Summer 2016

The Cramdown

The Newsletter of the Tampa Bay Bankruptcy Bar Association

Editors-in-chief, Noel R. Boeke, Holland & Knight, LLP
Megan W. Murray, Trenam Law

PRESIDENT'S MESSAGE

by Kelley Petry
Kelley Petry, P.A.

Thank you all for allowing me to be President of the Tampa Bay Bankruptcy Bar Association for the 2016 – 2017 year. This is a proud opportunity for me to assume the leadership of this great Association. I appreciate your ongoing support for the good works we can provide to our members and our community.

One of the largest ongoing projects this Association manages is the Pro Se Clinic. Every Monday and Wednesday from 1:00 pm to 4:00 pm, we staff the Attorney Resource Room with at least one volunteer attorney to provide legal advice to pro se filers. There is no shortage of pro se filers seeking help. There is a significant shortage in the number of attorneys who give so generously of their time to staff the Clinic.

Many attorneys who do not practice consumer bankruptcies are hesitant to participate. Thanks to the hard work and dedication of Judge McEwen, we have found a way to remedy that.

October 20, 2016, TBBBA, in conjunction with HCBA and Bay Area Legal Services, will be conducting a seminar. This seminar will be free to all attendees. This seminar will be aimed at giving attendees the information necessary to advise a pro se debtor on how to successfully maneuver through their case. We are not trying to give a tutorial on how to practice consumer bankruptcy. We are going to give the attendees the basic tools to solve the small problems. Materials will be provided by the National Consumer Law Center along with a PowerPoint presentation. These materials were prepared for the specific purpose of assisting pro bono programs.

Now here is where you come in. We need your help! If every attorney member could come to our seminar and volunteer for a single one hour shift at the Clinic each year, there would be no shortage for staffing. There would be hundreds more successful debtors, and there would be Judges happier for having their time on the Bench more efficiently used.

Of course, we continue to provide monthly CLE and Consumer lunches on current issues presented by knowledgeable speakers; and don't forget to mark your calendar for the annual View From The Bench seminar being held on November 3, 2016.

If you have any issues that you would like to have the TBBBA consider, or just have a question, please feel free to call me. I'm looking forward to the great things we can accomplish this year.

In This Issue

The *Cramdown* can be accessed via the Internet at www.flmb.uscourts.gov and www.TBBBA.com

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Costly Conduct: The Bankruptcy Court's Three Sources of Power to Impose Sanctions

by: Lara E. McGuire

While issues related to professionalism and misconduct often arise in disciplinary actions, sanctions remain an important, and often more immediate, remedy to deter misconduct. Two recent cases, issued within one day of each other, recognize the powers yielded by the bankruptcy court to impose sanctions, as well as the high standard required for such a ruling: *Castellanos Group Law Firm, L.L.C. v. FDIC*,[1] and a local case, *In re Strunk*.[2] While the facts of both cases are starkly in contrast with one another, they illustrate the circumstances in which the court is left to determine whether this conduct comes at a cost.

In *Castellanos*, the First Circuit B.A.P. upheld the issuance of sanctions totaling $14,270.60 on attorney Anabelle Quiñones-Rodriguez and the Castellanos Firm. In this case, the FDIC, later joined by the Trustee, petitioned the bankruptcy court to grant sanctions, claiming that for a period of three weeks, they had "repeatedly called and e-mailed… counsel in a genuine, honest, and good faith effort to resolve various defects…counsel, however, has refused to respond to a single message or otherwise speak with undersigned counsel."[3] The parties went further to state that the firm "categorically refused to respond to any communications."[4] Quiñones-Rodriguez attempted to justify her failure to communicate by claiming that her office was in the process of moving and, therefore, communications had been interrupted.[5] The First Circuit upheld the bankruptcy court's findings that "Quiñones-Rodriguez's actions display[ed] a disregard for the orderly process of justice, not negligence, inadvertence or incompetence."[6]

By contrast, in *Strunk*, the bankruptcy court denied two motions for sanctions brought by counsel for the debtor against Special Counsel for debtor's personal injury claim.[7] The motions for sanctions claimed that Special Counsel delayed the proceedings and further filed motions lacking legal or factual merit.[8] However, in denying the motions, the bankruptcy court found that "[n]one of the conduct cited… reaches the level of objective bad faith," and "the facts simply do not merit sanctions."[9]

The juxtaposition of these two cases demonstrate the level of misconduct necessary to warrant sanctions. In both cases, the courts reference the three sources of power that allow bankruptcy courts to impose sanctions: 28 U.S.C. § 1927, Fed. R. Bankr. P. 9011, and the court's inherent power.[10]

Section 1927

The key language in Section 1927 provides that excess costs, expenses, and attorneys' fees may be granted where an attorney "multiplies the proceedings in any case unreasonably and vexatiously."[11] The Eleventh Circuit has outlined the three requirements for sanctions pursuant to Section 1927: (1) the attorney must have engaged in unreasonable and vexatious conduct, which is conduct so egregious as to be tantamount to bad faith; (2) the attorney's conduct must have multiplied the proceedings; and (3) the sanctions awarded may not exceeds the costs, expenses, and attorneys' fees reasonably incurred because of the conduct.[12] Bad faith, as required by the Eleventh Circuit, is to be evaluated based on the

continued on p. 4

1 545 B.R. 401 (Bankr. App. 1st Cir. 2016).
2 8:07-BK-7297-KRM, 2016 WL 675819, at *1 (Bankr. M.D. Fla. Feb. 18, 2016).
3 Castellanos, 545 B.R. at 407.
4 Id. (emphasis added).
5 Id. at 408.
6 Id. at 421.
7 Strunk, 2016 WL 675819, at *1.
8 Id. at *2.
9 Id. at *6.
10 Castellanos, 545 B.R. at 418.
11 28 U.S.C. § 1927.
12 Strunk, 2016 WL 675819, at *4 (citing Amlong & Amlong, P.A. v. Denny's Inc., 500 F.3d 1230, 1239-42 (11th Cir. 2007)).

Sanctions
continued from p. 3

attorney's objective conduct. Significantly, "there is a 'longstanding rule that the provisions of § 1927, being penal in nature, must be strictly construed.' This is a 'high standard,' that requires a finding of 'particularly egregious' conduct."[13]

On this issue, the *Castellanos* and *Strunk* courts dealt with drastically differing conduct, resulting in their opposing outcomes. In *Castellanos*, the court affirmed the bankruptcy court's findings that counsel's "unjustified refusal" to engage in *any* communication with opposing counsel over the span of several weeks constituted a "cavalier disregard for both the [c]ourt and h[er] colleagues' time," and ultimately this behavior "is precisely the type of behavior targeted by § 1927."[14] This conduct is clearly distinguishable from that found in *Strunk*; because "Special Counsel did not knowingly or recklessly make allegations without any basis in fact or law," the conduct failed to reach the level of "particularly egregious" conduct required to grant sanctions under Section 1927.[15]

Rule 9011

As an additional source of power, Fed. R. Bankr. P. 9011 shifts its focus to the representations made by the parties in their petitions, pleadings, motions, and other papers. Under Rule 9011, sanctions are warranted where submissions to the court are presented in bad faith or for an improper purpose, such as harassment, to cause unnecessary delay, or to needlessly increase the cost of litigation, or where the legal contentions are frivolous.[16] In order to satisfy this standard, "there must be 'absolutely no evidence to support [the] allegations'" submitted to the court.[17]

Although the *Castellanos* court did not address the issuance of sanctions under Rule 9011,[18] the *Strunk* court weighed the merit of a motion for sanctions under the Rule. In evaluating the sufficiency of the claims presented, the bankruptcy court recognized that evidence that would ultimately be insufficient to succeed in trial may still be sufficient under Rule 9011, and in this case, Special Counsel provided *some* factual support deemed adequate to satisfy this requirement.[19] Consequently, the motion for sanctions under Rule 9011 was denied because there was no evidence in the record to support the allegation that submissions were made in bad faith.[20]

Inherent Power

Lastly, the Supreme Court has recognized that the inherent power of the federal courts grants courts "the ability to fashion an appropriate sanction for conduct which abuses the judicial process."[21] However, with great power comes great responsibility—"inherent power should be exercised with caution and its invocation requires a finding of bad faith."[22] Unlike Section 1927 or Rule 9011 sanctions, which focus on particular components of the litigation, the inherent power may be applied for any issue that arises during litigation.[23]

While the *Castellanos* court made no findings of sanctions through inherent powers,[24] the *Strunk* court once again focused on the issue of bad faith. In light of both the high standard to be considered through the court's inherent powers, as well as the lack of evidence of objective bad faith by counsel, the court declined to exercise its inherent power to impose sanctions.[25]

Although these three sources of sanctions present seemingly high standards, they are not impossible to obtain. As the *Castellanos* case proves, failure to act professionally and in good faith may result in a costly outcome.

13 Id. at *5 (internal citations omitted).
14 Castellanos, 545 B.R. at 422.
15 Strunk, 2016 WL 675819, at *5.
16 FED. R. BANKR. P. 9011(b)-(c). See also In re Mroz, 65 F.3d 1567, 1572 (11th Cir. 1995).
17 Strunk, 2016 WL 675819, at *5. This standard supports the intention that Rule 9011 deter claims with no factual or legal basis at all. Id. (citing Davis v. Carl, 906 F.2d 533, 538 (11th Cir. 1990)).
18 The court held that it was only necessary to affirm the issuance of sanctions on a single ground, in this case, the requirements of Section 1927, and therefore the court did not engage in a Rule 9011 analysis. Castellanos, 545 B.R. at 423.
19 Strunk, 2016 WL 675819, at *6.
20 Id.
21 Chambers v. NASCO, Inc., 501 U.S. 32, 44-45 (1991).
22 Strunk, 2016 WL 675819, at *6.
23 Id.
24 See supra n. 18.
25 Strunk, 2016 WL 675819, at *6.

The Eleventh Circuit Speaks: The Bankruptcy Code Does Not Preempt the FDCPA

by: Amy L. Drushal, Trenam Law

After a number of decisions from the District Courts in the Eleventh Circuit post-*Crawford v. LVNV Funding, LLC*, 758 F.3d 1254, 1261 (11th Cir. 2014), the Eleventh Circuit has now answered the question that it left open and that has been the subject of much discussion: whether the Bankruptcy Code preempts the Fair Debt Collection Practices Act ("FDCPA") for time barred proofs of claim. Specifically, in *Johnson v. Midland Funding*, 2016 U.S. App. LEXIS 9478 (11th Cir. May 24, 2016), the Eleventh Circuit held that the Bankruptcy Code does not preempt the FDCPA for time barred proofs of claims filed by "debt collectors" under the FDCPA in a Chapter 13 bankruptcy proceeding.

In *Johnson*, the debtor filed a Chapter 13 Bankruptcy Petition. The debt collector creditor filed a proof of claim, which was long past the six-year statute of limitations under Alabama law. In the *Johnson* decision, the Eleventh Circuit also consolidated the case of *Brock v. Resurgent Capital Services, LP*, in which the debtor filed a Chapter 13 Bankruptcy Petition, and the debt collection creditor filed a proof of claim, also past the six-year statute of limitations under Alabama law. The debtors filed suit against their respective creditors under the FDCPA, alleging that the creditors' claims were barred by the statute of limitations and, therefore, were unfair, unconscionable, deceptive, and misleading in violation of the FDCPA.

In *Johnson*, the District Court read the Bankruptcy Code to affirmatively authorize a creditor to file a proof of claim, including one that is time barred, if the creditor had a "right to payment" that had not been extinguished under state law. The *Johnson* District Court found an irreconcilable conflict with the FDCPA and held that creditors' right to file a time barred proof of claim under the Bankruptcy Code precluded debtors from challenging that practice as a violation of the FDCPA in the Chapter 13 Bankruptcy context. In the *Brock* matter, the District Court granted the creditor's motion for judgment on the pleadings based upon the same grounds.

On appeal, the debtors argued that the District Courts' decisions conflicted with *Crawford*, asserting that the Bankruptcy Code does not preclude their FDCPA claim simply because the claim was made in the context of a Chapter 13 proceeding. The *Johnson* Court discussed *Crawford* and then turned to the question it left unanswered, holding that the Bankruptcy Code does not preclude an FDCPA claim in the context of a Chapter 13 bankruptcy when a debt collector files a proof of claim it knows to be time barred. The Court recognized that the Bankruptcy Code allows creditors to file time barred proof of claims, but explained that, when a particular type of creditor – a debt collector under the FDCPA – files a knowingly time barred claim, the debt collector is vulnerable to a claim under the FDCPA. The Court also recognized that the FDCPA provides a safe harbor for debt collectors who might unintentionally or in good faith file a late proof of claim.

The Eleventh Circuit rejected the District Courts' finding of an irreconcilable conflict between the FDCPA and the Bankruptcy Code. The Court found that the Bankruptcy Code and the FDCPA can be reconciled because "they provide different protections and reach different actors." The FDCPA applies to debt collectors where the Bankruptcy Code applies to all creditors. "The Code establishes the ability to file a proof of claim . . . while the FDCPA addresses the later ramifications of filing a claim."

The Court noted that it reads the "regimes" together as providing "different tiers of sanctions for creditor misbehavior in bankruptcy." Thus, the Eleventh Circuit concluded that the FDCPA and Bankruptcy Code can co-exist. In further support of its opinion, the Court noted that: (1) no provision in either the FDCPA or the Bankruptcy Code governs the interrelations between the two statutes; and (2) Congress never expressed any clear and manifest intent to repeal the protections of the FDCPA when it enacted the Bankruptcy Code one year later. Because the debtors FDCPA claims were not precluded by the Bankruptcy Code, the District Courts' orders were reversed and remanded.

Analysis of Chapter 7 Attorney's Fees for the Middle District of Florida

by Timothy W. Stella
Fall 2015 Intern for the Honorable Judge Catherine Peek McEwen at the U.S. Bankruptcy Court for the Middle District of Florida and J.D. Candidate 2016, Stetson University College of Law

Of the nation's 90 bankruptcy courts, the United States Bankruptcy Court for the Middle District of Florida, as of FYE 9/30/15, is the fourth busiest based on number of filings. It contains 35 of Florida's 67 counties, including several of Florida's largest metropolitan areas. Approximately 10 million of Florida's 18 million people reside in the Middle District of Florida.

Pursuant to 11 U.S.C. § 329(a) and Bankruptcy Rule 2016(b), any attorney representing a debtor in a bankruptcy case shall file a statement of compensation with the court disclosing the attorney's requested fees.

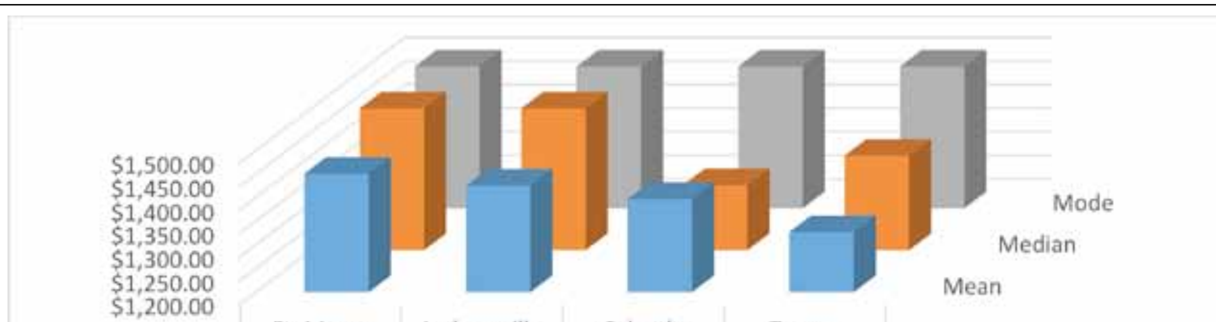
This article analyzes attorney's fees of the four bankruptcy divisions in the Middle District of Florida: Ft. Myers, Jacksonville, Orlando, and Tampa.

Using the required statements of compensation, which are readily available in case dockets found on the CM/ECF system, a sample size of the first 100 examples of attorney's fees for each division—omitting all pro se cases and fees in the unusually high/low ends of the spectrum—was obtained for cases active between October 1, 2015 and November 4, 2015. The sample size for each division was then analyzed for the Mean (average), Median, and Mode.

The Mode was homogenous over the four divisions at $1,500. The Median calculations for Ft. Myers and Jacksonville were identical at $1,500, followed by Tampa at $1,400, and Orlando at $1337.50.

The Mean contained variances across all four divisions with Ft. Myers garnering the highest average fee at $1,450.55, followed by Jacksonville at $1,425.06, Orlando at $1,397.13, and Tampa at $1,327.06.

The division with the least number of chapter 7 filings over the same period garnered the highest average compensation—Ft. Myers—while the division with the most chapter 7 filings over the same period garnered the lowest average compensation—Tampa. This corollary may be due to the fundamental economic concept of price affecting demand or, with the influx of large volumes of chapter 7 cases in the more densely populated divisions, attorneys may be more willing to lower compensation for individual cases while still maintaining their overall compensatory goals.



	Ft. Myers	Jacksonville	Orlando	Tampa
Mean	$1,450.55	$1,425.06	$1,397.13	$1,327.06
Median	$1,500.00	$1,500.00	$1,337.50	$1,400.00
Mode	$1,500.00	$1,500.00	$1,500.00	$1,500.00

Negotiation and Mediation Tips

by: Mark Stein, Mark Stein Law

I recently completed the Florida Supreme Court training to become a Certified Circuit/Civil Mediator. The training taught me many things about serving as a mediator, which are also applicable in any negotiation. Some of these seem obvious, but are worth repeating and I hope are helpful to you.

1. Listen more than you talk. This is really hard for lawyers, especially, litigators, but it is critical. Ever notice the best negotiators seem to say the least.

2. Ask questions rather than make statements. This is not only a great way to gather information, it is also a great way to help the litigants or the opposing party or lawyer come to a conclusion you want on his/her own.

3. Get the other side/the parties to talk. This seems obvious, but the more information you gather, the more potential options become available. For example, during an exercise in mediation training involving a dispute between a landlord and tenant, getting the sides to talk revealed the landlord owned multiple properties, which created an opportunity to craft resolutions that were not apparent at first.

4. Be creative. Often in negotiation or mediation, there are many ways to get to the same goal, but the negotiators lose sight of the possibilities by being too focused on what is right in front of them. Do not be afraid to explore the options.

5. It is not only about the money. I know, the money always seems to be the focus in almost every negotiation, but do not ignore the non-monetary terms. In my world of patent, trademark, copyright, computer and internet matters, the scope of a license or an injunction is often more important than the monetary terms.

6. Step back and look at the big picture. The first thing to figure out is what is globally driving the discussion or dispute. For example, going back to our landlord tenant dispute, the first question to ask is does the landlord want the tenant to remain in the property and does the tenant want the same thing? The answer to these big picture questions should frame the entire negotiation.

7. Do not play dirty pool. This is another that seems obvious, because sadly too many negotiators will engage in dishonest or disingenuous conduct. Since dishonesty always seems to come back in some form, play clean.

8. Pay Attention to body language. Invest time and effort in watching the physical reactions and body language in the room. Often you will be able to tell if someone is uncomfortable, anxious or angry. This is valuable information.

9. Ask questions rather than make statements. This is good advice in all aspects of our lives and if you do not think so, ask your spouse or significant other.

10. Listen more than you talk. This and number 9 are so important that they really bear repeating, especially since lawyers often struggle with both.

I hope you find the above helpful.

SAVE THE DATE

TBBBA 2016-2017
CLE LUNCHEON SCHEDULE

Location: University Club

Tuesday, October 11, 2016
No November Lunch
Tuesday, December 13, 2016
Tuesday, January 10, 2017
Tuesday, February 14, 2017
Tuesday, March 21, 2017
Tuesday, April 11, 2017
Tuesday, May 9, 2017

Volunteers to co-chair the May 2017 lunch are still needed. Please contact Kathleen DiSanto (kdisanto@jennislaw.com) or Jake Blanchard (jake@jakeblanchardlaw.com) if you are interested.

Clerk's Appreciation Luncheon
August 3, 2016
Courthouse

Paskay Award Recipients
June 23, 2016
Centre Club, Tampa

L-R: Correy Karbiener, Daniel Chehouri, and Lara McGuire

Congrats to Correy, who will start soon with Burr & Forman

The Tampa Bay Bankruptcy Bar Association
and
The Business Law Section of the Florida Bar

Cordially invite you to a Reception honoring the Bankruptcy Judges
held in conjunction with the View from the Bench Seminar

When:
Wednesday, November 2, 2016, at 5:30-7:30pm

Where:
The Vault
611 N. Franklin Street
Tampa, FL 33602

Admission Price:
Reception: $60.00 per person
Registration will open soon.
Please email Megan Murray at mwmurray@trenam.com with any questions.

Clerk's Appreciation Luncheon
August 3, 2016

SAVE THE DATE

TBBBA 2016-2017
CONSUMER LUNCH SCHEDULE

Location: Sam M. Gibbons United States Courthouse / 5th Floor Training Room

Free CLE / Lunch Provided

October 4, 2016

December 6, 2016

January 17, 2017

March 7, 2017

April 4, 2017

May 2, 2017

The Tampa Bay Chapter of the
Federal Bar Association
Proudly Presents

THE 9TH ANNUAL CIVIL SEMINAR

A Roundtable Discussion with
United States District, Magistrate,
and Bankruptcy Judges

EVENT: This luncheon program will be a conversation about pre-selected topics between the Judges, their law clerks, and members of the bar who will be seated together at the tables.

DATE: September 30, 2016

TIME: 12:00 p.m. – 1:30 p.m.

PLACE: University Club, 201 N. Franklin St., Suite 3800

COST: $35 (FBA members)* $40 (non-members)**
Federal Judges and Judicial Law Clerks are invited to attend at no cost.

*FBA law student members will receive a 50% discount

Golf Tournament
April 8, 2016

People on the Go

Leonard H. Gilbert Honored by the Hillsborough County Bar Association for Distinguished Career

TAMPA, Fla. (June 2, 2016) – Holland & Knight's Leonard H. Gilbert, a partner in the firm's Tampa office, was honored on May 26 at the Hillsborough County Bar Association (HCBA) Trial & Litigation Section's annual awards luncheon.

Mr. Gilbert received the Herbert G. Goldburg Award, the highest award given by the HCBA Trial & Litigation Section. The award recognizes trial lawyers who, during the course of a distinguished career, have exhibited fairness, integrity, courtesy, zeal, forensic skill, legal acumen, good sense, and respect for fellow lawyers.

Mr. Gilbert is a graduate of Harvard Law School and a member of Holland & Knight's Financial Services Practice Group. He represents clients in the areas of banking, commercial finance, creditors' rights, insolvency, mediation, arbitration and commercial litigation. He is recognized as a top bankruptcy and creditors' rights lawyer by Chambers USA and The Best Lawyers in America, and is AV rated by Martindale Hubbell.

Mr. Gilbert is a former president of the HCBA and The Florida Bar and member of its Board of Governors. He is a current member of the American Bar Association's House of Delegates and formerly served as the director of the American Bar Foundation.

About Holland & Knight LLP: Holland & Knight is a global law firm with more than 1,200 lawyers and other professionals in 27 offices throughout the world. Our lawyers provide representation in litigation, business, real estate and governmental law. Interdisciplinary practice groups and industry-based teams provide clients with access to attorneys throughout the firm, regardless of location.

Kathy McLeroy Receives the Florida Bar Foundations 2016 Medal of Honor Award

Carlton Fields is proud to announce that shareholder, Kathy McLeroy, will be receiving the Florida Bar Foundation's 2016 Medal of Honor Award—the Foundation's highest honor. Kathy chairs Carlton Fields' pro bono committee and currently serves as a member of the Florida Commission on Access to Civil Justice. She is being honored for her innovative ideas to increase Interest on Trust Accounts (IOTA) revenue, her successful efforts to preserve county funding for legal aid, her leadership of organizations supporting pro bono at the national, state and local level, as well as more than 20 years of direct services to pro bono clients. The Medal of Honor Award will be presented to Kathy at the Florida Bar Foundation's 40th Annual Reception and Dinner which will be held on June 16, 2016 at the Hilton Orlando Bonnet Creek. Congratulations Kathy!

Second Circuit Rules § 546(e) Safe Harbor Preempts Creditors' State Law Claims

by Daniel Fogarty, Stichter Riedel, Blain & Postler, P.A.

In the age of contagion spread by exotic derivatives contributing to the near-downfall of the global economy, one can tend to see a greater congressional intent in regulating securities markets to protected those markets and their participants, and by proxy protect the larger economy as a whole. Protecting the markets is not without its costs, and the attendant winners and losers in the preference of market protection. Although it pre-dates the current financial crisis and the aftermath that resulted, the safe harbor provision in Section 546(e) of the Bankruptcy Code has taken on greater importance as more transactions involve securities in some manner, and practitioners expand the outer reaches of the harbor in an effort to protect transactions from later avoidance.

In a recent decision, the Second Circuit Court of Appeals adjusted the balance between winners and losers in the congressional intent behind the safe harbor, ruling in the Tribune Fraudulent Transfer Litigation[1] that the safe harbor provisions of § 546(e)[2] preempted individual creditors' claims under state constructive fraudulent transfer laws as to the transaction, effectively barring not only claims of a trustee in bankruptcy but also of a creditor under state law.

Section 546(e) of the Bankruptcy Code provides a safe harbor from avoidance actions for certain transfers involving securities, whereby a trustee in bankruptcy cannot avoid certain payments as constructively fraudulent transfers. Specifically, § 546(e) provides:

> Notwithstanding sections 544, 545, 547, 548(a)(1)(B), and 548(b) of this title, the trustee may not avoid a transfer that is a … settlement payment, … made by or to (or for the benefit of) a … financial institution, financial participant, or securities clearing agency, … or that is a transfer made by or to (or for the benefit of) a…financial institution, financial participant, or securities clearing agency, in connection with a securities contract, … that is made before the commencement of the case, except under section 548(a)(1)(A) of this title.

The provision carves out from its limitation transfers the trustee on its own – rather than as a lien creditor under state law – might avoid on actual fraud grounds under § 548.

For purposes of securities transactions, a "settlement payment" is defined to include "any other similar payment commonly used in the securities trade."[3] A "securities contract" is defined in § 741(7) to include "a contract for the purchase, sale, or loan of a security,[4] a certificate of deposit, a mortgage loan, any interest in a mortgage loan, a group or index of securities, certificates of deposit, or mortgage loans or interests therein…."

Most commonly the provision arises in connection with LBOs, and has been applied to leveraged buyouts of public[5] and even very small private corporations.[6] In *Krol v. Key Bank National Association (In re MCK Millennium Centre Parking, LLC)* the bankruptcy court held that the safe harbor of § 546(e) applies to a debtor's payments made on mortgages pooled and held by a real estate mortgage investment conduit trust. *In re Bernard L. Madoff Inv. Sec. LLC*, 773 F.3d 411, 414 (2d Cir. 2014) follows the decisions of other courts that have applied the safe harbor to protect Ponzi scheme payments from recovery under certain circumstances. Courts also have applied § 546(e) to prevent avoidance of payments made in connection with commercial paper,[7] and redemption

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1 In re Tribune Co. Fraudulent Conveyance Litigation, 818 F.3d 98 (2d Cir. 2016).
2 All section references are to 11 U.S.C. § 101 et seq. (the "Bankruptcy Code"), unless otherwise indicated.
3 § 741(8). Although not at issue in the Tribune case as discussed below, courts have not uniformly applied the term "settlement payment" to non-public transactions. The clear majority of caselaw at the circuit level does not support a distinction between public and non-public markets, but there is authority that non-public transactions do not implicate markets and are therefore not settlement payments. E.g., In re Bankest Capital Corp., 374 B.R. 333, 346 (Bankr. S.D. Fla. 2007) (finding that payment was not settlement payment because the payment "did not involve the utilization of public markets or publicly traded securities."
4 The term "security" is itself broadly defined in § 101(49) to include stocks, bonds, debentures, transferable shares, and "other claim or interest commonly known as 'security.'" § 101(49)(a)(xiv).
5 Official Comm. of Unsecured Creditors v. Fleet Retail Fin. Group (In re Hechinger Inv. Co. of Delaware), 274 B.R. 71, 87 (D. Del. 2002) (holding that LBO payments made to both insider and non-insider shareholders of a publicly held company by a financial institution are protected by section 546(e)).
6 E.g., Cyganowski v. Lapides (In re Batavia Nursing Home, LLC), No. 11-13223 K, 2013 WL 3934237, at *1 (Bankr. W.D.N.Y. July 29, 2013) (applying section 546(e) to $1.179 million buyout of privately held securities), relying on AP Services LLP v. Silva, 483 B .R. 63 (S.D.N.Y.2012). But see, e.g., In re Bankest Capital Corp., 374 B.R. 333, 346 (Bankr. S.D. Fla. 2007) (finding that non-public securities transaction was not settlement payment).

of investments in mutual funds that were operated as Ponzi schemes.[8]

Although the provision has been in place for a significant amount of time,[9] recent developments have seen an expansion of the use of the safe harbor in private transactions arguably not implicating any systemic risks in the larger securities markets, as well as attempts to pursue avoidance actions in ways to limit the effectiveness of the provision. These efforts to limit, or plead around, the safe harbor have included creditors assigning rights under state law to a creditor trust, with the estate fiduciary pursuing rights not as a successor to the trustee but as the assignee of the creditor,[10] as well as, as was the case in *Tribune*, attempting simultaneous pursuit of actual fraudulent transfers or other actions by estate fiduciaries, while allowing to proceed constructively fraudulent transfer actions by individual creditors under state law.

Those efforts were dealt a substantial blow recently. In the *Tribune Company Fraudulent Conveyance Multidistrict Litigation*, the Second Circuit, reversing a lower court ruling, held that although creditors have standing to bring state law constructive fraudulent transfer claims in parallel with an action by a chapter 11 plan creditor trust challenging the same transfers under an intentional fraud theory, those claims are preempted by § 546(e).

Background of the Tribune Company Litigation

The *Tribune Company Fraudulent Conveyance Litigation* was the result of a leveraged buyout of a publicly-traded company that ultimately ended up in Chapter 11. In April 2007, private equity investors took the Tribune Company private, paying out billions to thousands of public shareholders. Following the buyout, the company operated for a year before it ended up in a chapter 11 case, in part as a result of massive debt taken on as part of the LBO.

During the case, the creditors committee was granted derivative standing and filed adversary proceedings against the former shareholders, officers, directors, financial advisors, and others in connection with the LBO, asserting, among other causes of action, that the shareholder buyouts were intentionally fraudulent transfers. No doubt because such claims would be barred under § 546(e), the creditors committee did not assert any constructively fraudulent transfers, and no such claims were brought by an estate fiduciary within the two-year limitations period under § 546(a).

As a result, in a series of orders entered in 2011, individual creditors were granted stay relief to file state law constructive fraudulent transfer claims outside of the bankruptcy court. These orders included stay relief orders as well as a confirmation order, confirming a plan and authorizing individual creditors to pursue their state-law constructive fraud transfer claims.[11] Although they were raised, the bankruptcy court did not rule on the standing or preemption issues, but deferred ruling on those issues to the courts that would hear the suits. The numerous lawsuits that resulted were consolidated in front of a multidistrict litigation panel in the district court in the Southern District of New York.

In a reported decision *("Tribune I")*,[12] the district court ruled that § 546(e) did not preempt the state law constructively fraudulent transfer claims asserted by individual creditors, but rather barred only those claims if brought by the trustee or, in this case, the Creditors' Committee standing in the trustee's shoes. However, the district court ruled that the automatic stay barred individual creditor pursuit of the claims while the estate fiduciary was pursuing avoidance of the same

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7 In re Enron Creditors Recovery Corp, 651 F.3d at 334-335
8 Peterson v. Somers Dublin Ltd., 729 F.3d 741, 748 (7th Cir. Ill. 2013).
9 The provision was originally enacted in 1982 as a carry-over from a provision applicable to commodity broker liquidations only, and has been augmented but not substantially revised in subsequent revisions to the Bankruptcy Code.
10 E.g., PHP Liquidating, LLC v. Robbins, 291 BR 603, 607(D. Del. 2003) ("However, in this case, PHP LLC has not asserted its claims against Movants in the capacity of a trustee or as a successor-in-interest to a trustee or debtor-in-possession. Rather, PHP LLC is bringing the instant claims as a direct assignee of the unsecured creditors. As such, Section 546(e) is not a bar to PHP LLC's claims." In contrast, in Whyte v. Barclays Bank PLC, 494 B.R. 196 (S.D.N.Y. 2013), a different district court judge held that a litigation trustee as representative of outside creditors was barred by § 546(g), similar to § 546(e) in operation. The district court in Tribune I distinguished the Whyte case as involving an estate fiduciary acting on behalf of individual creditors, rather than the individual creditors acting directly on their own behalf. In re Tribune Co. Fraudulent Conveyance Litigation, 499 B.R. 310, 319 (S.D.N.Y. 2013). In a number of cases, courts had barred a successor estate fiduciary from pursuing claims. Id., n. 10.
11 Tribune II, 818 F.3d at 107-109. (stating, in part, that the confirmation order "expressly allowed" pursuit of the claims, and provided that "'nothing in [the plan] shall or is intended to impair" the rights to pursue such claims.")
12 In re Tribune Co. Fraudulent Conveyance Litigation, 499 B.R. 310 (S.D.N.Y. 2013).

transactions, albeit on a separate theory. The district court held that the creditors were not technically subject to the operation of the stay, but did lack standing to pursue the claims because the committee was pursuing avoidance of the same transactions.[13] The district court cited the fact that the committee had not completely abandoned the claims, and that "unless and until" that happened, the creditors lacked standing to address the same transactions.[14]

The district court's ruling was consistent with a number of prior bankruptcy and district court decisions, and was followed by a number of subsequent decisions, perhaps the most significant of which was the decision in *Weisfelner v. Fund 1 (In re Lyondell Chem. Co.)*, 503 B.R. 348, 365 (Bankr. S.D.N.Y. 2014). In *Lyondell*, the court mirrored the Second Circuit's preemption analysis from a recent decision, and in a lengthy and reasoned opinion, held that § 546(e) did not preempt creditors' state law remedies.

In *Tribune*, both sides, the creditors and the shareholders, appealed to the Second Circuit Court of Appeals. On the two issues of standing and preemption, the Second Circuit (*"Tribune II"*) disagreed with the district court, holding that the stay no longer applied to the creditors' individual suits, but that the claims were preempted and therefore barred by the safe harbor provision of § 546(e).

Second Circuit Decision

Claims not Stayed…

The Second Circuit dispensed quickly with the shareholders' automatic stay arguments. Acknowledging that pursuit of the avoidance actions by creditors against third parties was initially subject to the automatic stay,[15] the Second Circuit found that the stay no longer applied, either because of the orders granting stay relief or under the confirmation order.[16]

On this seemingly straight-forward analysis, the Second Circuit overruled the district court, finding that the plain language of the bankruptcy court's orders lifting the stay and allowing the filing of the creditors' state law actions was sufficient to eliminate any bar from the stay.[17] The Second Circuit then moved to its preemption analysis.

But Claims are Preempted

Preemption analysis is a topic far too complex to treat in this article, but a brief summary will suffice to contextualize the Second Circuit's analysis. Under the Supremacy Clause of the U.S. Constitution, federal law prevails in a conflict with state law, in which case the state law would be preempted by the federal law. The conflict can be either express or implicit. Implied preemption occurs under different circumstances, including when "state law stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress."[18] There is a presumption against implied preemption which "usually goes to the weight to be given to the lack of an express statement overriding state law" and is strongest in an area traditionally governed by state law.[19] In *Tribune II*, the Second Circuit decided that the area it was considering was Congress' constitutional power to enact bankruptcy laws, characterizing it as one where "detailed, preemptive federal regulation of creditors' rights has, therefore, existed for over two centuries."[20] That, coupled with the extensive federal regulations of the securities markets, led the court to analyze preemption based on the intent of Congress, without any countervailing presumptions based on concerns about federal intrusion into state law concerns.[21]

Plain Meaning of § 546(e) does not Eliminate Conflict

A simple reading of § 546(e) is that it only applies to

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13 Id. at 323 (stating that the theory being pursued was irrelevant, because the stay under § 362(a)(1) stays creditors' claims "for as long as the trustee is exercising its avoidance powers.").
14 Id. at 325.
15 As was discussed later in the opinion and is discussed later in this article, it is unclear whether the Second Circuit believed the stay applied because the fraudulent conveyance actions were claims against debtor, or property of the estate, a lack of clarity that supported its preemption finding. Tribune II at 108, 114. The district court rejected the property of the estate theory, and analyzed the stay issues only under a claim against the debtor. Tribune I, 321-322.
16 See supra Note 10.
17 In a preview of the issues framed by the Second Circuit, the bankruptcy court's order lifting the automatic stay provided that the court did not determine whether creditors had standing or whether they "regained the right . . ." Tribune I at 324 n. 16. The Second Circuit held that the claims were not stayed, but did not address the standing issue separately; rather the court focused on the preemption issues.
18 Tribune II, 818 F.3d at 110, quoting Hillman.
19 Id.
20 Id. at 111.

Safe Harbor

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trustees,[22] as its plain language suggests, and as other courts have held.[23] If the use of the limited term "trustee" is a clear expression of congressional intent not to preclude pursuit of the same transfers subject to § 546(e) by individual creditors based on their state law rights, then no preemption should be found.

Focusing instead on the larger structure of the Bankruptcy Code, the Second Circuit rejected the narrow focus only on the use of the word "trustee." In analyzing this plain language argument, the court focused on the underpinnings of the creditors' position: reversion of avoidance actions. The court summarized the creditors position as when the case is filed, the claims are stayed, and that once the stay is no longer in effect, either because the claims are not pursued or the stay is lifted, the claims revert back to the creditors.

Under the Creditors' argument, if the claims of the trustee are not pursued, they pass through and revert back to creditors in an undiminished form. The court found that result at odds with the scheme, if not specific provisions, of the Code. First, the trustee's power to pursue avoidance actions appear to be exclusive during the two-year limitations period. Second, staying collection actions by creditors is a simple method to consolidate litigation and equitable distribution; allowing creditors to pursue claims later or simultaneously limits the trustee's ability to effectively pursue the litigation leads to piecemeal actions by both creditors and estate fiduciaries, a method neither simple or equitable. The creditors argued that this result was the product of a balancing of interests made by Congress in limiting § 546(e) to trustees – markets are protected by limiting the rights of the most likely plaintiff (the estate fiduciary), and creditors are protected by not limiting their rights should they choose to pursue them. Finding no articulation of that balance in the statute, the court found the use of the term "trustee" ambiguous, and therefore not determinative that there is no conflict between § 546(e) and creditors' pursuit of claims it would bar.

The court then determined that allowing the creditors to pursue their constructive fraud claims clearly would conflict with the goals of § 546(e),[24] and rejected what it viewed as a post-hoc analysis of the balancing test that Congress applied in limiting the provision's application to a trustee.

After reaching that conclusion, the court dispelled with arguments that § 546(e) does not preempt the claims at issue in *Tribune*, rejecting as distinguishing that creditors were not suing the intermediaries but only the ultimate recipients,[25] or that the securities market concerns do not apply to an LBO.[26] The court read the safe harbor provision as reflecting an intent "to address a particular problem . . . and using statutory language broader than necessary to resolve the immediate problem" at 120. The court also rejected the arguments that § 546(e) was in conflict with a goal of maximizing a return to creditors, stating that goal cannot trump § 546(e) without thwarting the section's purposes of protecting markets by limiting creditors' rights.[27] Finally, the court held that neither the failure of Congress to include express preemption language,[28] nor to amend the statute when requested,[29] precluded a finding of implied conflict preemption.

Takeaways

At least in the Second Circuit, the § 546(e) safe harbor has been widened to include claims of creditors under state law in the context of an LBO of a publicly-traded corporation brought directly by those creditors post-petition. However, as demonstrated by the several cases in the district courts in New York, the views on the safe harbor in general, and preemption in particular, are

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21 Id. at 112.
22 Recognizing that the powers of trustees can be exercised by other estate fiduciaries, including in the Tribune case the creditors committee and then the plan trust, in its opinion the Second Circuit uses a shorthand of the "trustee et al."
23 E.g., Tribune I at 316 (citing, inter alia, PHP Liquidating, LLC v. Robbins, 291 BR 603, 607(D. Del. 2003)).
24 Tribune II at 119 ("Every congregational purpose reflected in Section 546(e), however narrow or broad, is in conflict with [the creditors'] legal theory."). The district court had come to the opposite conclusion. Tribune I, 499 B.R. at 318.
25 Tribune II at 119, n. 7
26 Id. at 122.
27 Id. at 123.
28 Section 544(b)(2) contains express preemption language, which the creditors argued proved that Congress knew how to preempt claims by creditors as well as the trustee, but chose not to do so in § 546(e).
29 A request to include express preemption was made by the CFTC, and at least one case impliedly held that the claims were not preempted. See In re PHP Liq., supra note 9.

Safe Harbor

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not universally shared.

In *Matter of Munford, Inc.*, 98 F.3d 604 (11th Cir. 1996), the Eleventh Circuit rejected the application of § 546(e) to an LBO. However, it did so on the basis that the transfers were made by the debtor to shareholders, with the financial institutions involved acting as mere conduits that had no beneficial interest in the payments or securities. *Id*. at 610. As a result, there was no transfer to or from a financial institution or participant. The Second Circuit had rejected this argument before in the context of *Enron*,[30] and did so again, or at least did not consider the issue, in *Tribune II*. Other courts outside the Eleventh Circuit have done the same.[31]

The *Munford* court did not base its ruling on a market impact basis, stating that the LBO payments could be "settlement payments" for purposes of § 546(e) notwithstanding the lack of any systemic risks based on a single transaction. *Id*. at 610 n. 4 ("even granting trustees avoidance powers under limited circumstances in the LBO context has the potential to lessen confidence in the commodity market as a whole.")

As to preemption, as the *Tribune II* court acknowledged, there is almost no precedent on the issue. However, one Delaware bankruptcy court has already narrowed the *Tribune II* ruling. In a case argued before *Tribune II* was issued, *Physiotherapy Holdings*,[32] the court held that a litigation trustee may pursue creditors' state law claims where the transfers involve private securities and pose no threat to the securities markets, and were made to insiders alleged to have acted in bad faith. Although *Physiotherapy Holdings* decision reflects different factual circumstances than in *Tribune*, it follows the preemption analysis conclusions made by *Tribune I* and *Lyondell*, finding that avoidance of the transfers at issue would have no systemic risk effect on the markets, and that the plain language evidences no congressional intent to bar creditor actions (even when brought by the trustee as assignee).

Does the safe harbor limitation preempt claims even if the bankruptcy case is filed and dismissed? There is language in *Tribune II* to that effect.[33] What about if the case is not filed? In considering preemption of laws of those states whose state law assignment for the benefit of creditors statutes include avoidance of preferential transfers, courts have found preemption even where no pending case raises the conflict between the two statutes.[34] As a result of *Tribune II*, it appears that allowing individual creditors to avoid securities settlement payments would conflict with the congressional purposes of market protection, and so should be preempted even in the absence of an actual bankruptcy filing by the debtor.

The *Tribune* case resulted from a creative way to try and work around the § 546(e) limitations of an estate fiduciary by not pursuing constructively-fraudulent transfers, leaving intentionally fraudulent transfer claims to creditors, and no doubt hoping to use a pincer maneuver to gain maximum leverage and recovery. The workaround was unsuccessful, perhaps in part because the transfers were being pursued by the fiduciary on different theories – at least that was the district court's ruling. The district court ruled that it was a standing issue – the transfers cannot be the subject of simultaneous competing claims, even on separate theories. If no claims were pursued, would the result have been different?

Of course, it is important to note that trustees and creditors are not without remedies, and transferees not without exposure. Section 546(e) carves out intentionally fraudulent transfers from the safe harbor.[35] Additionally, § 546(e) does not bar all types of claims that could be brought under the circumstances.[36] However, plaintiffs should plead carefully: the safe harbors have gotten wider.

30 Enron Creditors Recovery Corp v. Alfa S.A.B. de C.V. (In re Enron Creditors Recovery Corp.), 651 F.3d 329 (2d Cir. 2011).
31 Contemporary Indus. Corp. v. Frost (In re Contemporary Indus. Corp.), 564 F.3d 981 (8th Cir. 2009) (applying 546(e) to LBO payments made through financial institution as escrow agent).
32 PAH Litigation Trust v. Water Street Healthcare Partners, L.P., et al. (In re Physiotherapy Holdings, Inc.), Adv. No. 15-51238-KG (Bankr. D. Del. June 20, 2016).
33 Tribune – 111 ("Appellants claims were preempted when the chapter 11 proceedings commenced and were not dismissed.")
34 See, Sherwood Partners Inc. v. Lycos Inc., 394 F.3d 1198, 1200 (9th Cir. 2005). But see, Ready Fixtures Co. v. Stevens Cabinets, 488 F. Supp. 2d 787 (W.D. Wisc. 2007) (finding statute not preempted).
35 Under the Tribune result, pursuit of state law intentionally fraudulent transfers arguably are barred in total, because the plain language only allows for claims under § 548, not under state law through § 544.
36 See, e.g., In re Lehman Bros. Holdings Inc., 469 B.R. 415, 450 (Bankr. S.D.N.Y. 2012) ("The safe harbors necessarily do not extend to the open waters of litigation and are not an impenetrable barrier to other claims against a market participant that has behaved in a manner that may expose the actor to potential liability."); AP Services LLP v. Silva, 483 B.R. 63 (S.D.N.Y.2012) (claim for unjust enrichment was barred by § 546(e), but claims for breach of fiduciary duty and aiding and abetting breach of fiduciary duty were not preempted); In re U.S. Mortgage Corp., 491 B.R. 642, 667-68 (Bankr. D.N.J. 2013) (counts for civil conspiracy, aiding and abetting civil conspiracy and fraud, and conversion "all based on the same operative facts and seek effectively the same relief—the avoidance and recovery of the transfers or the funds used to make the transfers.").

Judge Colton Investiture
July 15, 2016
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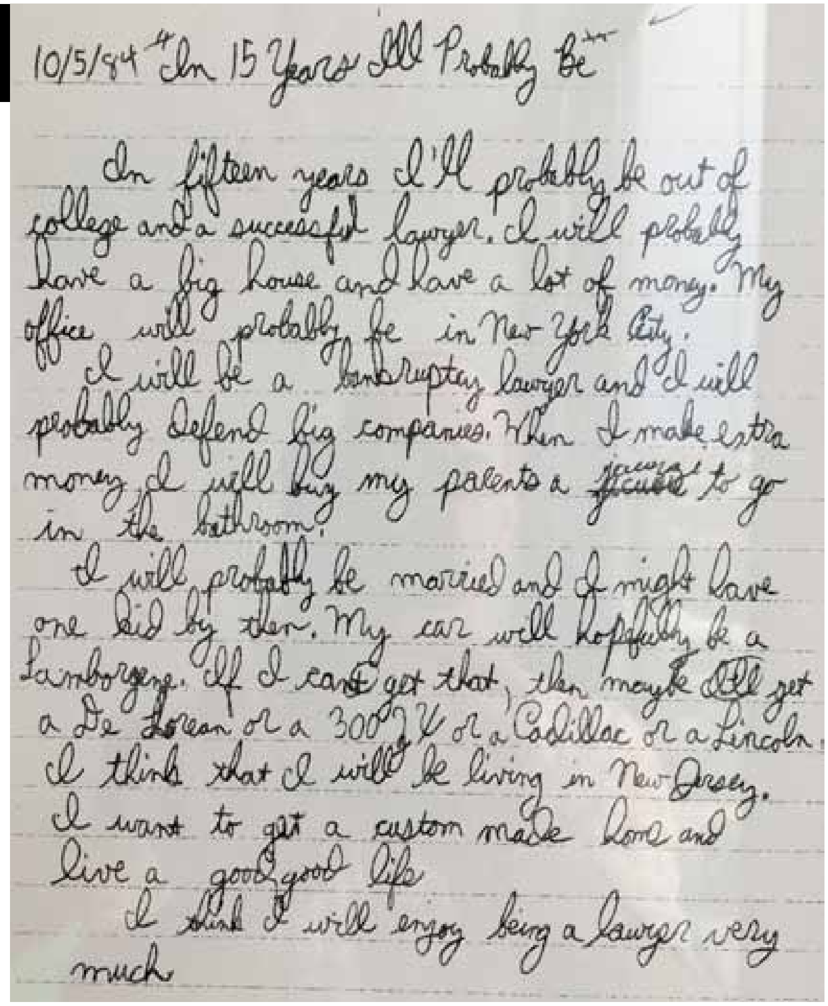
Right: Written by Scott Grossman while in 6th grade (Greenberg Traurig)



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