judgment to stabilize "the rights and legal relations of the parties to a justiciable controversy that involves substantial legal interests, when ... the judgment will have some practical effect." *Goodman v. Reisch*, 220 A.D.2d 383, 384 (2d Dept. 1995); *see also James v. Alderton Dock Yards, Ltd.*, 256 N.Y. 298, 305 (1931) (stating that "[t]he general purpose of the declaratory judgment is to serve some practical end in quieting or stabilizing an uncertain or disputed legal relation either as to present or prospective obligations.") In general, a declaratory judgment is not ripe for

determination if any declaration that the court might issue will only take effect if a future event, that may or may not occur, actually comes to pass. *See Prashker v. U.S. Guar. Co.*, 1 N.Y.2d 584, 596 (1956). However, "[w]here the probability of occurrence of the contingent event is great" or a declaration "may have an immediate and direct impact on the parties' conduct," declaratory relief is appropriate. *Remsen Apartments, Inc. v. Nayman*, 89 A.D.2d 1014, 1015 (2d Dept. 1982), *aff'd*, 58 N.Y.2d 1083 (1983).

In *Remsen Apartments, Inc.*, a lessee of apartment units in a residential premises brought a declaratory judgment action against the lessor, to declare the parties' rights under their lease agreement with respect to the planned conversion of the premises to co-operative ownership. The lessor counterclaimed, also for declaratory relief: among other things, the lessor sought a declaration that certain payments and stock that the lesee might receive in connection with the conversion constituted "gross income" under the lease, thereby increasing the lessee's rent. The trial court dismissed the counterclaim, apparently on the ground that the conversion had not occurred because, among other things, the Attorney General had not yet approved the conversion plan. *Remsen Apartments, Inc.*, 89 A.D.2d at 1014-15.

The Appellate Court found that the trial court should have issued a declaratory judgment with respect to the counterclaim. The Court acknowledged that the lessee would only be required to make additional payment to the lessor under paragraph 38 of the lease if (1) the Attorney-General approved the co-operative conversion and (2) the lessee thereafter sold co-operative units. But, the Court found, a declaration of the parties rights under paragraph 38 would not constitute an advisory opinion, because "[t]here can be little doubt that the conduct of [the lessee] would be affected by knowledge of whether it must share with [the lessor] any of the conversion

proceeds." *Id.* at 1015. If a declaration was issued before a conversion, the *Remsen* Court implied, the lessee could better decide whether investing in the conversion was a sound business decision. *Id.*

Likewise, in these cases a pre-verdict declaration that construed the proviso in CPLR 1601(1) will immediately affect the parties' conduct. It would allow them to more accurately gauge the plaintiffs' possible recovery and the defendants' possible exposure, which in turn will improve their ability to weigh the economic risks and benefits of litigating versus settling. For these reasons, the time is ripe for a declaratory judgment.

Motions re: CPLR 1601(1)

Until recently, the major decision addressing how bankrupt tortfeasors are treated under CPLR Article 16 was issued by the United States Court of Appeals for the Second Circuit. *In re Brooklyn Navy Yard Asbestos Litig.*, 971 F.2d 831 (2d Cir. 1992), *affirming In re E. & S. Dists. Asbestos Litig.*, 772 F.Supp. 1380 (E. & S.D.N.Y. 1991). The Second Circuit construed "jurisdiction" in CPLR 1601(1) to mean "effective jurisdiction" and held that the plaintiffs could not obtain "effective jurisdiction" over the bankrupt tortfeasors because they were precluded from continuing actions or processing claims against the bankrupts. For that reason, the Court concluded, the bankrupts' shares were excluded from the CPLR Article 16 calculation. *In re Brooklyn Navy Yard Asbestos Litig.*, 971 F.2d at 846; *see also In re N.Y.C. Asbestos Litig.*, 175 Misc.2d 819, 823-24 (Sup. Ct. N.Y. Co. 1998) (following Second Circuit decision).

The Second Circuit acknowledged that the plaintiffs could obtain "jurisdiction" over the

bankrupts.[13] But the Court interpreted "jurisdiction" in CPLR 1601(1) to mean "effective jurisdiction" because of its concern that joinder would be futile. *In re Brooklyn Navy Yard Litig.*, 971 F.2d at 846. In so doing, the Court created an additional category of defendants to whom the proviso applied, and carved out a variance in Article 16 that the Legislature had not prescribed.

The federal courts' construction no longer controls because of recent New York State case law. The Court of Appeals has stated that the general legislative intent of Article 16 is "to remedy the inequities created by joint and several liability on low-fault, 'deep pocket' defendants." *Rangolan v. Co. of Nassau*, 96 N.Y.2d 42, 46 (2001). The statute is the result of "a painstaking balance of interests" by the Legislature and addresses the concerns both of "innocent plaintiffs" and low-fault defendants who "were consistently paying a disproportionate share of damage awards." *Morales v. Co. of Nassau*, 94 N.Y.2d 218, 224; *see also Chianese v. Meier*, 98 N.Y.2d 270, 276 (2002) (in interpreting Article 16, courts' role "is to implement the will of the Legislature.") To further this balancing of interests, the Legislature set forth provisos and exceptions in CPLR 1601 & 1602 that either exempt certain parties and actions from Article 16's modified rule of joint and several liability, or vary the rule. *Id.* When the Legislature has not chosen to include an exemption or variance in the statute, the courts may not create one to address public policy or equitable concerns. *Id.* at 221 (rejecting court-made Article 16 exemption for domestic violence cases and orders of protection as "an entirely new exemption that is not suggested by the language of the statute or its history"); *see also Washington v. N.Y.C.*, 160 Misc.2d 230, 231-32 (Sup. Ct. Bronx Co. 1994) (declining to create exemption favoring

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[13] *In re Brooklyn Navy Yard Asbestos Litig.*, 971 F.2d at 846 ("As a technical matter entities which have filed bankruptcy are subject to suit....")

plaintiff, who could not recover against an insolvent tortfeasor found 80% liable, because "equitable considerations simply have no standing in the interpretation of article 16.").

In a recent decision, *Kharmah v. Metro. Chiropractic Ctr.*, 288 A.D.2d 94 (1st Dept. 2001), the First Department specifically addressed how the liability shares of bankrupt tortfeasors are treated under Article 16. In *Kharmah*, the plaintiff brought claims for medical malpractice against a chiropractic clinic and an individual chiropractor (the "Chiropractic Defendants"), and a hospital and three doctors (the "Medical Defendants"). After discovery concluded but before the trial began, the Chiropractic Defendants filed for Chapter 7 bankruptcy protection. To continue the action against the Medical Defendants, plaintiff moved for an order severing the action against the Chiropractic Defendants. Over defendants' opposition, the IAS Court granted the motion. *Id.* at 94. Sometime after the severance order was issued, plaintiff discontinued the action against one of the doctors.

Thereafter the remaining Medical Defendants (the "Appellants") appealed the severance, arguing among other things that severance "would substantially prejudice the rights of the remaining defendants to litigate their cross-claims against and assert their statutory equitable-share-allocation rights against [the Chiropractic Defendants]."[14] The Appellate Division affirmed the severance as "a proper exercise of discretion," but modified the trial court's severance order to preserve the Appellants' "CPLR article 16 equitable share allocation rights." *Kharmah*, 288 A.D.2d at 94. The Court stated that

> equity requires that [the Appellants] have the benefit of CPLR article 16 rights, even though there is an automatic stay by virtue of bankruptcy (*see, Duffy v. County of Chautauqua*, 225 AD 261, 267, *leave dismissed* 89 NY2d 980). In

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[14] Br. for Defs.- Appellants at 2.

> accordance with the purpose of CPLR article 16, if the [Appellants'] culpability is 50% or less, their exposure for non-economic damages should be limited proportionately to their share of fault.

Id. at 94-95.

The First Department indicated that the bankrupt Chiropractic Defendants' share of liability must be included when calculating the solvent defendants' exposure, because, within the meaning of CPLR 1601(1), the plaintiff could "obtain jurisdiction" over them. The Court cited *Duffy v. County of Chautauqua*, 225 A.D.2d 261 (4th Dept.), *appeal dismissed*, 89 N.Y.2d 980 (1996), in support of its decision. *Kharmah*, 288 A.D.2d at 94-95. In *Duffy*, two construction workers were injured and a third killed when a bridge collapsed while the three workers were driving a truck over it. Plaintiffs sued the County of Chautauqua (the "County") for negligence, who impleaded the workers' employee, G & J Construction Corp. ("G & J"), and its principal, Steven Nichols, who had been driving a 16-ton crane that was also on the bridge when it collapsed. After trial, a jury found the County 25% liable and G & J and/or Nichols 75% liable for accident. *Duffy*, 225 A.D.2d at 265-66.

The Fourth Department held that the negligence of plaintiff's decedent John Duffy, the truck's driver, could be included when apportioning the tortfeasors' liability share under CPLR 1601, although Duffy's co-worker plaintiffs were barred from suing him under the statutory "fellow servant" rule. *See* Workers' Compen. Law §§ 11, 29(6)[15]. The Court found that "the statutory bar of the Workers' Compensation Law does not constitute the inability to obtain jurisdiction as intended by CPLR 1601," because the term "jurisdiction" in CPLR 1601(1)

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[15] The *Duffy* decision preceded the addition in 1996 of the second proviso in CPLR 1601(1), *see supra* n. 6, and thus did not address it.

"refers to personal rather than to subject matter jurisdiction." *Duffy*, 225 A.D.2d at 266, 267; *cf. Rezucha v. Garlock Mech. Packing Co.*, 159 Misc.2d. 855, 860 (Sup. Ct. Broome Co. 1993) (holding that, although State of New York was immune from suit in court, plaintiff could obtain "jurisdiction" over State within the meaning of CPLR 1601(1)); *Dominguez v. Fixrammer Corp.*, 172 Misc.2d 868, 869-70 (Sup. Ct. Bronx Co. 1997) (when plaintiff had served corporate defendant which then dissolved before trial, "jurisdiction" had been obtained pursuant to Article 16). Inasmuch as Duffy's co-workers had never shown that they could not obtain personal jurisdiction over him by serving his estate, the CPLR 1601(1) proviso did not apply and "Duffy's negligence, if any, would ordinarily be a factor in apportioning liability." *Duffy*, 225 A.D.2d at 267.

The Fourth Department's construction of "jurisdiction" in CPLR 1601(1) to mean "personal jurisdiction"is technically dicta, because the Court did not need to analyze CPLR 1601(1) to reach its ultimate holding that CPLR 1602 exempted the action from apportionment under Article 16. *Duffy*, 225 A.D.2d at 267-68. But in *Kharmah*, the First Department relied upon that analysis of CPLR 1601(1) to reach its holding that the Appellants' shares were unaffected by the Chiropractic Defendants' bankruptcy, thus binding this Court.

Personal jurisdiction is unaffected by a party's bankruptcy filing and the attendant automatic stay: a bankruptcy stay merely suspends other court proceedings outside the bankruptcy proceeding, and does not divest those courts of jurisdiction over the bankrupt. *See Kleinsleep Prods. v. McCrory Corp.*, 271 A.D.2d 411, 412 (2d Dept. 2000) (automatic stay "did not deprive the court of jurisdiction over the action commenced but merely suspended the proceedings"); *Intl. Fidelity Ins. v. European Am. Bank*, 129 A.D.2d 679, 679-80 (2d Dept. 1987)

(same).

Accordingly, it is declared that "jurisdiction" in CPLR 1601(1) means "personal jurisdiction," and that the culpability of a bankrupt, non-party tortfeasor will be included when calculating the defendant-tortfeasors' exposure under CPLR 1601(1), unless the plaintiff proves that he or she with due diligence could not obtain personal jurisdiction over the bankrupt or its estate,[16] or unless an exemption set forth in CPLR 1602 applies.[17]

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[16]For example, a plaintiff may with due diligence be unable to obtain jurisdiction over a non-domiciliary of New York State if there is no basis for long-arm jurisdiction. *See* David D. Siegel, *New York Practice* § 168C, 270 (3d ed., West Group 1999).

[17]Some NYCAL defendants, as *amicus curaie,* seek a further declaration that, as a matter of law, the plaintiffs have not diligently tried to join the bankrupts. The application is denied. Whether the plaintiffs have used due diligence is at least partly an issue of fact, and no proof about plaintiff's efforts to join the bankrupts has been adduced. Moreover, the plaintiffs can still try to join the bankrupts.

Cross-motion re: CPLR 1602(10)

Plaintiffs cross-moved "for an order holding defendants jointly and severally liable" for the liability share of any bankrupt non-party asbestos manufacturer, pursuant to CPLR 1602(10). This cross-motion is deemed to be an application for a declaration construing the provision,[18] which affects several-only liability in a products liability action in a products liability action if the plaintiff is unable with due diligence to obtain "jurisdiction" over the manufacturer, and the manufacturer's liability is based on the doctrine of strict liability.[19] In that case, the party tortfeasors are jointly liable for the manufacturer's share.

In the cross-motion, plaintiffs again contend that "jurisdiction" in this provision means "effective jurisdiction," but that argument is rejected for the same as set forth above.[20] As in CPLR 1601(1), "jurisdiction" in CPLR 1602(10) refers to personal jurisdiction, *see* Vincent C. Alexander, *Prac. Commentaries* at 619, CPLR § 1602 (McKinney 1997), and jurisdiction may be obtained over a bankrupt.[21]

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[18]*See* discussion *supra* p. 6-7.

[19]"The limitation set forth in [Article 16] shall: ... not apply to any person held liable in a product liability where the manufacturer of the product is not a party to the action and the claimant establishes by a preponderance of the evidence that jurisdiction over the manufacturer could not with due diligence be obtained and that if the manufacturer were a party to the action, liability for claimant's injury would have been imposed upon said manufacturer by reason of the doctrine of strict liability, to the extent of the equitable share of such manufacturer."

[20]*See supra* pp. 10-15.

[21]A plaintiff may be unable to obtain jurisdiction under CPLR 1602(10) in other situations. *See supra* n. 16.

Conclusion

For the reasons set forth above, it is

ADJUDGED AND DECLARED that "jurisdiction" in CPLR 1601(1) refers to personal jurisdiction, and that the culpability of a bankrupt, non-party tortfeasor will be included when calculating the defendant-tortfeasors' exposure under CPLR 1601(1), unless the plaintiff proves that with due diligence he or she was unable to obtain personal jurisdiction over the bankrupt or its estate, or unless an exemption set forth in CPLR 1602 applies, and it is further

ADJUDGED AND DECLARED that "jurisdiction" in CPLR 1602(10) refers to personal jurisdiction.

Dated: October 31, 2002

HE Freedman

Helen E. Freedman, J.S.C.

BASIC BANKRUPTCY

CONRAD B. DUBERSTEIN
CHIEF BANKRUPTCY JUDGE
UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF NEW YORK

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BASIC BANKRUPTCY

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BASIC BANKRUPTCY

The first major bankruptcy law known as the Bankruptcy Act of 1898 was adopted to furnish an acceptable legal system necessary to establish and determine the rights and obligations of debtors and creditors. In 1938 major changes were incorporated in the Chandler Act which provided for new Chapters dealing with reorganization and rehabilitation known as Chapters X, XI, XII and XIII. The bankruptcy law was again amended with the enactment of the Bankruptcy Reform Act of 1978. It is the present bankruptcy law in effect and is popularly known as the Bankruptcy Code. It too underwent several major changes in 1984 with the enactment of the Bankruptcy Amendments and Federal Judgeship Act and in 1986 with the Bankruptcy Judges, U.S. Trustees and Family Farmers Bankruptcy Act, and again in 1994 with the Bankruptcy Reform Act of 1994. In order to carry out the provisions of the Code and its Amendments, a set of Bankruptcy Rules was adopted referred to as the Federal Rules of Bankruptcy Procedure. Many bankruptcy courts have also adopted Local Rules. Thus, it is necessary to look to the Code and the Rules to fully comprehend bankruptcy laws and procedure.

I. THE CHAPTERS OF THE CODE

The Code has many significant features and consists of eight Chapters set forth in Title 11 U.S.C. §§ 101 to 1330.

Chapter 1 contains provisions dealing generally with definitions, rules of construction, the applicability of the Chapters, waiver of sovereign immunity, the power of the bankruptcy court and the qualifications required of debtors for relief under the various remedies provided for by the Code, and penalties for preparers of bankruptcy petitions.

Chapter 3 deals with case administration in voluntary as well as involuntary cases. It includes sections relating to bankruptcy proceedings outside of the United States where debtors or liquidators in those cases seek to affect assets in the United States. It also sets forth sections relating to the role and capacity of those involved in the administration of the estate such as the attorneys, accountants, trustees, examiners and other professionals, as well as their compensation. Included are provisions dealing with meetings of creditors, the right of persons to claim immunity from testifying, and provisions relating to dismissal, conversion or reopening of a case. Perhaps one of the most important of the Chapter 3 provisions is § 362 which provides for the automatic stay of acts against the debtor and its property, referred to as the "automatic stay" because it is effective immediately upon the filing of the petition in bankruptcy. See XIII, B, p. 33.

This Chapter also deals with the nature of adequate protection for creditors affected by the bankruptcy, the right to the use, sale or lease of property, and provisions relating to obtaining credit and the use of cash collateral required by the debtor undergoing reorganization. It also relates to the rights and obligations arising out of executory contracts and unexpired leases affecting the debtor and those with whom it has entered into contracts, including landlords, franchisers, consultants and equipment lessors.

Chapter 5 contains sections dealing with the rights of creditors including the filing and allowance of claims, determination of the secured status of secured creditors, claims to priority in payment, and the subordination of creditors. This Chapter also sets forth the duties of the debtor, its exemptions which allow it to retain certain of its assets, exceptions to the dischargeability of debts, the effect of the bankruptcy discharge and the protection of debtors against discriminatory treatment. It also deals with the property of the estate as well as its turnover to the representative of the estate, the power of the trustee to avoid liens, fraudulent conveyances and preferential transfers, and the liability of transferees of avoided transfers. Also included is the post-petition effect of security interests, the right of set-off, abandonment of property, and provisions relating to interests in and disposition of grain and the contractual right to liquidate repurchase agreements.

Chapter 7, which is concerned with the liquidation of bankrupt estates as distinguished from their reorganization or rehabilitation, involves the most prevalent of all of the bankruptcy procedures. It includes the functions and duties of the trustee appointed or elected to administer the estate, and the dismissal or conversion of a Chapter 7 case, the rights of an individual debtor to redeem certain personal property, the order of distribution of the estate to the creditors and provisions dealing with acts which may prevent a debtor from receiving a discharge of its debts. The Chapter also contains provisions relating to liquidations of stockbrokers and commodity brokers.

Chapter 9 deals with the adjustment of debts of a municipality.

Chapter 11 contains the substantive law relating to the reorganization or rehabilitation of debtors or plans for the liquidation of their assets.

Chapter 12 deals with the adjustment of debts of certain farmers.

Chapter 13 is concerned with the adjustment of debts of individuals with regular income whose financial problems do not call for the application of Chapter 11.

II. THE BANKRUPTCY RULES

The Bankruptcy Code sets out little in the area of bankruptcy procedure. The Federal Bankruptcy Rules ("Rules") provide for various types of procedures in a bankruptcy case to obtain an order of a Bankruptcy Judge, or to obtain a result or conclusion within the case.

The Rules must be considered along with the provisions of the Code. They deal generally with the commencement of the bankruptcy case relating to the petition and order for relief (l00l-l020); notice, meetings, examinations, elections, attorneys and accountants (200l-2020); claims, distribution to creditors, and plans (300l-3022); matters relating to the debtor's

discharge and dischargeability of its debts, its duties and benefits (4001-4008); courts and clerks (5001-5011); collection and liquidation of the estate (6001-6010); adversary proceedings including many provisions of, and which track the Federal Rules of Civil Procedure, as for example, motions for summary judgment, motions to dismiss, temporary restraining motions and discovery procedure (7001-7087); appeals (8001-8020); general provisions, including those dealing with extensions or reductions of time, sanctions in line with FRCP 11, contempt, motions, contested matters and non-core procedure (9001-9036).

As has been noted above, most bankruptcy courts have adopted Local Rules which must be considered in the administration of a bankruptcy case.

III. PERTINENT JUDICIAL CODE PROVISIONS UNDER TITLES 18 AND 28 OF THE U.S. CODE

Equally important to an understanding of bankruptcy procedure are some of the sections of Title 28 of the United States Code. These include §§ 151-158 which deal with the designation of the bankruptcy court and its procedures; §§ 1334, 1408-1412 and 1452, which govern jurisdiction, venue and removal of cases; §§581-589a which relate to the United States Trustees; and §1930 which sets forth the fees for filing the various petitions for relief or required during the case or proceedings.

Title 18 of the United States Code deals with bankruptcy crimes. These are enumerated in §§ 151-157 which include concealment of assets, false oaths and claims, bribery, embezzlement by court officers or the trustee, knowing disregard of bankruptcy law or rule, and bankruptcy fraud. Also covered are RICO actions involving bankruptcy cases (§ 1961); bankruptcy investigations (§ 3507); and § 6001, dealing with the immunity of witnesses in bankruptcy cases.

IV. THE JURISDICTION OF THE DISTRICT COURT AND THE BANKRUPTCY COURT - 28 U.S.C. §§ 151-158, 1334, 11 U.S.C. 305

A. General Provisions

The district courts have original and exclusive jurisdiction of all cases under Title 11 (the Bankruptcy Code). § 1334(a). They have original but not exclusive jurisdiction of all civil proceedings arising under Title 11, or arising in or related to cases under Title 11. § 1334(b). They have jurisdiction of all of the property of the debtor wherever located. § 1334(e). The district courts have referred all such cases and proceedings set forth in § 1334(a) and (b) to the bankruptcy court. § 157(a). The bankruptcy judges constitute a unit of the district court known as the bankruptcy court. § 151. Each bankruptcy judge, as a judicial officer of the district court exercises the authority conferred with respect to any action, suit or proceeding except as otherwise provided by law or rule or order of the district court. The bankruptcy

judge is appointed by the judges of the Circuit Court of Appeals in which the bankruptcy court is located for renewable terms of 14 years, subject to good behavior. § 152.

The district court may withdraw a case or proceeding sua sponte or on motion of a party in interest, but it must withdraw a case or proceeding if resolution requires consideration of the Bankruptcy Code and the federal laws affecting interstate commerce. § 157(d). The bankruptcy court may also abstain from hearing a proceeding in the interest of comity with State courts or respect for State law. § 1334(c)(1). Upon timely motion, the court must abstain from hearing a proceeding based upon a State Law claim or State Law cause of action, related to but not arising under or in a bankruptcy case with respect to which an action could not have been commenced in a court of the United States absent jurisdiction under 28 U.S.C. 1334 if an action was commenced and can be timely adjudicated in a State forum. § 1334(c)(2). The bankruptcy court's decision not to abstain under the mandatory abstention provision of § 1334(c)(2) is reviewable by the court of appeals or the Supreme Court. It may also dismiss a case, or suspend all proceedings, if the interests of the creditors and the debtor would be better served, as for example, where an out-of-court settlement is opposed by a few recalcitrant creditors. § 305.

The Bankruptcy Reform Act of 1994 added a new subsection 28 U.S.C. § 157(e) which permits a bankruptcy judge to conduct a jury trial in proceedings over which section 28 U.S.C. 157 applies, if specially designated to exercise such jurisdiction by the district court and if all parties expressly consent.

Appeals from the decision of the bankruptcy judge are taken to the district court for determination by the district judge or to bankruptcy appellate panels which circuits are now required to establish unless the judicial council finds that there are "insufficient judicial resources" or that such panels would cause undue delay or increased cost. §158. District judges, however, must by majority vote authorize appeals to the bankruptcy appellate panel ("BAPS") in their district. At present, the First, Sixth, Eighth, Ninth and Tenth Circuits have opted to have BAPS, but not all districts within each of those circuits have established them.

Further appeals are decided by judges of the Circuit Court of Appeals. § 158(d). Final appeals are taken to the Supreme Court of the United States.

Orders increasing or decreasing the exclusivity period for filing plans of reorganization in Chapter 11 cases, which were currently treated as interlocutory appeals, may now be appealed, as of right, to the district court. 28 U.S.C. 158(a)(2).

B. "Core and "Non-Core" Proceedings - § 157(b) & (c)

Core proceedings under § 157(b) are those matters which arise under Title 11 or arise in a case under Title 11 in which the bankruptcy judge may enter final orders or judgments.

Section 157(b)(2) provides for various non-exclusive examples of core proceedings which include, but are not limited to (A) matters concerning the administration of the estate; (B) allowance or disallowance of claims against the estate or exemptions from property of the estate, and estimation of claims or interests for the purposes of confirming a plan under chapters 11, 12, or 13 but not the liquidation or estimation of contingent or unliquidated personal injury tort or wrongful death claims against the estate for purposes of distribution in a case under Title 11; (C) counterclaims by the estate against persons filing claims against the estate; (D) orders in respect to obtaining credit; (E) orders to turn over property of the estate; (F) proceedings to determine, avoid, or recover preferences; (G) motions to terminate, annul, or modify the automatic stay; (H) proceedings to determine, avoid, or recover fraudulent conveyances; (I) determinations as to the dischargeability of particular debts; (J) objections to discharges; (K) determinations of the validity, extent, or priority of liens; (M) orders approving the use or lease of property, including the use of cash collateral; (N) orders approving the sale of property other than property resulting from claims brought by the estate against persons who have not filed claims against the estate; and (O) other proceedings affecting the liquidation of the assets of the estate or the adjustment of the debtor-creditor or the equity security holder relationship, except personal injury tort or wrongful death claims.

Section 157(b)(1) authorizes the bankruptcy judge to hear and determine all cases under Title 11 and all core proceedings arising under Title 11, or arising in a case under Title 11, and enter appropriate orders and judgments, subject to appeal under § 158.

The bankruptcy judge may hear a non-core proceeding that is otherwise related to a case under Title 11, in which event the judge shall submit proposed findings of fact and conclusions of law to the district court, and any final order or judgment shall be entered by the district judge after a de novo review to which any party has timely objected. § 157(c)(1). However, the bankruptcy judge may hear, determine and enter orders and judgments with the consent of all parties, subject to appeal under § 158. § 157(c)(2).

V. THE UNITED STATES TRUSTEE - 28 U.S.C. §§ 581-589a

The Code provides for a system of United States Trustees approved by the Attorney General, supervised and assisted by the Department of Justice in all states except Alabama and North Carolina. The main duties of the United States Trustee and administrators are to monitor the cases, appoint trustees, examiners and creditors' committees, review and comment on fee applications uniformly in accordance with procedural guidelines adopted by the Executive Office of the United States Trustee, monitor and comment on Chapter 11 disclosure statements and plans, and remove administrative duties from the bankruptcy judge.

VI. THE INTERIM TRUSTEE, SUCCESSOR TRUSTEE AND ELECTED TRUSTEE - 11 U.S.C. §§ 701-704

Upon the filing of a Chapter 7 case an interim trustee is appointed by the U.S. Trustee from a panel of private trustees who must complete a questionnaire and undergo an F.B.I. investigation. While most trustees are attorneys it is not necessary for them to be so. The trustee presides over the first meeting of creditors where he conducts an examination of the debtor's affairs, reviews the schedules and statement of affairs, investigates the assets and liquidates the non-exempt assets, issues a Report of No Distribution if there are none, as well as taking steps to abandon them. The trustee also analyzes motions by creditors affecting the assets, institutes adversary proceedings to recover preferences or fraudulent conveyances, compels turnover of property, assumes or rejects executory contracts or leases, objects to or seeks revocation of the debtor's discharge, reviews proofs of claim and moves to expunge or reduce them where warranted. The trustee may retain counsel or an accountant subject to the order of the Court to perform duties other than those required of the trustee, file tax returns for the estate and pay taxes incurred by it. Upon conclusion of the case the trustee must file a Final Report and Accounts for which a hearing will be held before the Court to pass upon and fix the trustee's commissions and fees for the professionals retained. The trustee's commissions are fixed by §§ 326 and 330. The services of the interim trustee terminate if a trustee is elected by the creditors pursuant to § 702. A successor trustee is appointed in the event a trustee dies, resigns or fails to qualify. § 703. The duties of the trustee are set forth in § 704.

VII. ATTORNEYS AND ACCOUNTANTS - §§ 327-330

The Code and the Rules make provision for the employment of attorneys and accountants by debtors-in-possession, trustees, and committees subject to court order and approval by the U.S. Trustee. § 327, Rule 2014. Attorneys who appear in the bankruptcy court should be admitted to practice in the district court where the bankruptcy court is located, be familiar with the provisions of the Bankruptcy Code as amended to date, the Bankruptcy Rules, the Local Rules, the Federal Rules of Civil Procedure, and the Federal Rules of Evidence. They should also be familiar with and conform to the Model Rules of Professional Conduct adopted by the American Bar Association or codes of professional conduct as adopted by various states. The bankruptcy judge determines the amount of reasonable compensation after reviewing applications for fees which set forth time-sheets reflecting the nature and extent of their services. These applications for fees are reviewed in light of certain relevant factors in § 330. §§ 328 and 330; Rule 2016. Attorneys are held to strict accountability as to the documents signed by them to the extent of subjecting themselves to sanctions in accordance with Bankruptcy Rule 9011(c) which tracks the sanction provisions of FRCP 11(c).

VIII. AUCTIONEERS AND APPRAISERS - §§ 327-330

These professionals are called in by the bankruptcy courts on numerous occasions where liquidation and appraisals of assets are required. Their employment, compensation, conduct and responsibilities are governed by §§ 327, 328 and 330; Rules 2014 and 6005. They are employed by the trustee subject to the order of the Court.

IX. CLERK OF THE BANKRUPTCY COURT

Both the Code and the Rules designate the Clerk of the Bankruptcy Court to provide various types of services. The Rules refer to the functions of the Clerk. All petitions for relief and documents relating to the cases and proceedings arising thereunder are filed in that office. The Clerk is required to keep dockets reflecting the activity in all cases and proceedings, as well as a claim docket, and an index of cases. Most of the Clerk's offices are equipped with advanced computer equipment which has modernized the administrative functions of the office to a sophisticated degree. The activities of the Clerk's office is subject to the Administrative Office of the United States Courts. The Clerk is appointed by the bankruptcy judges of the district. The Clerk may appoint, with the approval of the bankruptcy judges, and in such number as approved by the Administrative Office, necessary deputies, and may remove them with the approval of the bankruptcy judges.

X. ADVERSARY PROCEEDINGS AND CONTESTED MATTERS

Rules 7001-7087 dealing with "adversary proceedings" apply to certain categories of proceedings to 1) recover money or property except where directed against the debtor; 2) determine the validity, priority or extent of a lien; 3) obtain approval for the sale of both the interest of the debtor and a co-owner in property; 4) object to or revoke a discharge; 5) revoke the confirmation of a Chapter 11 or Chapter 13 plan; 6) determine the dischargeability of a debt; 7) obtain an injunction or other equitable relief; 8) subordinate certain types of claims; 9) obtain a declaratory judgment relating to any of the above; and 10) determine a claim or cause of action removed to the bankruptcy court.

Adversary proceedings are initiated by a summons and complaint. They are equivalent to civil actions in the district court where the Federal Rules of Civil Procedure ("FRCP") apply and which govern matters relating to pleadings, pre-trial procedure, discovery, motions for judgment on the pleadings, motions for summary judgment and other procedures provided for by the FRCP which the Rules track. Rule 9017 and the Federal Rules of Evidence provide that those rules of evidence shall apply in the bankruptcy court.

The Rules also allow for "contested matters" as described by Rule 9014 which are initiated by motion.

The words "case" and "proceedings" appear in the Code and the Rules. They are not synonymous. The "case" covers the affairs of the debtor and the rights of creditors. "Proceedings" are the causes of action or other procedures within the case which resolve the disputes and actions of creditors, trustees, and the debtor in respect to the estate.

XI - ELIGIBILITY FOR RELIEF UNDER CHAPTERS 7, 9, 11 12 AND 13

There is no reference to the word "bankrupt" in the Code. The debtor is the entity that comes into the bankruptcy court for relief voluntarily, or involuntarily where a petition for relief is filed against it. Generally, debtors eligible for relief are specified in § 109 which provides that only a person who resides, has a domicile, a place of business, or property in the United States is eligible to be a debtor under Chapters 7, 9, 11, 12 or 13. "Persons" are defined to include certain types of partnerships and corporations.

There is no limitation on the amount of debt which the debtor owes in order to obtain relief except in Chapter 12 cases where the debtor-farmer must have less than $1,500,000 in debt, (see XII, C, 2, (a).), and in Chapter 13 cases where the unsecured debt must be less than $290,525 and the secured debt must be less than $871,550 (11 U.S.C. § 109(e)). (See XII, C, 3, (a).)

Individual debtors who have engaged in abusive multiple filings have been disqualified from relief under the bankruptcy laws by many bankruptcy courts.

Eligible partnerships include limited partnerships or other forms of partnerships recognized by non-bankruptcy law. The Rules provide that all general partners must consent to the filing of a voluntary petition, but it is not necessary that all general partners execute the petition. Rule 1004(a).

Corporations which may seek relief in bankruptcy are broadly defined to include virtually all kinds of limited liability organizations other than limited partnerships. § 101(9). Not-for-profit corporations are eligible but cannot be the subject of an involuntary petition in bankruptcy. § 303(a).

Stockbrokers may file for Chapter 7 relief under special sub-chapters as provided for by §§ 741-752. The Securities Investor Protection Act provides for the Securities Investor Protection Corporation (SIPIC) to file an application with the district court for the liquidation of Debtor/Stockbrokers by a trustee appointed by the District Judge and the proceedings are referred to the bankruptcy court for administrative purposes.

The liquidation of commodity brokers in the bankruptcy court is governed by §§ 761-766.

Domestic insurance companies, savings and loan associations, building and loan associations, credit unions, banks, or similar institutions which are subject to governmental regulations, are expressly made ineligible for bankruptcy relief. Similarly, foreign companies engaged in those businesses in the United States are also ineligible (but if such a company merely has assets here and is not engaged in business it is eligible). § 109(b)(2)(3). Railroads may seek reorganization pursuant to a sub-chapter of Chapter 11 set forth in §§ 1161-1174.

Probate or decedent estates are excluded. However, a bankruptcy case does not terminate if an individual debtor dies or becomes incompetent during the pendency of the case. Rule 1016.

An individual cannot file a petition in bankruptcy if during the preceding 180 days a prior bankruptcy case was dismissed due to the debtor's willful failure to appear before or comply with orders of the court, or it was voluntarily dismissed at the debtor's request following a request for relief from stay. § 109(g); § 362(d) and (e).

When a bankruptcy petition is filed with the court, the party filing the petition must pay a fee to the clerk of the court, known as the filing fee. See, Fed. R. Bankr. P. 1006. The filing fee required when filing either a voluntary or involuntary Chapter 7 bankruptcy petition is $200, the filing fee required when filing a Chapter 13 bankruptcy petition is $185, and the filing fee required for a voluntary or involuntary Chapter 11 bankruptcy petition is $830. 28 U.S.C. §1930. These filing fees may not be waived, in fact, a debtor may be barred from obtaining bankruptcy relief if the debtor fails to pay the filing fee. United States v. Kras, 409 U.S. 434 (1973). However, in the case of a voluntary bankruptcy petition by an individual, if the individual debtor is unable to pay the filing fee at the time of initial filing, the fee may be deferred for an amount of time determined by the court. Fed. R. Bankr. P. 1006(b). Prior to the §341 Creditors' meeting the court may (i) order the fees paid or (ii) determine the number, amount and dates of the installment payments. The number of installments fixed by the court may not exceed 4 and the final installment must be payable within 120 days after the commencement of the case. Fed. R. Bankr. P. 1006(b)(2).

XII. ALTERNATIVES UNDER THE CODE

A. Chapter 7 Straight Bankruptcy: §§ 109(a)(b), 701-728

1. General Provisions

While the Code offers several alternative forms of relief for debtors experiencing financial difficulty, the most common is Chapter 7, sometimes referred to as "straight bankruptcy."

A Chapter 7 case begins with the filing of a petition in bankruptcy with the bankruptcy court serving the area where the debtor resides, or has a domicile, a place of business, or property.

The debtor's duties are set forth in Section 521 which requires the debtor to file a list of creditors, a schedule of assets and liabilities, current income and current expenditures and a statement of its affairs. § 521(1). If liabilities include consumer debts secured by the debtor's property, it must file a statement of its intention to retain or surrender the property, specifying that it is claimed as exempt, that it intends to redeem such property or to reaffirm the debt secured by the property. §521(2)(A). The debtor is also required to cooperate with the trustee, surrender to it all property of the estate and all books, papers and records relating to the estate whether or not it can claim immunity, submit to examinations and attend the meeting of creditors known as the § 341 meeting. It also must attend hearings of objections to discharge and testify if called as a witness unless granted immunity.

The primary reason for filing a Chapter 7 bankruptcy petition and the principal advantage bankruptcy relief offers a debtor that non-bankruptcy remedies are unable to provide is the benefit associated with discharge. The discharge of the debtor's financial obligations is viewed as granting the debtor a "fresh start" that enables it to proceed unhampered by the financial burdens of the past. The bankruptcy discharge relieves the debtor of virtually all pre-bankruptcy obligations, § 727, permanently enjoins any action to enforce discharged debts (§ 524), and protects a debtor against discriminatory treatment by a governmental unit or private employer based solely on the debtor's bankruptcy (§ 525). Chapter 7 results virtually in a fair distribution to creditors of the liquidation value of whatever non-exempt property the debtor has. In return, the debtor receives a fresh start through a discharge of indebtedness permitting it to retain future earnings, although it sacrifices all non-exempt assets.

2. Partnerships - §§ 723(a)-(d)

If there is a deficiency in a partnership estate to pay creditors in full in which general partners are personally liable, the trustee shall have a claim against the general partners for the deficiency. Rule 1007(b) and (g) authorizes the court to require the general partners to file a statement of personal assets and liabilities, a statement of their financial affairs, schedules of their current income and expenditures, a statement of their financial affairs and a statement of their executory contracts. The court is empowered to order the non-debtor general partners to indemnify the estate or not to dispose of property pending a determination of the deficiency. The partnership trustee is required to seek recovery from the estate of each general partner that is a debtor in a bankruptcy case to the extent that under applicable non-bankruptcy law such general partner is personally liable for such deficiency. The trustee is entitled to share equally with the partners' individual creditors in the assets of the partners' estates. Claims of partnership creditors who may have filed against the partner will be disallowed to avoid double counting.

3. Property of the Estate - § 541

All of the debtor's property, legal or equitable, wherever located and by whomever held, passes to the estate upon commencement of the case. § 541. It includes property held by the debtor with its spouse as tenants by the entirety or as community property if it is under the

sole, equal, or joint management and control of the debtor, or the property is liable to the extent of a claim against the debtor. Section 363(h) permits the trustee to sell both the interest of the debtor and the non-debtor spouse or a co-owner only if partition is impracticable, the sale of the estate's individual interest would realize significantly less for the estate than the sale of the property free of the interests of such co-owner, and the benefit to the estate of such a sale free of the interests of the co-owners outweighs any detriment to such co-owners. However, before the consummation of such a sale, the co-owner is given the right to purchase the property at the sale price in which event it is credited to the extent of its interest, less the pro-rated costs and expenses of sale. After the sale, the trustee must pay over to the debtor the amount of its homestead exemption and the balance is retained for the estate. § 363(j). Exemptions vary with states (see below).

Property which becomes an asset of the debtor within 180 days after the commencement of the bankruptcy petition passes to the estate if during that time it is inherited by the debtor or is the result of a matrimonial property settlement or represents the proceeds of a life insurance policy or death benefit plan. § 541(a)(5).

4. Exemptions - § 522

The debtor may exempt a portion of assets in accordance with § 522 or, in most states which have opted for their own exemptions, including New York, by state statute, in which the debtor has its domicile. (See New York CPLR 5205-5206; New York Debtor & Creditor Law §§ 282 and 283). Exemptions are intended to provide the debtor with a fresh start and an opportunity to rehabilitate itself. The exemptions include social security, retirement, unemployment, and veterans' benefits, as well as household goods, wearing apparel, the debtor's interest in any implements, professional books, or tools of the trade of the debtor or the trade of the dependent of the debtor not to exceed $1,750, matrimonial support, $7,500 for claims for personal bodily injury not including pain and suffering or compensation for actual pecuniary loss and compensation for loss of future earnings necessary for support. Also included, among other exemptions, is a $2,775 exemption for the debtor's interest in an automobile. Insurance policies owned by the debtor, and pension plan funds, including IRA funds and 401K plans which qualify under IRS rules, are wholly exempt by New York State statute. CPLR 5205. New York also provides for a $10,000 homestead exemption in the debtor's principal residence (the joint-debtor may take the same exemption). CPLR 5206.

The debtor may avoid a lien on an interest it has in property to the extent that it impairs an exemption if the lien is a judicial lien other than a judicial lien that secures a debt to a spouse, former spouse, or child of the debtor, for alimony, maintenance, or support payments in connection with a separation agreement, divorce decree or other order of the court, § 522(f)(1)(A). It may avoid a nonpossessory, nonpurchase-money security interest in household furnishings and goods and other items held for personal use, as well as tools of the trade. § 522(f)(1)(b).

The debtor is provided the protection afforded by § 362, the "automatic stay" except in certain circumstances. See XIII, B.

Upon the filing of the bankruptcy petition the case is referred to a bankruptcy judge and an Interim Trustee is appointed. See XI.

After the petition is filed, a meeting of creditors is held on notice to all creditors and parties in interest under § 341. The debtor must attend this meeting and creditors may appear and question the debtor regarding its financial affairs and property. In addition, the trustee must likewise orally examine the debtor. §§ 341-343. The creditors may also elect a trustee as successor to the Interim Trustee. §§ 701-704. If a husband and wife have filed one joint petition, they must both attend the creditors' meeting.

It is important for the debtor to cooperate with the trustee, and provide any financial records or documents that the trustee requests. See § 521 for debtors' duties. In order to preserve their independent judgment, bankruptcy judges are prohibited from attending the creditors' meeting. (§ 341(c)).

There is a filing fee of $155, an administrative fee of $30,and a $15 fee to be used for the Chapter 7 trustee's compensation making a total of $200 to file a petition for relief under Chapter 7. Joint petitions for relief may be filed by husband and wife with no increase in the fee. The fee is to be paid in full upon filing. Individuals may, with the court's permission, pay the fee in installments. Rule 1006(b) see also XI. Failure to pay may result in dismissal of the case or delay in receiving a discharge.

5. Filing of Claims - Rule 3002

In Chapter 7 cases, creditors' claims must be filed within 90 days after the first date set for the meeting of creditors pursuant to § 341, except where the § 341(a) notice indicates that no claims need to be filed in a "no-asset" case, subject to further notice fixing a filing date where assets come into the estate except in certain limited circumstances. Rule 3002(c)(1)(5).

6. Discharge and Dischargeability

a. Denial of Discharge - § 727

In the Chapter 7 case, only individual debtors may receive a discharge. The Code does not permit discharges for corporations and partnerships. If general partners file petitions as individuals, each partner so filing will obtain a discharge from both its business and personal debts.

Section 727(a)(2)-(10) sets forth various grounds for the denial of a discharge of a Chapter 7 debtor. The debtor is not entitled to a discharge if, with intent to defraud, hinder, or delay creditors, it transferred, removed, destroyed, mutilated or concealed property within one year prior to the filing of the petition or after the date of the filing of the petition. § 727(a)(2). Discharge will be denied if the debtor has concealed, destroyed, mutilated, falsified, or failed to keep or preserve records from which its financial condition may be ascertained.

§727(a)(3). The debtor knowingly and fraudulently or in connection with the case made a false oath or account, presented or used false claims, gave, offered, received or authorized to obtain money, property or advantage for acting or forbearing to act, or withheld any recorded information, including books, records or papers relating to the debtor's property or financial affairs. § 727(a)(4). Discharge will also be denied for failure to explain any loss or deficiency in assets. § 727(a)(5). The refusal to obey a lawful order of the court or to answer pertinent question may also be grounds for the denial of discharge. § 727(a)(6). However, the refusal to testify on the ground of the privilege against self-incrimination may not bar a discharge if the debtor has been granted immunity prior to the refusal. § 344. Immunity may be obtained from the United States Attorney. 18 U.S.C. §§ 6002-6003.

The commission of a bankruptcy crime under 18 U.S.C. §§ 151-157 may bar the debtor's discharge. These acts are treated as felonies under the United States Code, punishable by a fine, imprisonment or both and include the making of a false oath orally or in writing during the pendency of the case, presenting or using a false claim against the estate, giving or receiving a bribe, withholding records, and includes a bankruptcy petition preparer who disregards the requirements of Title 11, or a person who attempts to use Title 11 to defraud. All of those acts must have been made knowingly and fraudulently. (See §§ 151-157 of Title 18 of the U.S. Code).

Objections to the discharge are brought on by the institution of adversary proceedings. Bankruptcy Rule 4007 requires the objecting creditor or objecting trustee to file a complaint within 60 days of the date set for the § 341 meeting unless extended by the court within that time. The debtor is permitted to respond and unless a settlement is worked out between the parties, the case will undoubtedly go to trial and be subject to the decision of the court. The standard of proof in discharge proceedings has been established by the Supreme Court by "preponderance of evidence" and not by "clear and convincing proof".

A debtor may, if it receives a discharge, waive the privilege of discharge if it executes a written waiver.

The Code permits a discharge only once within a six year period commencing with the filing of the previous petition. §727(a)(8). The denial of a discharge does not prevent a debtor from filing a Chapter 13 case at any time. See XII, C, 3 for discussion of Chapter 13.

The trustee, a creditor, or the United States Trustee may object to the granting of a discharge. On request of a party in interest the court may order the trustee to examine the acts and conduct of the debtor to determine whether a ground exists for a denial of discharge. § 727(c)

b. Revocation of Discharge - §§ 727(d) and (e)

At the request of the trustee, a creditor or the United States Trustee, the court shall revoke a discharge if it was obtained through the fraud of the debtor and the requesting party did not know of such fraud until after the granting of such discharge. § 727(d). The request

for revocation is to be made within one year after the discharge was granted. It may also be possible to revoke the discharge if the debtor acquired property which would be property of the estate, or became entitled to acquire such property, if the debtor knowingly and fraudulently failed to report the acquisition or entitlement to such property, or to deliver or surrender it to the trustee, or the debtor refused to obey a lawful order of the court, other than an order to respond to a material question, or to testify on the ground of privilege against self-incrimination, after it had been granted immunity provided for in §727(a)(6). They are required to request the revocation within one year after the discharge was granted, or sought under § 727(d)(2) or (3), before the later of one year after the granting of the discharge and the date the case is closed. § 727(e).

c. Nondischargeable Debts - § 523

The Code provides for a discharge of debts. In weighing the need for a fresh start, however, Congress carved out various categories of nondischargeable debts or "exceptions to discharge". The difference between the so-called "objections to discharge" and the "exceptions to discharge" is that the former relates to the complete bar of a discharge whereas the exceptions to discharge allow one or more particular debts to survive bankruptcy despite the discharge of remaining liabilities.

The first exception is for taxes. Income tax claims for which a return was due within three years of the bankruptcy petition are not dischargeable nor are withholding and sales taxes for which the debtor is liable in any capacity regardless of when they became due. Other taxes which are not dischargeable, depending upon the time they become the debtor's liability, are for example, unemployment, excise, and customs duties. Taxes due from debtors who failed to file tax returns or who made a fraudulent return are not dischargeable. § 523(a)(l).

Debts arising from or incurred by fraud are nondischargeable. These include debts for which the debtor obtained money, property, services or an extension, renewal or refinancing of credit by false pretense, false representation or actual fraud (§ 523(2)(A)), or by the use of a materially false statement in writing made with intent to deceive, upon which the creditor reasonably relied. §523(2)(B)). Consumer debts owed to a single creditor aggregating more than $1,150 for "luxury goods or services" incurred by an individual debtor within 60 days from the date of the petition in bankruptcy or cash advances aggregating more than $l,150 obtained by an individual debtor within 60 days are presumed to be nondischargeable.

"Luxury good or services" do not include those reasonably acquired for the support or maintenance of the debtor or its dependents. § 523(a)(2)(C).

Debts arising out of fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny are not dischargeable. § 523(a)(4). Another important exception applies to any debt owed to a spouse, former spouse or child of the debtor, for alimony, maintenance or support in connection with a separation agreement or a divorce decree or other order of a court of record, or a property settlement in lieu of maintenance or support, and to the extent the debt is assigned to a governmental agency. § 523(a)(5). Debts for willful

and malicious injury or damage to property caused by the debtor are not dischargeable, § 523(a)(6), as well as obligations to pay a fine, penalty or forfeiture owed to a governmental unit or was fixed as restitution for a criminal act. § 523(a)(7). Educational benefit overpayments or loans made, insured or guaranteed by a governmental unit, or made under any program funded in whole or in part by a governmental unit or nonprofit institution ("student loans") are dischargeable if they will impose an undue hardship on the debtor and its dependents. § 523(a)(8). Debts arising out of death or personal injury caused by the debtor's operation of a motor vehicle if such operation was unlawful because the debtor was intoxicated from using alcohol, a drug, or another substance, are not dischargeable. § 523(a)(9). If there was a denial of the debtor's discharge in an earlier Chapter 7 case, or if the debtor waived discharge in a prior bankruptcy case, the debts that existed before the prior bankruptcy case may not be discharged in a subsequent Chapter 7 case unless the previous denial of discharge was based solely on the six year bar as provided for by §727(a)(8). § 523(a)(l0). Other exceptions to discharge are for any payment of an order of restitution issued under title 18 of the U.S. Code, incurred to pay a tax to the United States that would be nondischargeable under § 523(a)(1). Also nondischargeable are debts incurred in the course of a divorce or separation agreement or in connection with a separation agreement, divorce decree or other court order other than those set forth in § 523(a)(5). § 523(a)(15). This Section is intended to clarify whether or not a property settlement arising out of debts referred to in § 523(a)(5) are dischargeable, depending in general upon the ability of the debtor to pay the debt from his income or property, not reasonably necessary to be expended for maintenance or support of the debtor or his dependent, or for the payment of expenses necessary for the continuation of his business or that discharging such debt would result in a benefit to the debtor that outweighs the detrimental consequences to the spouse, former spouse, or child of the debtor. Subject to certain requirements, fees due on a condominium ownership or cooperative interest are also nondischargeable. § 523(a)(16).

The debtor shall be discharged from debts arising under § 523(a)(2)(4), (6), or (15) for fraud, embezzlement or larceny, willful and malicious injury, or matrimonial property settlement unless the creditor initiates adversary proceedings to have the debt deemed nondischargeable and the court so finds. Rule 4007(c) governs the proceedings which must be instituted by a complaint filed not later than 60 days following the first date set for the §341 creditors' meeting subject to extensions of time by application granted within that period. A complaint to determine the dischargeability of all other debts, such as student loans, matrimonial obligations other than property settlements, certain taxes, and unscheduled debts

covered by § 523(c) may be filed at any time, and a closed case may be reopened for that purpose. Rule 4007(b). Where a proceeding is brought to except debts for fraud or arising out of a false financial statement, the court may grant judgment in favor of the debtor for costs and attorneys fees if the court finds that the proceeding was not justified. § 523(d).

As in proceedings involving objections to a discharge, the standard of proof in objections to dischargeability of debts is by "preponderance of evidence" and not by "clear and convincing proof".

Unscheduled debts due creditors without knowledge of the bankruptcy are not dischargeable if the time to file a claim in an "asset case" had expired or where the debt would not have been discharged under §§ 523(a)(2)(4) or (6). See also § 523(a)(3).

d. Effect of Discharge - § 524(a)

Discharge voids any judgment against the debtor and operates as an injunction against the commencement or continuation of an action or an act to collect a debt discharged.

e. Reaffirmation of Debt - § 524(c)(d)

The debtor may reaffirm a debt that is dischargeable, by agreement made before the granting of the discharge. A reaffirmation hearing is only required if the debtor was not represented by counsel. There are also certain requirements that reaffirmation agreements have to meet. The debtor may rescind the agreement within 60 days from the date it is filed or prior to discharge, whichever occurs later.

f. Protection Against Discriminatory Treatment - § 525

A governmental unit may not discriminate by denying, revoking, suspending or refusing to renew a license or other similar grant or deny employment or terminate employment of a person that is or has been a Debtor. § 525(a). No private employer may terminate the employment of or discriminate against an individual who is or has been a Debtor.§ 525(b).

g. Redemption of Property - § 722

An individual debtor may redeem tangible personal property intended primarily for family, household, or personal use from a lien securing a dischargeable consumer debt if exempt or abandoned by the trustee, by paying the lienor the allowed amount of the claim, that is, the actual value of the personalty involved. (See § 506(a) for valuation of the secured collateral).

7. Conversion § 706

The debtor may convert its case to one under Chapter 11, 12 or 13 at any time if the case was not previously converted from those Chapters. On request of a party in interest, and after notice and hearing, the court may convert the case to one under Chapter 11. Conversion may be made to Chapter 12 or 13 only if requested by the Debtor. § 706.

8. Dismissal § 707

The court may dismiss a Chapter 7 case on motion of the debtor. The court may, after notice and hearing to all creditors and parties in interest, dismiss the case for cause, including

unreasonable delay by the debtor that is prejudicial to creditors, for non-payment of fees, and on motion of the U.S. trustee, for failure to file schedules and other data timely required by the Code. § 707(a), Rule 1017. The court, on its own motion or on motion by the United States Trustee may dismiss a Chapter 7 case filed by an individual debtor whose debts are primarily consumer debts, if the court finds that the granting of relief would be a substantial abuse of Chapter 7. § 707(b), Rule 1017. Failure to appear at the § 341 meeting has also been deemed cause for dismissal.

B. The Involuntary Petition in Chapter 7 - §§ 109(a) and (b), 303

An involuntary petition may only be commenced under Chapter 7 or 11 of this title. It enables the maximization of the debtor's estate by marshalling its assets and then liquidating them. The main purpose for filing an involuntary petition for liquidation is to achieve an equal distribution of the debtor's property among each class of creditors without preferential treatment. It also provides for the elimination of certain avoidable liens. Basically, these purposes are accomplished by the appointment or election of a trustee who is given powers with which to represent the general creditors. See XIX for trustees avoiding powers.

1. General Provisions - § 303

Any person who may file a voluntary petition under Chapter 7 may become the subject of an involuntary bankruptcy case, except a farmer, family farmers, or a corporation that is not a moneyed, business, or commercial corporation. Thus, not-for-profit corporations are excluded.

One petitioning creditor is sufficient to commence an involuntary petition in bankruptcy if the debtor has fewer than 12 creditors. If there are 12 or more creditors the petition must be executed by at least three petitioning creditors. The petitioner or petitioners must have claims against the debtor that are not contingent and aggregate at least $11,625 above the value of any security interests, such as mortgages or liens which the petitioning creditors may have on the debtor's property. Finally, the petitioning creditors must have claims that are not the subject of bona fide disputes. Creditors other than the original petitioning creditors may join in the petition to fill the statutory requirement if any of the petitioning creditors fail to qualify. If the debtor fails to answer, move or plead, an order for relief will be granted and an interim trustee appointed. The court may require the petitioners to file a bond to indemnify the debtor. In the event of a dismissal of the petition other than by consent, the court may grant judgment against the petitioners for costs, attorneys fees or, if the petition was filed in bad faith, for damages. The debtor may continue to operate until an order for relief is granted but may be subject to the control of the court. The court may order the appointment of an interim trustee to take possession of the debtor's assets and operate its business pending the trial of the issues raised by the petition in order to preserve and prevent loss.

Absent proof from the debtor otherwise, the court will approve the involuntary petition and order the Chapter 7 to proceed if the debtor is generally not paying its debts as they

become due unless they are subject to a bona fide dispute, or if the debtor had made an assignment for benefit of creditors of its assets within 120 days of the petition.

Section 303(b)(3) deals with involuntary petitions involving a partnership. If all of the general partners in a partnership are in bankruptcy then the general partners or the trustee of a single, general partner, or the holder of a claim against the partnership, may file an involuntary petition against the partnership. The petition may be filed by fewer than all the general partners notwithstanding agreement to the contrary. A general partner in a partnership debtor may file an answer to the involuntary petition against the partnership if he did not join in the petition; a partnership petition filed by less than all of the general partners is treated as an involuntary, not a voluntary, petition.

C. Reorganization and Debt Adjustments - Chapters 11, 12 and 13

1. Chapter 11 Reorganization: § 1101-1146

(a) General Provisions

Stockbrokers, commodity brokers and those persons and entities not qualified for Chapter 7 relief are also not eligible for Chapter 11 relief. § 109(d). The Code provides for involuntary Chapter 11 petitions but an involuntary petition may not be filed against farmers, whether they be individual or corporate farmers, or against a corporation that is not a moneyed, business or commercial corporation. § 303(a). A Chapter 7 case may be converted to a Chapter 11 case. § 706.

A railroad ineligible for relief under Chapter 7 may seek relief under Chapter 11 pursuant to a special subchapter of Chapter 11. §§ 1161-1174.

The debtor must attend the § 341 meeting and be subject to examination as described and set forth above in Chapter 7 cases on page 12. § 343.

The Supreme Court has held that the Bankruptcy Code does not expressly require that a Chapter 11 debtor be engaged in business operations. While Chapter 11 is primarily aimed at business debtors and is more expansive than Chapters 7 or 13, several recent cases have illustrated that consumer debtors might find Chapter 11 appropriate under certain circumstances, as for example where the amounts of their debts exceed the maximum allowed for Chapter 13 relief.

Although most of the cases administered in the bankruptcy court revolve around individual consumer types of proceedings, the major cases concern themselves with the problems of corporations or partnerships which for one reason or another seek the benefits of Chapter 11. A few are the result of the filing of an involuntary petition against them by their creditors. The proceedings are primarily aimed at effecting a reorganization or orderly liquidation of the debtor. The court may dismiss a Chapter 11 case if it finds that it was not filed in good faith. § 1112.

The most prevalent of the reasons for seeking Chapter 11 relief arises out of the unusual provisions of § 362 of the Code which stays most acts against the debtor or its property. The major Chapter 11 cases arise out of the need of the debtor to seek the benefits of the automatic stay in order to enable it to extricate itself from serious financial difficulties. Companies such as Johns-Manville and A.H. Robins, which were the subject of severe substantial tort claims, were able to put a freeze on an untold number of lawsuits instituted against them arising out of their alleged liability for damages caused by their asbestos and birth control products. The Texaco case stemmed from the need to restrain Pennzoil from proceeding to enforce its judgment running into billions of dollars. Problems arising out of pension benefits and its liabilities caused by pension fund requirements led to the LTV Chapter 11. Others were occasioned by the adverse economic effect on companies saddled with substantial, financial commitments caused by leveraged buyouts and the issuance of so-called "junk bonds" which were evident in the Drexel Burnham Lambert, Federated and Allied Stores bankruptcies. The Chapter 11 filed by Eastern Airlines was the result, among others, of its union problems. The recent Enron case arose out of questionable accounting procedures. Kmart filed as a result of severe competition. Whatever the reason, where failure to stem ongoing problems involving the financial condition of a company would precipitate its demise, companies have sought sanctuary in Chapter 11. Another major reason for seeking Chapter 11 relief is the right to reject burdensome executory contracts, particularly leases of commercial property or to assume and then assign them as discussed at XIII, E.

Debtors who have difficulty in meeting their obligations also seek Chapter 11 relief to restructure their debt to accommodate their income availability. Another useful tool of Chapter 11 is to provide for a merger or consolidation with another entity. Its provisions also enable orderly liquidation of equipment or inventory not necessary for the merger or consolidation or the debtor's future operations.

In many instances, lenders from whom debtors have sought to obtain new financing have preferred the safeguards provided for by the Bankruptcy Code as a condition to advancing funds.

Where out-of-court settlements are met with resistance by a few recalcitrant creditors, the debtor may file a "pre-packaged" Chapter 11 case accompanied by a plan of reorganization which in essence comprises all of the terms of the settlement agreement. By so doing, the debtor may effectuate a plan without delay and which would bind the objecting creditors. This technique has been used successfully both in bankruptcy and as leverage against the troublesome creditors in the pre-bankruptcy workout.

Because the Code provides for creditor control or greater participation in the affairs of the debtor, Chapter 11 is recommended by them as a means of effecting a viable reorganization. The appointment of an Examiner to review the debtor's financial affairs, or the appointment of a Trustee to operate the business, both under § 1104, and the appointment of a creditors' committee under § 1102, or the employment of independent auditors under § 327 are among the advantages available to the creditor body. Debtors have also availed themselves of turnaround specialists, investment bankers and experienced consultants in

seeking meaningful reorganization. The right of a creditors' committee to avoid preferential or fraudulent transfers absent such actions by the debtor or operating trustee is another reason for creditors to employ the Chapter 11 type of relief. It is for those reasons which enable the creditor body to participate in the reorganization process that creditors have been prompted to file involuntary Chapter 11 petitions.

The debtor is referred to as the "debtor-in-possession" in Chapter 11 cases when it, not a Trustee or any other party, is in possession of its assets and operates its business. Although it is customary for the debtor to remain in possession, upon request and after notice and hearing, § 1104 provides that the court is authorized to order the appointment of a Trustee for fraud, dishonesty, incompetence or gross mismanagement, or where the appointment of a Trustee would be in the best interest of the creditors. The United States Trustee appoints the Trustee in the event such appointment is ordered by the bankruptcy judge. The Chapter 11 Trustee operates the debtor's business where directed by the court, investigates the affairs of the debtor, the operation of its business, the desirability of the continuance of such business, and any other matter relevant to the case. The Trustee may also propose a plan of reorganization. The debtor-in-possession has all the powers of a Trustee in a Chapter 11 case as well as many powers of a Chapter 7 Trustee. § 1107.

Section 1104 also provides for the appointment of an Examiner by the United States Trustee where ordered by the court. An Examiner may be appointed in any type of Chapter 11 case, large or small, where the debtor is permitted to remain in possession. Appointment must be requested by a party in interest, after notice and hearing. It must appear that the appointment is in the best interest of creditors, equity security holders and other interests of the estate or that the debtor's fixed, liquidated, unsecured debts, other than for goods, services, taxes or owing an insider, exceed $5,000,000. An Examiner is required to conduct and file a report of its investigation of the debtor's affairs as required of a Chapter 11 Trustee. The Examiner does not operate the business nor propose a plan.

Provision is made in the Code for the appointment by the United States Trustee of creditors' and equity holders' committees. § 1102. The primary purpose of committees is to function as negotiating bodies for the formulation of a plan of reorganization in Chapter 11 cases. The powers and duties of committees include the right to consult with the Trustee or debtor-in-possession concerning the administration of the case, investigate the financial affairs of the debtor, participate in the formulation of a plan, request the appointment of a Trustee or Examiner and employ attorneys, accountants or other agents. A Chapter 11 creditors' committee has an absolute right to intervene in adversary proceedings instituted by a Trustee or debtor-in-possession and under certain conditions may also commence litigation for the benefit of the estate. In many Chapter 11 cases, a Receiver may have been in possession of the debtor's property as the result of foreclosure proceedings instituted prior to bankruptcy. Section 543 requires the Receiver to deliver to the debtor or Trustee and account for property that came into his possession or control. This would include rents collected by the Receiver. The court, for cause shown, may direct the Receiver to continue in possession and continue to collect the rents. § 543(d).

i. - Rejection of Collective Bargaining Agreements - § 1113

Because the right to reject an executory contract (see XIII) includes the rejection of a collective bargaining agreement, Chapter 11 has been used frequently for that purpose. In order to prevent the erosion of such contracts, the Code provides various restrictions on the rejection powers of the trustee or the debtor. The net effect is to foster negotiating processes with the labor union, protection of confidential or proprietary information, and the creation of rejection standards which provide for a more equitable means of determining whether or not the union contract should be rejected.

Proofs of claim may be filed anytime prior to confirmation of a plan. However, the court may enter a "bar order" fixing the time within which a claim may be filed. A proof of claim in Chapter 11 is deemed filed if the creditor and the amount due it is listed in the debtor's schedules, except for a claim that is scheduled as disputed, contingent or unliquidated. Rule 3003.

The Chapter 11 may be dismissed or converted to a Chapter 7 case as provided for by § 1112 before or after confirmation of the plan. It can also be dismissed if not filed in good faith.

The fee for filing a petition for relief under Chapter 11 is presently $830.

(b) Treatment of Small Business Under Chapter 11

Various sections of the Code have also been amended to permit an expedited and less expensive procedure for reorganizing a small business, defined as a person engaged in commercial or business activities (other than solely real estate), with noncontingent, liquidated debts of $2 million or less. § 101. The amendments are as follows:

Section 1102(a)(3) permits the bankruptcy court, at the request of a party in interest, to order that an official committee of creditors not be appointed in a case in which the debtor is a small business.

Section 1112(b) permits the bankruptcy administrator as well as the U.S. Trustee to request dismissal or conversion of a Chapter 11 case, whether or not it concerns a small business.

Section 1121 provides that when the debtor is a small business, and elects to be treated as such:

1) the debtors exclusive period to file a plan is 100 days;

2) all plans must be filed within 160 days; and

3) on request of a party in interest, after a notice and a hearing, either period may be reduced "for cause" or the debtor's 100 day period may be increased if the debtor shows that "the need for an increase is caused by circumstances for which the debtor should not be held accountable.

Section 1125(f), when the debtor elects to be treated as a small business, permits conditional approval of a disclosure statement, subject to final approval after notice and hearing on confirmation; permits the solicitation of votes on a plan based on a conditionally approved disclosure statement "so long as the debtor provides adequate information to each holder... that is solicited;" and requires that the conditionally approved disclosure statement be mailed at least 10 days prior to the hearing on confirmation.

(c) The Chapter 11 Plan

(i) Who May File a Plan - § 1121

The debtor, other than a small business as above-noted, may file a plan at any time. It has such exclusive right during the first 120 days after the commencement of the case. The time to file a plan and acceptances may be reduced or extended for cause by the court on application made within the 120 day period or within the time extended.

After expiration of the exclusive period, multiple plans may be submitted. Any party in interest may file a plan. A party in interest includes the debtor, the Trustee, a creditors' committee, an equity security holders' committee, a creditor, an equity security holder, or an indenture trustee. Such parties may file a plan if a Trustee has been appointed or the debtor has not filed a plan before the expiration of the exclusivity period or, if a plan was filed, it has not been accepted within the time fixed by the court. The exclusive period may be modified for cause.

(ii) Classification and Designation of Claims - § 1122

A plan may designate separate classes of claims. The plan may place a claim or interest in a particular class only if they are substantially similar to others of such class. The plan may also designate a class consisting of every unsecured creditor owed a debt under a specified amount if reasonable and necessary for administrative convenience.

(iii) Contents of the Plan - § 1123

The plan must provide adequate means for its implementation. Provision may also be required for the transfer of all or any part of the property of the estate to one or more entities; merger or consolidation; sale of all or part of the property; satisfaction or modification of any lien; cancellation or modification of any indenture or similar instrument; curing or waiving of any default; extension of a maturity date or a change in the interest rate or other term of outstanding securities; amendment of the debtor's charter; or the issuance of securities of the debtor or the debtor's successor under the plan. It may also provide for the inclusion in the

corporate charter of a provision prohibiting the issuance of non-voting stock, and contain provisions consistent with the interests of creditors, shareholders, and with public policy regarding the manner of selection of any officer or director.

The plan must specify classes of claims that are impaired or unimpaired. It may impair or leave unimpaired any class of claims, secured or unsecured, or of interests of shareholders. See (iv) below. It may also provide for the assumption, rejection or assignment of any executory contract including employment contracts, and unexpired leases in which the debtor is the tenant or sub-tenant, which were not previously assumed or rejected. Provision may be made for the retention, enforcement, settlement or adjustment of any claim belonging to the debtor, the sale of the property of the estate and the distribution of the proceeds among holders of claims or interests as well as the sale of property subject to or free and clear of liens and the satisfaction of any lien.

The sale of all or substantially all of the property of the estate and distribution of the proceeds is considered by the Code as a liquidation plan. The term "reorganization," as used in Chapter 11 encompasses systematic liquidation of a debtor as provided by the plan.

The plan must comply with the applicable provisions of the Code, be proposed in good faith, and not by any means forbidden by law. It must disclose any payments made or to be made by the debtor, or the plan proponent, or by any person issuing securities or acquiring property under the plan, for service or for costs and expenses. Any such payment must be approved by the court as reasonable. The identity and affiliation of each person who will serve as a director or officer of the reorganized debtor or of an affiliate participating in a plan with the debtor or successor to the debtor must also be disclosed.

Administrative and priority creditors must be paid in full in cash on confirmation of the plan unless otherwise mutually agreed upon. Certain tax obligations must be paid over a period not exceeding six years after the date of assessment of such claim if the taxing authority receives deferred cash payments of a value equal to the allowed amount of its claim. (This is another reason for the filing of a Chapter 11 case.) Wage and consumer priority creditors, if their classes accept, may be paid in cash or over a period of time if agreed, provided that the deferred payments have a present value of the allowed amount of their claims.

(iv) Impairment of Classes of Claims - § 1124

This section specifies the ways in which a plan may leave a claim or interest unimpaired. They are deemed impaired unless the plan proposes not to alter the rights of the claimant or holder of an interest, reinstate a claim or interest by curing any default and date of maturity.

(v) Disclosure Statement - § 1125

Assuming the debtor is not a small business no acceptances can be solicited until the court has approved a Disclosure Statement setting forth pertinent financial information about the debtor and the plan. The court will hold a hearing on the adequacy of the Statement on notice to the major parties in interest. Their objections, if any, play a significant role in the process of going forward with the confirmation of the plan. A copy of the approved statement, the plan, and ballots of acceptance or rejection of the plan are then sent to all creditors and parties in interest.

(vi) Acceptance of the Plan - § 1126

A class that is not impaired is conclusively presumed to have accepted the plan, and the solicitation of acceptances of that class is not required. Acceptance by a class of claims requires acceptance by not less than two-thirds in amount and a majority in number of the allowed claims of creditors in that class who actually vote. Acceptance by a class of interests, i.e., preferred or common stockholders, requires acceptance by two-thirds in amount of the security interest of the members of that class who actually vote. At least one class of impaired claims must accept the plan without counting the acceptances of insiders (see § 101(31)) if there is at least an impaired class of claims under the plan. §1129(a)(10). Acceptances or rejections obtained prior to this proceeding (i.e., a "pre-packaged Chapter 11") may be included in the computation if the solicitation was in compliance with non-bankruptcy regulations (S.E.C., etc.) or in accordance with the Disclosure Statement requirements of § 1125.

(vii) Hearing on Confirmation - § 1128

The Code requires the court to conduct a hearing on confirmation on notice to all creditors and parties in interest, any of whom may appear and object.

(viii) Confirmation of Plan - § 1129

With respect to each impaired class of claims or interests, each member of such class must either accept the plan or receive under the plan property with a value at least equal to that which it would receive in a Chapter 7 liquidation. This "best interests" test has been construed to mean that creditors and interest holders will be at least as well off in the reorganization as in a Chapter 7 liquidation. If the plan provides that the debtor will retain the collateral which is subject to a lien, the secured creditor may elect to forego any unsecured deficiency claim it may have even though it may actually be a non-recourse creditor in accordance with the security agreement and treat its entire claim as a secured claim. § 1111(b).

The plan must be feasible. If the plan is not a liquidation plan the court must determine that the debtor or its successor is not likely to require liquidation or further financial reorganization.

Except in situations where the plan can be "crammed down" (see discussion below), that is, forced upon a class of creditors, the court may not confirm the plan unless each class accepts the plan or the class is not impaired.

(ix) "Cram Down" - § 1129(b)

If a plan meets all of the general standards for confirmation including its acceptance by at least one impaired class of creditors but an impaired class has not accepted the plan, the court may nevertheless confirm the plan under its "cram down" power if the proponent of the plan requests confirmation, the plan does not discriminate unfairly, and the plan is fair and equitable.

The Code sets forth tests which, if met, will satisfy the requirements that the plan is fair and equitable for secured claims, unsecured claims and equity interests.

A plan will be fair and equitable to a dissenting class of <u>secured</u> claims if the secured class retains the liens securing its claims, whether the property subject to the liens is retained by the debtor or is transferred, to the extent of the allowed amount of the secured claim, (see § 506(a)), and the holder of such claim receives deferred cash payments having a present value at least equal to the value of its interest in the estate's interest in the encumbered property. Since the ultimate right of a secured creditor is to obtain its collateral, abandonment to such creditor would meet the standard. Giving the secured creditor a lien on similar property might also suffice. Alternatively, if the collateral is sold, the lien will attach to the proceeds of sale, or the secured class will receive the indubitable equivalent of its claim.

To be fair and equitable to a class of <u>unsecured</u> claims, the plan must provide that each unsecured creditor receives property having a present value equal to the allowed amount of the claim. If unsecured creditors are not so provided for, the plan will be fair and equitable if no class of claims or interests junior to that of the dissenting class of unsecured creditors receives or retains any property. However, many courts hold that such junior claims, shareholders for example, may retain an interest under the plan if the holders of the junior claims provide "new value" by way of a substantial monetary contribution or the transfer of other property to the debtor. This is a modification of the "absolute priority rule" which prevailed in the former Chapter X. There is an implied converse requirement that no senior class may receive or retain more than needed to effect full payment to it.

The "cram down" against a class of interests, i.e., preferred or common stockholders, is similar to that involving a class of claims. To be fair and equitable the plan must provide that each member of such class receives or retains property equal to the greatest of the amount of any fixed liquidation preference to which it is entitled, any fixed redemption price, or the value of its interest.

The application of the fair and equitable test requires the court to evaluate the business of the debtor on a going concern basis. This is invariably a costly and time-consuming process

strongly suggesting a compromise of the controversy. A going concern valuation, however, will not be required if the plan is a liquidation plan.

(x) Effect of Confirmation - § 1141

The provisions of a confirmed plan bind the debtor, all entities issuing securities, and all entities acquiring property under the plan, and any creditor, entity or security holder or general partner in the debtor, whether or not their claims are impaired under the plan, and whether they have or have not accepted the plan. Except as otherwise provided in the plan or in the order confirming the plan, the confirmation of a plan vests all of the property of the estate in the debtor. The confirmation of a plan discharges the debtor from any debt that arose before the date of confirmation. A debtor is not discharged if the plan is a liquidating plan, the debtor does not engage in business after consummation of the plan, and the debtor would be denied a discharge in a Chapter 7 case, (i.e. if the debtor is an individual). The confirmation of a plan does not discharge an individual debtor from any debt excepted from discharge as discussed in XII, A6.

(xi) Modification of Plan - § 1127

Only the proponent of a plan may modify it at any time before confirmation subject to §§ 1122 and 1123 governing classification and plan contents. The proponent or reorganized debtor may modify the plan after confirmation but before substantial consummation as defined in § 1101, and subject to the requirements of §§ 1122 and 1123, as well as § 1129. Unless the modification is minor, it must comply with the disclosure provisions of § 1125 as discussed above.

The fee for filing a petition for relief under Chapter 11 is $800. In addition, quarterly fees are required to be paid by the debtor to the United States Trustee. 28 U.S.C. § 1930(a)(6).

2. Chapter 12 Relief - Adjustment of Debts of a Family Farmer With Regular Annual Income: §§ 1201-1231

(a) General Provisions

Chapter 12 is known as the Family Farmer Bankruptcy Act. It was enacted in 1986, in an effort to make the Bankruptcy Code fit the rehabilitation needs of farmers. To be eligible for relief a farmer must have less than $1,500,000 in debt, 80% of which must come from the farming operation, and must have earned more than one-half of the gross income from farming in the year before the Chapter 12 petition is filed. The petition may also be filed by a corporation whose stock is owned or controlled by a farmer. (§101(18-20). A Trustee will be appointed but generally the farmer will continue to operate the farm. The Trustee will monitor and play a vital role in the case. The Trustee or a creditor may move to have the Trustee placed in control of the farming operation on account of fraud or gross

mismanagement. To satisfy the adequate protection requirements, a farmer need only compensate a secured creditor for any decrease in the value of the creditor's collateral by cash payments or substitute liens. The debtor is required to file a plan within ninety days of the case being filed, and while there is a provision for that period to be extended, the extension will only be granted if due to circumstances for which the debtor should not be held accountable. § 1221. The court is required to conclude the confirmation hearing within forty-five days of the plan being filed, and extensions may only be granted for cause. The plan is to run for three years or less, but extensions not to exceed five years may be granted for cause.§ 1224. Secured debts may be modified and the plan may provide for their payment over a period that exceeds five years. The Code provides broad authority for the farmer debtor to modify the rights of both secured and unsecured creditors.

Unsecured creditors must receive at least what they would in a Chapter 7 liquidation. If the plan pays less than 100% and there are nonaccepting unsecured creditors, then the debtor must contribute all of his disposable income. Secured creditors are entitled to retain their liens. One other means of dealing with a secured creditor would be simply to surrender the collateral. The final requirement for confirmation is for the debtor to show that its plan is feasible, that it will be able to make all plan payments and that it will be able to comply with the plan.

The fee for filing a petition for relief under Chapter 12 is presently $230.

3. Debt Adjustments for Individual Debtors With Regular Income Under Chapter 13: §§ 1301-1330

(a) General Provisions

Chapter 13 is designed to enable individual debtors under court protection and supervision to apply a portion of future earnings to the payment of all or a portion of their debts over three years, but extensions not to exceed a total of five years may be granted for cause. The debtor is protected from creditors by the automatic stay while a plan of repayment is developed and carried out. Chapter 13 debtors are encouraged to pay their debts instead of merely seeking a discharge under Chapter 7.

Any individual whose income is sufficiently stable and regular so that payments under a Chapter 13 plan can be made, except for stockbrokers or commodity brokers, qualifies as an "individual with regular income." §109(e). Individuals may qualify even if their primary income, aside from wages, is from pensions, disability benefits, welfare or social security payments, investments or from any other source as long as it is regular. Self-employed business people may take advantage of Chapter 13. Whereas Chapter 11 reorganizations are designed for the larger businesses, Chapter 13 is appropriate for the smaller businesses. §1304.

The debtor must owe non-contingent, liquidated, unsecured debts of less than $290,525, and non-contingent, liquidated, secured debts of less than $871,550. § 109(e). A secured creditor whose claim exceeds the value of the collateral may be deemed secured to the extent of the value, and unsecured for the balance pursuant to § 506(a). In that event the bifurcated,

unsecured portion when included in the remaining unsecured debt may increase such debt to a sum in excess of $290,525 thereby exceeding the statutory maximum and render the debtor unqualified for Chapter 13 relief. A joint petition may be filed by husband and wife. Their aggregate liabilities may not exceed the aforementioned limits. The Code does not permit involuntary petitions under Chapter 13.
§ 303.

A Chapter 13 case begins with the filing of a petition, schedules of assets and liabilities, and a statement of financial affairs with the bankruptcy court serving the area where the debtor lives. The case is immediately referred to a bankruptcy judge and then to a Chapter 13 trustee (see (b) below).

The debtor will need to compile and file a list of all creditors; a list of all of the debtor's property; the source, amount, frequency and reliability of the debtor's income; and a budget setting forth a detailed list of the debtor's monthly living expenses, i.e., rent, mortgage payments, food, clothing, utilities, taxes, transportation, medicine, etc. §§ 1322 and 1325. In order to accurately assess financial responsibilities, however, even when only one spouse files, the income and expenses of the non-filing spouse should be included.

Approximately 20 to 40 days after the petition is filed, a meeting of creditors is held under § 341. The debtor must attend this meeting at which creditors may appear as well as the Trustee and question the debtor's regarding its financial affairs and the proposed terms of the plan. § 343. Note that if a husband and wife have filed one joint petition they both must attend the creditors' meeting. The Chapter 13 trustee will also attend this meeting and question the debtor on the same matters. In order to preserve their independent judgment, bankruptcy judges are prohibited from attending. § 341(c). If there are problems with the plan, they are typically resolved during or shortly after the creditors' meetings. Generally, problems may be avoided if the petition and plan are complete and accurate, and the Trustee has been consulted prior to the meeting.

(b) The Chapter 13 Trustee

The Chapter 13 Trustee is appointed by the United States Trustee and serves as the principal administrator in the case. § 1302. The Trustee has the responsibility of investigating the debtor's financial affairs, accounting for payments made to it by the debtor and distribution by it of the payments to the creditors under the debtor's plan, examining proofs of claim, objecting to the allowance of improper claims and making a final report of the administration of the estate. The Trustee also examines the debtor at the meeting of the creditors called for by the statute, assumes or rejects contracts and leases, and may recover preferences and set aside fraudulent conveyances. It may appear before the court and is heard on important issues including a recommendation as to the confirmation of the plan. In many pro se cases the Trustee may also find itself acting as the pro bono attorney for the debtor. The trustee receives a commission not to exceed 10% of the plan payments.

(c) The Plan - §§ 1321-1330

The heart of the Chapter 13 case is the plan. The debtor is the only one who has the right to file a plan. § 1321. The Code allows for substantial flexibility with respect to its provisions. However, the plan must provide for the submission of all or a portion of future earnings or other future income to the Trustee to the extent that it is necessary for the execution of the plan. § 1322(a)(1). This is determined by the budget filed at the inception of the case. The remaining income stays within the debtor's control to be used for the support of the debtor and the debtor's family. Another mandatory provision in the plan requires payment in full of certain wage and tax claims. § 1322(a)(2). It may provide for deferred cash payments to those creditors but the present value must equal the full amount of their claims unless they agree to a different treatment. If claims are classified, each claim within a class must be accorded the same treatment. § 1322(b)(1). The Code provides for payment to creditors over a period of three years but extensions not to exceed a total of five years may be granted for cause. § 1322(d).

The plan may modify secured claims except that a claim secured only by a real estate mortgage on the debtor's principal residence may not be modified by the plan. § 1322(b)(2). It may provide for the curing or waiver of defaults. § 1322(b)(3). Secured creditors must receive at least the value of their collateral. Many courts had permitted the bifurcation of a mortgage on the debtor's residence under § 506(a) which provides for the reduction of the mortgage and its allowance as a secured claim to the extent of the value of the property and the balance as an unsecured claim. The Supreme Court has held that such bifurcation is not permissible in Chapters 7 and 13 cases.

The Code assists the debtor by permitting the plan to provide for the curing of any default within a reasonable time. Thus, the debtor may avoid loss of the property by proposing the payment of all past due installments as long as the cure is made without undue delay. Defaults must be cured within a reasonable time and contractual payments must be maintained on any unsecured or secured claim. § 1322(b)(5). The debtor may assume or reject any executory contract or unexpired lease. § 365.

Unsecured claims must be paid at least their liquidation value, that is, what they would realize in a Chapter 7 liquidation case. § 1325(a)(4). Claims must be filed within 90 days after the date set for the § 341 meeting. Rule 3002. Post-petition consumer claims may be filed and allowed for property or services necessary for the debtor's performance of the plan if the claimant knew or should have known that prior approval by the trustee was practicable and was not obtained. § 1305.

After the debtor files a plan, the court is required to conduct a hearing on notice to all creditors and interested parties to consider whether the plan should be confirmed. The requirements for confirmation are not as strict or complex as those for confirmation of a Chapter 11 plan. § 1324. For example, Chapter 13 does not require nor give unsecured creditors the right to vote to accept or reject the plan. § 1325.

A plan may not be confirmed unless it is proposed in good faith. Several courts have denied confirmation of plans offering nominal or no payments to unsecured creditors. On the other hand, other courts have held that the amount of payments is irrelevant to the good faith issue. If it can be shown that the plan represents the debtor's best effort and it was made in good faith it will not be a bar to the confirmation of the plan as long as the cash payments to be distributed are not less than the amount that would be paid to creditors if the estate were liquidated under Chapter 7. If the Trustee or an unsecured creditor objects to the confirmation of a plan, the court may not confirm it if the plan fails to provide that all of the debtor's disposable income to be received within three years will be applied to make the payments. Disposable income is defined to mean income that is not reasonably necessary for the maintenance or support of the debtor or its dependents. § 1325(b)(1)(2).

If the plan is confirmed by the bankruptcy judge, the trustee commences distribution of the funds received from the debtor. If the plan is not confirmed the funds paid to the Trustee are returned to the debtor after deducting the trustee's costs, as authorized by the court. § 1326(a)(2). On occasion changed circumstances will affect a debtor's ability to make payments, or a debtor may inadvertently have failed to list all creditors. In such instances, the plan may be modified before confirmation by the debtor under § 1323 or after confirmation by the debtor, the trustee or the holder of an allowed unsecured claim under § 1329.

Once the court confirms the plan, it is incumbent upon the debtor to make the plan succeed. The debtor must make regular payments to the trustee, which will require adjustment to living on a fixed budget for the period of the plan. The plan requires the debtor to submit to the Trustee all future earnings or other income necessary to execute the plan. § 1322(a)(1). It should not incur any significant credit obligations without consulting the trustee, as they may impact upon the plan. § 1305.

In the absence of the debtor's consent to the deduction of the plan payments from its paycheck, the Trustee generally obtains a wage garnishment. Experience has shown that this practice may increase the likelihood that payments will be made on time and plans completed. The debtor is required to commence making payments within 30 days after the plan is filed. § 1326. It is also required to make its monthly mortgage or rent payments as they become due after the Chapter 13 case has been filed. Failure to make the payments may result in the lifting of the stay by motion of mortgagees or landlords or it may also lead to dismissal of the case or its conversion to a liquidation proceeding under Chapter 7 of the Bankruptcy Code. §§ 362 and 1307(c).

The automatic stay against debt-collection and lien enforcement also applies in Chapter 13 cases. Co-debtors are protected by the stay under limited circumstances: relief from the stay is available if the plan proposed by the debtor does not provide for the payment of the claim in full. If the debtor defaults in the payments in its plan, the creditor may request the dismissal of the case or may collect from the debtor or co-debtor the total amount due. §1301.

(d) Confirmation of Plan - § 1324

The court shall hold a hearing on the confirmation of the plan after notice to all creditors and parties in interest, all of whom may object to the confirmation.

(e) Effect of Confirmation - § 1327

The confirmed plan binds the debtor and each creditor whether or not the claim of such creditor is provided for by the plan and whether or not such creditor has accepted the plan. Except as otherwise provided for in the plan or order confirming it, confirmation vests all of the property of the estate in the debtor.

(f) Revocation of Plan - § 1330

On request of a party in interest within 180 days after confirmation and after notice and hearing the court may revoke the order of confirmation if procured by fraud.

(g) Property of the Estate - § 1306

Property of the Chapter 13 estate includes, in addition to all property of the debtor as of the commencement of the case pursuant to § 541, all property and earnings acquired by the debtor after the commencement of the case. Except as provided in a confirmed plan or order confirming the plan, the debtor shall remain in possession of all property of the estate.

(h) Conversion or Dismissal - § 1307

The debtor may convert its Chapter 13 case to one under Chapter 7 at any time. Upon request of the debtor, if the case was not previously converted from Chapter 7, 11, or 12, the court shall dismiss the case. Upon request of a party in interest or the U.S. Trustee, after notice and hearing, the court may convert the case to Chapter 7 or dismiss it for cause, including, among other grounds, unreasonable delay by the debtor, non-payment of fees, failure to file a plan timely, failure to commence payments required, denial of confirmation, or material default of the terms of the plan, and for other reasons only on request of the United States Trustee. A case may not be converted to a case under another Chapter unless the debtor may be a debtor under such Chapter.

(i) Discharge Provisions - § 1328

Discharge provisions differ from those in the Chapter 7 case. Chapter 13 does not require a finding that the debtor is not guilty of any act that would constitute an objection to discharge. Upon completion of payments the debtor is granted a discharge from all debts excluding non-dischargeable student loans, debts for criminal restitution, long-term mortgage loans, claims for most taxes, and debts for alimony and maintenance due a spouse or former spouse and child support. Those creditors who were provided for in full or in part under the

plan, may no longer initiate or continue with any legal or other action against the debtor to collect the obligations.

After confirmation of a plan, there are circumstances under which the debtor may request the court to grant a "hardship discharge" when the debtor has failed to complete plan payments. Generally, such a discharge is only available to a debtor whose failure to complete the plan payments is due to circumstances beyond the debtor's control and through no fault of the debtor, after creditors have already received at least as much as they would have received in a Chapter 7 liquidation proceeding, and when modification of the plan is not possible. Injury or illness that precludes employment sufficient to fund even a modified plan may serve as the basis for a hardship discharge. Such a discharge does not discharge the debtor from "nondischargeable" debts. See XII, A, 4.

(j) Reasons for Filing

Most Chapter 13 cases are filed in order to invoke the automatic stay so as to prevent foreclosures of mortgages or to dispossess the debtors and their families from their apartments. Many debtors who come into the bankruptcy court for that purpose may obtain relief as long as the payments under the plan are met. Failure to perform under the plan as well as the failure to keep current in post-petition payments to the Trustee, mortgagee or landlord has been prevalent in numerous cases with the result that the stays are lifted and the Chapter 13 case is dismissed.

The numerous advantages of Chapter 13 as have been indicated are further augmented by the inexpensive legal fees for this type of proceeding. Most Chapter 13 case are handled by attorneys for a fee in the area of $1500. The fact that fees for Chapter 11 cases are so much higher is another reason why debtors who are qualified to file a Chapter 11 case opt for the Chapter 13 relief.

The fee for filing a petition under Chapter 13 is presently a filing fee of $155 and an administrative fee of $30, for a total of $185.

XIII. OTHER PERTINENT BASIC BANKRUPTCY PROVISIONS

A. Adequate Protection - § 361

When adequate protection of an interest in property is required under various provisions of the Code, e.g. the interest of a secured creditor, it may be provided by (1) requiring the debtor-in-possession or operating Trustee to make cash payments or periodic cash payments to such entity in the event of a decrease of its interest in its collateral; (2) providing to such entity an additional replacement lien; (3) granting the entity the indubitable equivalent of its interest.

B. The Automatic Stay - § 362

Section 362 is one of the most important sections of the Code. In general, the section provides for an automatic stay immediately upon the filing of the bankruptcy petition. It prevents the continuation or commencement of any action or proceeding against the debtor, the enforcement of any judgment against it or its property, any act to obtain possession of its property or to exercise control over it, and any act to create or enforce a lien against the property. It also prevents a set-off of any debt owing to the debtor that arose before the commencement of the case so that the debtor's bank may not apply funds in the debtor's account to reduce its loan. Secured creditors are stayed from foreclosing their mortgages and other liens, judgment creditors are prevented from executing against the debtor's assets, landlords are enjoined from dispossessing the debtor as a tenant, and prolonged, costly litigation arising out of substantial tort claims are contained. The rights of the parties affected by the stay are not extinguished but are merely held in abeyance while the debtor endeavors to effect a satisfactory method of providing the creditors with relief, or its equivalence, as ultimately determined by the bankruptcy court. In consideration of the temporary relief from the pressure, the debtor is required to provide the affected secured creditor with adequate protection against loss arising out of the stay as discussed above.

It is required that hearings be held expeditiously to determine the issues arising out of the stay. The court may terminate, annul or modify the stay for cause, including the lack of adequate protection, or if the debtor does not have any equity in the property (generally referred to as the "equity cushion") and it is not necessary to an effective reorganization. §362(d)(l) and (2). In Chapter 11 cases discussed later, the court may lift the automatic stay if it finds that the petition was filed in bad faith. The stay is not operative as to the commencement or continuation of a criminal action against the debtor or the collection of alimony, maintenance or support. It does not stay government agencies from enforcing their regulatory policies.

Although actions ordinarily are not stayed against non-debtors, usually officers who are guarantors, several courts have invoked their pervasive powers under § 105 and have applied the stay against the third-party where the action will jeopardize the ongoing reorganization or where it has an absolute right to be indemnified by the debtor.

Violation of the stay may subject the violator to contempt or sanctions and may also render void acts such as transfers of property. An individual injured by willful violation may recover actual damages including costs, attorneys fees and punitive damages. § 362(h). Some Circuits other than the Second Circuit have permitted recovery by corporations as well as by individuals.

The stay continues until the affected property is no longer property of the estate, as for example where a lease of non-residential property was terminated at the expiration of its term before the commencement of the case. § 54l(b)(2). All other stays continue until the earliest of the time the case is closed, dismissed or if in Chapter 7, until the debtor's discharge is granted or denied. § 362(c).

C. Use, Sale or Lease of Property - § 363

If the business of the debtor is authorized to be operated by the debtor-in-possession or by the Trustee, they may do so in the ordinary course of business, otherwise an order of the court is required after a hearing on notice to all parties in interest. The court has the right to prohibit or condition the same where necessary to provide adequate protection to the affected party. Where the entity has an interest in cash collateral, which includes among others, rent, accounts receivables and proceeds rising out of the sale of property subject to the entity's interest, the same may not be used by the debtor-in-possession or the operating Trustee unless the entity consents or the court, after notice and a hearing authorizes the same.

D. Obtaining Credit - § 364

This Section governs the procedure regarding financing of debtors-in-possession or Trustees. They are authorized to obtain unsecured credit and incur unsecured debt in the ordinary course of business. Debts so incurred are allowed as administration expenses. The court may also authorize them to obtain unsecured credit other than in the ordinary course of business, such as in order to wind up a liquidation or to obtain a substantial loan where the business is being operated, in which event those debts are also allowable as administrative expenses. If the Trustee or the debtor-in-possession are unable to obtain unsecured credit, they may obtain credit with some special priority, as for example, priority over any and all other administration expenses or secured by a lien on unencumbered property. The court may authorize the obtaining of credit and the incurring of debts with a super-priority, that is, a lien on encumbered property which is senior or equal to the existing lien on the property, only if they are otherwise unable to obtain credit and if there is adequate protection of the existing lienholders' interest.

E. Assumption or Rejection of Executory Contracts and Unexpired Leases - § 365

The Code provides for the assumption or rejection of any executory contract or unexpired lease of the debtor. § 365(a). If there has been a default, neither the debtor nor the Trustee in Chapter 11 or the Chapter 7 Trustee may assume such contact or lease unless the default is cured at the time the assumption or adequate assurance for a prompt cure is provided. §§ 365(a) and (b). Special provisions govern shopping center leases and lessees of an aircraft terminal or aircraft gate. §§ 365(b)3) and 365(d)(5).

In a Chapter 7 case if the trustee does not assume an executory contract or unexpired lease of residential real property or personal property of the debtor within 60 days after initiation of the case, or within such additional time extended by the court during that period, then the contract or lease is deemed rejected. § 365(d)(l). In cases under Chapters 11, l2, or l3, an unexpired lease of residential real property or contacts relating to personal property may be assumed or rejected any time before confirmation of a plan. The court, on request of the party to the contract or lease, may order the Trustee or debtor to determine within a specific time whether to assume or reject. § 365(d)(2). In a case under any Chapter, if there is no assumption or rejection of an unexpired lease of non-residential real property within 60

days after the initiation of the case, or within such time as extended by the court during that period, the lease is deemed rejected and the debtor or Trustee shall immediately surrender the real property to the lessor. § 365(d)(4). All obligations of the debtor, including payment of rent under the non-residential lease, must be performed until the lease is assumed or rejected, subject to extensions by the court for cause. § 365(d)(3). If the trustee does not assume or reject an unexpired lease of an aircraft terminal or aircraft gate before the termination date, the lease will be deemed rejected 5 days after the termination date. The time may, however, be extended. In addition, if rejected, the trustee shall surrender the property to the airport operator only if the airport operator waives any right to damages.§ 365(d)(5).

Leases and executory contracts cannot be terminated nor deemed terminated because of a provision which provides for such termination in the event of bankruptcy of the debtor. § 365(e). Neither the trustee nor the debtor may assume or assign an executory contract or an unexpired lease if the law excuses the other party from performance to someone other than the debtor, unless the other party consents. Thus, for example, the trustee of a recording-star debtor may not assign the debtor's contract to perform for a record company unless the company consented to the assignment. Nor can a contract to make a loan or extend other debt financing for the benefit of the debtor be assigned. A lease of non-residential real property which has been terminated under the law prior to the initiation of the case, may not be assumed or assigned. § 365(e)(2)(A) and (B).

If the Trustee or debtor rejects an unexpired lease of real property under which the debtor is the lessor, or a timeshare interest under which the debtor is the timeshare interest seller, the lessee or timeshare interest purchaser may treat such lease or timeshare plan as terminated by such rejection. In the alternative, the lessee or timeshare interest purchaser may remain in possession for the balance of the term for any renewal or extension. If they remain in possession, they may offset against the rent reserved under the lease or monies due for the timeshare interest, any damages occurring after such date caused by the nonperformance of the obligation of the debtor, but such lessee or timeshare interest purchaser does not have any rights against the estate on account of any damages arising from such rejection, other than such offset. § 365(h). Also the lessor's rejection of a lease in a shopping center in which the lessee elects to retain its rights does not affect the enforceability under non-bankruptcy law of any provision regarding radius, location, use, exclusivity, or tenant mix or balance. § 365(h)(1)(C).

If the Trustee or debtor rejects an executory contract of the debtor for the sale of real property or for the sale of a timeshare interest under which purchaser is in possession, such purchaser may treat such contract as terminated, or in the alternative, may remain in possession. In that event the purchaser shall continue to make all payments due under the contract, but may offset any damage occurring after the date of the rejection caused by the nonperformance of the debtor, but such purchaser does not have any rights against the estate on account of damages other than such offset, and the Trustee or debtor shall deliver title to such purchaser in accordance with the contract. It is relieved of all other obligations to perform under the contract. § 365(i).

A person that treats such an executory contract as terminated, or a party whose executory contract to purchase real property from the debtor is rejected and under which such party is not in possession, has a lien on the interest of the debtor in such property for the recovery of any portion of the purchase price that such purchaser or party has paid. § 365(j).

Notwithstanding a provision in an executory contract or unexpired lease of the debtor that prohibits the assignment of the contract or lease, the Trustee or debtor may assign the contract or lease, except for a terminated aircraft terminal or gate lease, only if they first assume the contract or lease in accordance with the provisions of the Code as set forth herein, and adequate assurance of future performance by the assignee of such contract or lease is provided. § 365(f). If approved by the court, the assignment relieves the Trustee or the debtor from any liability for any breach of the contract or lease occurring after the assignment. § 365(k). If the lease is assigned, the lessor of the property may require a deposit or other security for the performance of the debtor's obligations under the lease substantially the same as would have been required by the landlord upon the initial leasing to a similar tenant. § 365(l).

Where a lease of non-residential property was terminated at the expiration of its term before the commencement of the case, the debtor's interest as a lessee ceases and is not deemed property of the estate. § 541(b)(2). Thus, the lease cannot be assumed nor rejected.

F. Utility Service

A utility may not alter, refuse or discontinue service to a trustee or debtor solely on the basis of the commencement of the bankruptcy or that a debt was owed by the debtor for services rendered before the bankruptcy case was filed. The utility may discontinue service if neither the trustee nor the debtor, within 20 days after the date of the order for relief, furnishes adequate assurance of payment in the form of a deposit or other security for such service after such date, subject to modification by the court of the amount of the deposited requested.

XIV. CREDITORS' CLAIMS - §§ 501-507

A. Generally

The present Bankruptcy Code recognizes the need to maintain a fair relationship between debtors and creditors. The concern of the Bankruptcy Code to protect and preserve the rights of creditors is evident in the discussion contained in this material. The Code in § 101(10) defines a creditor as an entity that has a claim against the debtor which arose at the time of or before the order of relief concerning the debtor, and in certain conditions, even after the petition was filed. Section 101(5) provides that a claim means the right to payment whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured or unsecured, or the right to an equitable remedy.

In Chapter 7 and Chapter 13 cases, a proof of claim must be filed within 90 days of the date set for the § 341 meeting. In Chapter 7 cases, if notice of insufficient assets to pay a dividend was given to creditors informing them that a claim need not be filed, where the trustee subsequently notifies the court that the payment of a dividend appears possible, the clerk shall notify the creditors of that fact and they may file proofs of claims within 90 days after the mailing of the notice. In Chapter 11 cases, a proof of claim is deemed filed if the creditor and the amount due it is listed in the debtor's schedules unless the amount is incorrectly stated or it is listed as disputed, contingent or unliquidated, in which event a claim must be filed in order for the creditor to participate in any distribution. § 1111(a). Where a creditor did not file a claim in a Chapter 11 case it must file if the case is converted to a Chapter 7 case.

B. Allowance of Claims - § 502

1. Allowance or Disallowance in General

A claim filed or deemed filed shall be allowed unless a party in interest objects to it. § 502(a). Claims will be disallowed to the extent that they are unenforceable against the debtor such as for usury, unconscionability, or failure of consideration, or represent a deficiency by an under-secured creditor on a non-recourse loan or under a state anti-deficiency law. § 502(b).

2. Landlord Claims - § 502(b)(6)

The claim of a landlord of the debtor arising out of the termination or rejection of a lease of real property is allowed as a general, pre-petition claim, but is limited to the greater of one year or 15% of the remaining portion of the lease not to exceed three years after the date of the filing of the petition or surrender of the premises, whichever is earlier, together with any unpaid rent due. § 502(b)(6).

3. Breach of Employment Contracts - § 502(b)(7)

Claims for damages for breach of employment contracts are allowed as general, pre-petition claims but are limited to one year following the date of the petition or termination of the contract, whichever is earlier. § 502(b)(7).

4. Administration Expense Claims - § 503

These claims consist of expenses incurred during the course of the bankruptcy case, representing necessary costs and expenses of preserving the estate, including wages, rent and reasonable compensation for professional services rendered by attorneys or accountants authorized to render such services by the court.

5. **Priority Claims - § 507**

These consist in pertinent part as follows:

a. Administration expense claims allowed under §503 as noted above. (§507 (a)(1)).

b. Claims which arose in an involuntary case after the initiation of the case but before the earlier of the trustee's appointment allowed under §502(f). (§ 507(a)(2)).

c. Wage claims including vacation, severance, sick-leave pay, and sales commissions, not to exceed $4,650 earned within 90 days from the date of the filing of the petition or cessation of business, whichever was first. (§507(a)(3)). The balance of the claim will be allowed as a general claim.

d. Union claims for benefit plans such as pension, health or welfare, in an amount calculated by multiplying the maximum allowable $4,650 wage priority by the number of employees covered by the plan, less the total distribution paid to the wage claimants. (507(a)(4)).

e. Consumer deposits to the extent of $2,100 each. (§ 507(a)(6)).

f. Claims for debts to a spouse, former spouse, or child of the debtor for alimony or maintenance payments in connection with a separation, divorce, or settlement agreement but not to the extent that the debt is assigned to another entity or includes a liability designated as alimony, maintenance, or support, unless such liability is actually in the nature of alimony, maintenance, or support. (§ 507(a)(7)).

g. Income taxes, gross receipt taxes, employment and excise taxes for which returns are due within three years of the filing of the petition; property taxes and customs duties for one year, and tax penalties for pecuniary loss. (§507(a)(8)).

h. Super priority claims - Where a creditor's action is stayed pursuant to the automatic stay, and the protection given the creditor proves to be inadequate, the creditor shall be given a super priority over all priority claims. (§507(b)).

6. **Secured Claims - § 506**

A claim of a creditor secured by a lien on property in which the estate has an interest, or that is subject to setoff, is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such

property, or to the extent of the setoff. It is an unsecured claim to the extent that the value of the creditor's interest is less than the amount of the claim. To the extent that the secured claim is secured by property whose value is greater than the claim, there shall be allowed to the claimant, interest and any reasonable fees, costs, or charges provided for under the agreement which gave rise to the claim.

XV. DETERMINATION OF TAX LIABILITY - § 505

A. Generally

Unless hereinafter otherwise provided, the bankruptcy court may determine the amount of legality of any tax, fine or penalty relating to a tax whether or not previously assessed, whether or not paid, and whether or not contested before and adjudicated by a judicial or administrative tribunal of competent jurisdiction. The court may not so determine the same if such amount or legality was contested before and adjudicated by such tribunal before the commencement of the case.

XVI. SUBORDINATION - § 510

A. Generally

(a) A subordination agreement is enforceable to the same extent that such agreement is enforceable under applicable nonbankruptcy law.

(b) For the purpose of distribution, a claim arising from recision of a purchase or sale of a security of the debtor or an affiliate, for damages arising from the same, or for reimbursement or contribution on account of such claim, shall be subordinated to all claims or interests that are senior to or equal the claim or interest represented by such security, except that if such security is common stock, such claim has the same priority as common stock.

XVII. DISTRIBUTION OF PROPERTY OF THE ESTATE - § 726

A. Generally

(a) Except as provided in subsection 510 dealing with subordination discussed above, property of the estate shall be distributed only as follows:

(1) first, in payment of claims in order of priority as set forth in § 507, proof of which is timely filed;

(2) second, in payment of any allowed unsecured claim, except as otherwise provided for in this section, proof of which is timely filed or, if tardily filed, the creditor that holds such claim did not have notice or actual knowledge of the case in time for such timely filing and proof of such claim is filed in time to permit its payment;

(3) third, in payment of any allowed unsecured claim, proof of which is tardily filed other than a claim of the kind specified above;

(4) fourth, in payment of any allowed claim, whether secured or unsecured, for any fine, penalty or forfeiture, or for punitive damages arising before the filing of the bankruptcy case or the appointment of a trustee, to the extent that the same are not compensation for actual pecuniary loss suffered by the claimant;

(5) fifth, in payment of interest at the legal rate from the date of the filing of the petition on any of the foregoing claims;

(6) sixth, to the debtor.

(b) Payment of the foregoing claims shall be pro rated among the similar claims in each of the foregoing classifications.

XVIII. TREATMENT OF CERTAIN LIENS - § 724

A. Generally

(a) The trustee may avoid a lien that secures a claim of the kind specified in § 726(a)(4) described above.

XIX. TRUSTEE'S AVOIDING POWERS - §§ 544, 546, 547, 548, 549, and 550

A. Preferences - § 547

The trustee may institute proceedings to void preferential transfers made in violation of § 547 which is aimed at any transfer of the debtor's property for the benefit of a creditor on account of an antecedent debt of the debtor, made while the debtor was insolvent (there being a presumption of such insolvency which can be rebutted), within 90 days, or in the case of an insider, within one year before the bankruptcy petition was filed and which enabled the transferee to receive more than it would receive in a liquidation case. Transfers are not deemed preferences if they constituted a contemporaneous exchange or were given for new value or were in payment of a debt incurred in the ordinary course of business, made in the

ordinary course of business according to ordinary business terms, or created a security interest in property acquired by the debtor and were given to enable the debtor to acquire such property. The Code includes as an insider a relative or general partner of the debtor, or a director or officer, or any entity in control of a debtor corporation. See § 101(31). No preference arises in the case of an individual debtor whose debts are primarily consumer debts where the value of the transfer is less than $600.

The Chapter 11 debtor-in-possession has the same rights as a Trustee set forth above. § 1107.

B. Fraudulent Conveyances - §§ 544 and 548

Section 544 gives the trustee the rights and powers of a judicial lien creditor as of the date of bankruptcy. This enables him to avoid any transfer of property or an obligation of the debtor which could be avoided by a creditor on a simple contract who could have obtained such judicial lien, whether or not such creditor exists, or by a creditor with an execution returned unsatisfied, all as determined by the law of the State in which such transfer occurred, as well as the rights of a bona fide purchaser of real property whether or not such purchaser exists.

Under § 548 the trustee has the right to avoid fraudulent conveyances made within a year of the filing of the bankruptcy petition. A transfer is deemed void if made by the debtor with actual intent to hinder, delay or defraud creditors. It is also voidable if at the time of transfer the debtor received less than reasonably equivalent value and was insolvent or became insolvent as a result of the transfer, or left the debtor with unreasonably small capital or resulted in the debtor's inability to meet its obligations as they became due.

Section 544 also provides that the trustee may alternatively use any state statute which is not inconsistent with section 548. For example, in the State of New York, the trustee may avail himself of the Uniform Fraudulent Conveyance Act, which mirrors the provisions of section 548 except for a much more liberal statute of limitations of six years.

The Chapter 11 debtor-in-possession has the same rights as a trustee set forth above. § 1107.

C. Post-Petition Transfers - § 549

The trustee may avoid a transfer of property of the estate that occurs after the commencement of the case not authorized by the court.

D. Liability of Transferee of Avoided Transfer - § 550

The trustee or debtor-in-possession in a Chapter 11 case may recover the property transferred or its value from the initial transferee, the entity for whose benefit the transfer was made or from any immediate transferee of the initial transferee.

E. Preservation of Avoided Transfer - § 551

Transfers avoided or liens deemed void are preserved for the benefit of the estate.

F. Statute of Limitations - § 546

Section 546 provides that proceedings brought under §§ 544, 547 and 548 may not be commenced after the earlier of:

1) the latter of (A) 2 years after the entry of the order for relief or (B) 1 year after the appointment or election of the first trustee, or

2) the time the case is closed or dismissed.

The right of a seller of goods to a debtor is covered by § 546(c).

XX. FEES AND COMPENSATION - §§ 326-331, Rules 2014 and 2016 and 28 U.S.C. 1930

The court may allow reasonable compensation to the Chapter 7 or 11 trustee upon application to the court after a hearing and notice to all parties in interest including the U.S. Trustee, as limited by §§ 326 and 330 and Rule 2016.

After notice to all parties in interest and the U.S. trustee, the court may award to the trustee, operating Trustee and examiner in Chapter 11, a professional person employed by the debtor, trustee or committee, reasonable compensation for actual, necessary services rendered by them, together with reimbursement for actual, necessary expenses. Attorneys are required to submit detailed time records setting forth the time spent and description of the work involved, to assist the court in establishing a fee. § 330 and Rule 2016. Compensation to the attorney for the debtor may include a retainer on an hourly or contingent fee basis. The court may allow compensation different from that provided under such terms and conditions after the conclusion of such employment in light of developments not previously anticipated. §§ 326-328.

The attorney for the debtor is required to file a statement of the compensation paid or agreed to be paid if such payment or agreement was made within a year of the bankruptcy, for services rendered or to be rendered in contemplation or in connection with the case and the source of such compensation. If it exceeds the reasonable value of such services, the court may cancel the agreement, or order the return of the payment to the extent excessive. The return is to be made to the estate if paid by the debtor or to the entity that made such payment. § 329 and Rule 2016.

The Trustee, examiner, attorney for the debtor, or any professional person employed pursuant to an order of the court may apply to the court not more than once every 120 days

after the order for relief, or more often if the court permits, for such compensation for services rendered before the application is made or reimbursement of expenses in the nature of interim compensation. § 331.

Fees to the U.S. Trustee are enumerated in 28 U.S.C. § 1930. Fees to auctioneers and appraisers are usually fixed by the local rules of the bankruptcy court.

XXI. CASES ANCILLARY TO FOREIGN PROCEEDINGS - § 304

A case ancillary to a foreign proceeding may be commenced by filing a petition with the bankruptcy court by a foreign representative to enjoin the commencement or continuation of any action against the debtor with respect to property involved in the foreign proceeding and for other equitable relief.

XXII. ABSTENTION - § 305

The Court may dismiss a case or may suspend proceedings if the interests of creditors and the debtor would be better served or there is pending a foreign proceeding under § 304 in which the dismissal or suspension is warranted. See also 28 U.S.C. 1334 in IV above.

XXIII. REMOVAL OF CLAIMS RELATED TO BANKRUPTCY CASES - 28 U.S.C. § 1452

A party may remove any claim or cause of action in a civil action related to a bankruptcy case other than a proceeding in the United States Tax Court or a civil action by the government to enforce its police or regulatory power, to the district court where such civil action is pending. The district court will then refer the claim or cause of action to the bankruptcy court where the case, affected by the action, is pending. The bankruptcy court may remand such claim or cause of action back to the court from which the claim or civil action had been removed.

CONCLUSION

Bankruptcy law has sought to keep abreast of the constant changes which have affected its growth over the past 200 years. It has met the demands of debtors and creditors in their quest for fair and equitable treatment. The many changes the law has experienced is indicative of its favorable response to those demands. It represents the dedication of the country's lawmakers in enacting legislation which demonstrates their concern for the welfare of debtors and creditors alike. Equally important is the fulfillment of the judicial responsibility of the bankruptcy judge in interpreting those laws, and the bankruptcy lawyers who dedicate themselves in making the benefits of those laws available to those for whom the laws exist.

CONRAD B. DUBERSTEIN
CHIEF BANKRUPTCY JUDGE
UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF NEW YORK