The Cramdown

The Newsletter of the Tampa Bay Bankruptcy Bar Association

Editor-in-Chief, Suzy Tate, Suzy Tate, P.A.

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PRESIDENT'S MESSAGE

by Stephenie Biernacki Anthony, Esquire, Anthony & Partners, LLC

A New Year And The Four Cs

I am looking forward to a great year ahead as your new TBBBA President and would like to reiterate herein my goals for the year, as previously expressed at the annual dinner as the four Cs for the TBBBA.

Consistency: Chief Judge Jenneman has given much time, energy, and focus to the goal of harmonizing the divisions within the United States Bankruptcy Court for the Middle District of Florida. It is extremely common for lawyers from Jacksonville, Orlando, Tampa, and Fort Myers, to represent clients in cases pending in other divisions. The goal of establishing consistency and procedure from one division to the next will ultimately improve the quality of representation and the efficiency of the process for all involved. I plan to support these efforts and promote consistency as a means to producing user friendly for everyone within the Middle District.

Community: Judge McEwen has been an advocate of our pro bono efforts to date, and it seems to me that if Judge Williamson can take time out of his schedule to teach business people in Liberia, Afghanistan, and other struggling countries, than the lawyers in this community should be able to give some of their own time and intellect to those who cannot presently afford it, in our district. I plan to prioritize our pro bono efforts this year and encourage everyone to get involved by spending some time in the 9th Floor Attorney Resource Room located in the Sam M. Gibbons United States Courthouse during the hours designated by the TBBBA to assist pro bono debtors in understanding court procedures and prosecuting their bankruptcy cases. Said efforts will not only aid debtors but the same will assist our Judges in moving their over crowded dockets.

Collective Wisdom: As a new member of the TBBBA and a young lawyer, I enjoyed volunteering to write articles and put on programs that I thought mattered in terms of legal issues and practice pointers for professionals. I have enjoyed staying involved in that over the years because it is fun to learn new things, especially when you are learning with friends. We have had some lively discussions and panels over the years, and I know that the contributing judges and lawyers work hard, research, and prepare programs that have us all talking and remembering months later. Our scholarship as a group puts us all in a better position in terms of representing our clients. So, I would like to encourage our members to get involved, stay involved, and participate in the upcoming CLE luncheons and seminars, write an article for the CramDown, and take advantage of the "Collective Wisdom" our organization has to offer.

Camaraderie: It goes almost without saying that nobody visits a bankruptcy lawyer because everything is going fine. Our clients, in large cases and small, on the debtor's side and on the creditor's side, are fighting for their financial lives and livelihoods. Keeping that in mind, and recognizing the ethical duty that we have to represent our clients zealously, our first goal should be to try to figure out if we can resolve our cases in a manner that saves money and leaves everyone a winner. In this profession, however, sometimes parties cannot agree, and that is when it is up to everyone who is part of this legal system to focus on the facts, focus on the governing law, and to maintain professionalism. Over the centuries, some of the worst atrocities have been committed by people who are invoking high moral authority, and so I am not talking about professionalism as another weapon for the court room. I am simply talking about treating others as you would expect to be treated in like circumstances. The lawyers in this association are known for their professionalism, and I encourage everyone to continue in these efforts.

Inside This Issue

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When Worlds Collide: A Review of Loan Participation Transactions in Bankruptcy

by Chris Broussard

In a typical loan participation transaction a lead lender divides a large loan into shares, which are offered for sale to other financial institutions (i.e., the participants). The relationship between the lead lender and the participants is governed by a participation agreement. Bankruptcy courts review participation agreements to determine whether they are, in fact, true participation agreements or instead "loans in disguise" to the lead lender. When a participation agreement is re-characterized as a loan to the lead lender, unexpected and potentially severe consequences often follow. To help shed some light on that dynamic, this article reviews the court's opinion in *In re Brooke Capital Corp.*, 2012 WL 4793010 (Bankr. D. Kan. Oct. 5, 2012) (hereinafter *"Brooke Capital"*), which illustrates analysis pertaining to loan participation transactions in bankruptcy.[1]

Background

In *Brooke Capital*, the court analyzed a slew of transactions and documents pertaining to two separate loans made to Brooke Capital Corp. ("*Debtor*"). In the first loan, Debtor borrowed approximately $12 million from one of its subsidiaries, Brooke Capital Advisors ("*BCA*"). BCA's loan to Debtor (the "*BCA-Debtor Loan*") was secured by certain shares of stock held by Debtor ("*Stock*"). In the second loan, Debtor borrowed approximately $9 million from Citizens Bank & Trust, Co., ("*Citizens*") (the "*Citizens-Debtor Loan*"). The Citizens-Debtor loan was secured by certain assets belonging to Debtor, but did not include the Stock pledged to BCA.

Debtor subsequently defaulted on the Citizens-Debtor Loan. Workout discussions ensued and Debtor eventually granted Citizens a substitute security interest in the Stock (the "*Citizens Substitution*") and BCA executed a Payment Agreement, which essentially subordinated its interest in the Stock to that of Citizens. Citizens filed a financing statement to perfect that interest.

Prior to the Citizens Substitution, however, BCA sold portions of its interest in the BCA-Debtor Loan to four purchasers. Each transfer was independently documented via agreements specifying (1) the collateral for the BCA-Debtor Loan includes the Stock and (2) BCA will not, without participant's written consent, release or allow for the substitution of any collateral, "outside the normal course of dealing with Borrower so as to substantially reduce the possibility of repayment of the Loan."[2]

None of the purchasers filed financing statements to perfect their interests. BCA did not receive consent from any of the purchasers regarding the Citizens Substitution. Debtor eventually ended up in bankruptcy. In Debtor's bankruptcy, the Stock was sold for $2.5 million (the "*Proceeds*"). Citizens commenced an adversary proceeding to determine priority to the Proceeds.

Risk of Loss & Re-Characterization

BCA sold just over 72% of the BCA-Debtor Loan to three purchasers. Those three were unique from the fourth; their Participation Certificates and Agreements with BCA each contained certain guarantees. Specifically, BCA was bound to repurchase the interests after a certain amount of time. Additionally, those three purchasers were empowered to offset the purchase price paid to BCA against debt owed to another of Debtor's subsidiaries in the event of Debtor's default on the BCA-Debtor Loan.

Ironically, these guarantees, which should have ensured repayment, were ultimately the three purchasers' undoing. This is because a defining feature of true loan participation agreements is that both the lead lender and participants assume the same risk of borrower's default.[3] Accordingly, in true loan participations, the participant's right to repayment cannot arise unless and until the lead lender is paid by the borrower.[4]

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1 The court's findings and analysis in *Brooke Capital* are lengthy and comprehensive. This article, however, is much more limited in scope. As a result and in the interest of brevity, many of the more technical aspects of the court's review are either briefly summarized or addressed via reference to *Brooke Capital* and/or additional sources.
2 *In re Brooke Capital*, 2012 WL 4793010, at *4, 6.
3 *See e.g., In re Sackman Mortgage Corp.*, 158 B.R. 926, 933 (Bankr. S.D.N.Y. 1993) ("In determining whether a transaction is a loan or a participation agreement, courts have generally viewed the risk allocation as the most significant factor, finding that agreements whereby the 'participant' bears no risk of loss constitute debtor-creditor relationships in the form of loans rather than true participation agreements.").
4 *See e.g., In re Coronet Capital Co.*, 142 B.R. 78, 82 (Bankr.S.D.N.Y.1992); *see also In re Brooke Capital Corp.*, 2011 WL 204278, at *8 (Bankr. D. Kan. Jan. 20, 2011) (discussing *In re Coronet*).

When World's Collide

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The *Brooke Capital* court notes: "If the participant is not subject to [the risk of loss resulting from borrower's default], the transaction is a loan to the participation seller, not a participation in the seller's loan to its borrower."[5] Because the multiple layers of guarantees eliminate any risk of loss, the court concluded the Participation Certificates and Agreements must be treated as loans in disguise to BCA.

The consequences of re-characterization were ultimately quite severe. The court explains: "While true loan participants are allowed to rely on their lead lender's perfection of security interest to protect their interests, purchasers of participations that are recharacterized as loans to the lead lender are not entitled to rely on that perfection … [instead] such participants' interests are unperfected if they took no steps independent of the lead to perfect the interests."[6] Because none of the purchasers took any steps to perfect their interests in the Stock whereas Citizens did, the court held Citizens was entitled to the Proceeds ahead of the three purchasers.[7] Further, because these transactions were re-characterized as loans to BCA, whether BCA had authority to subordinate their interest in the Stock was considered moot.

The fourth purchaser, however, was an entirely different story. BCA sold 14.54% of the BCA-Debtor Loan to the Bank of Kansas' predecessor ("BoK"). Unlike the Participation Certificates and Agreements discussed above, BoK's Participation Agreement with BCA did not contain any guarantees or anything else problematic. In fact, the court commented: "Citizens has pointed to nothing that would justify recharacterizing the Agreement as a loan, rather than a participation arrangement."[8] Moreover, because BoK never consented to the Citizens Substitution or subordination of BCA's interst in the Stock, the court determined BoK remains entitled to its 14.54% share of the Proceeds.

Conclusion

There are several key takeaways from *Brooke Capital* worth pointing out. First, the efforts of BCA to engage in the Citizens Substitution demonstrates the value of participation agreements carefully delineating precisely what a lead lender can and cannot do as well as the dangerous possibilities flowing from permissive or less precise participation agreements. Second, the possibility of re-characterization highlights the importance of reviewing participation agreements for not just explicit guarantees regarding the lead lender, but for any provisions shielding a participant from all or any portion of the risk of loss arising from the possibility of borrower's default. Third, the consequences cast upon the three purchasers after re-characterization on account of perfection shows that in certain circumstances, it might be prudent for participants to take steps independent of the lead lender to protect their interests. When participants do not, for example, file a separate financing statement or request an amendment to the lead lender's financing statement specifying their participation interest, they may be susceptible to arguments similar to those reviewed in *Brooke Capital*.

Finally, the court's subordination analysis granting Citizens priority to a portion of the Proceeds, has received criticism.[9] However, the mere fact the three purchasers were stripped of the Proceeds, regardless of whether correct or not, emphasizes the profound effects re-characterization can have in bankruptcy.[10] Those effects highlight the importance of cases like *Brooke Capital*, which advise a comprehensive understanding of participation agreements and ways in which variables such as, for example, guarantees and perfection, may influence both the possibility and consequences of re-characterization.

5 *In re Brooke Capital.*, 2012 WL 4793010, at *15.
6 *Id.* at *16; *see also In re Amron Technologies, Inc.*, 2007 WL 917236, at *3 (Bankr. M.D. Ga. Mar. 22, 2007) ("In a participation agreement, one lender (the lead lender) provides the loan, and only that lender has a contractual relationship with the borrower and needs to file a financing statement.").
7 *See In re Brooke Capital.*, 2012 WL 4793010, at *16 ("The three Defendants had at most unperfected security interests in the [Stock], so whether BCA's perfected security interest could be subordinated without these Defendants' consent has no bearing on the outcome of the controversy.").
8 *Id.*
9 *See* John F. Hilson & Stephen L. Sepinuck, *The Perils of Participations (and Secrets to Successful Subordinations)*, THE TRANSACTIONAL LAWYER, Dec. 2012 at 1, 3 (available at: http://www.paulhastings.com
/Resources/Upload/Publications/2305.pdf).
10 *See id.* ("We think that aspect of the court's decision in *Brooke Capital* is simply wrong, but who is to say what other courts will be misled by it.").

Unsecured Second Mortgage Strip Off Available to Chapter 7 Debtors

by: Shawn C. Gearhart, Law Clerk, The Reissman Law Group, P.A.

After the 11th Circuit Court of Appeals issued its unpublished[1] *McNeal* decision, some courts were allowing Chapter 7 debtors the ability to "strip off" their wholly unsecured junior mortgages.[2] Now that the decision has been published, bankruptcy attorneys in the 11th Circuit have yet another selling point for their chapter 7 clients. Some are even considering reopening closed chapter 7 cases to seek this relief.

In *McNeal*, the Debtor sought to strip off her second mortgage pursuant to 11 U.S.C. §506(a) and (d). The Debtor estimated the value of her home was $141,416, subject to a first mortgage in the amount of $176,413, and a junior lien in the amount of $44,444. The Debtor argued that because the first mortgage was greater than the value of her home, the second mortgage was wholly unsecured and avoidable under §506(d). This is something that Chapter 13 debtors do all the time, but up until now, it was unavailable to Chapter 7 debtors.

Many Circuit Courts concluded that the U.S. Supreme Court decision in *Dewsnup v. Timm*, 112 S. Ct. 773 (1992), which held a Chapter 7 debtor could not cram down a partially secured lien under §506(d), stopped Chapter 7 debtors from stripping off unsecured junior mortgages.[3] The 11th Circuit Court of Appeals did not agree with this reasoning.

The 11th Circuit decided that their previous decision in *Folendore v. United States Small Bus. Admin.*, 862 F.2d 1537 (11th Cir. 1989) controlled the issue on appeal as opposed to *Dewsnup*. In *Folendore*, the Court held that an allowed wholly unsecured claim was voidable under §506(d).[4] The Court noted that the decision in *Dewsnup* was limited to cramming down partially secured liens, and therefore not applicable to stripping off wholly unsecured liens.[5] The 11th Circuit reasoned that because the holding in *Dewsnup* was not directly on point, the prior holding in *Folendore* still controls in the 11th Circuit.[6]

It is not news that homeowners are still struggling. According to CBS Money Watch, nearly 25% of American homeowners owe more than their home is worth. Struggling homeowners can sometimes wait for years in an attempt to modify their mortgages. In the end, many of these homeowners do not qualify for mortgage modification and seek out the help of a bankruptcy attorney to save the family home. The Bankruptcy Code, while providing the ability to cram down secured loans in most cases, does not allow the cram down of a first mortgage on a debtor's primary residence. The relief many homeowners found available, up until this decision, was to file Chapter 13 and strip off an unsecured second mortgage. But what about debtors without regular income? What about debtors trying to save their homes who cannot pay for both mortgages? When the McNeal holding was first issued, it was not published so some debtors' attorneys were unsure as to whether their clients could strip off a wholly unsecured mortgage in Chapter 7.

This changed earlier this year. On February 22, 2013, the *McNeal* Court entered its Order staying the proceedings in the appellate case because of the Automatic Stay imposed under Title 11 Sec. 362, which arose in the Appellee's Chapter 11 case. The *McNeal* Court directed the parties to inform the Court when the bankruptcy court terminated the stay. The parties entered into a stipulation in the Appellee's bankruptcy case to terminate the stay "for the purpose of allowing the Appellate Proceeding to continue to final resolution, including, but not limited to, publication of the Eleventh Circuit Order." After the bankruptcy court approved the stipulation, the Appellant, Lorraine McNeal filed a motion in the appellate case asking the Court to publish the previously unpublished opinion. On August 2, 2013, the *McNeal* Court entered its Order granting Appellant's motion to publish the opinion.

Now that the 11th Circuit published its opinion in *McNeal*, courts in the 11th Circuit are bound to follow the holding. Chapter 7 debtors in the 11th Circuit now have a new tool to try to save the family home and receive a fresh start which, after all, is the underlying policy consideration in bankruptcy.

1 "Although unpublished opinions may be cited as persuasive authority, they are not considered binding precedent." 11th Cir. R. 36-2.
2 *McNeal v. GMAC Mortgage, LLC* (In re McNeal) (11th Cir. 2012).
3 See, e.g., *Ryan v. Homecomings Fin. Network*, 253 F.3d 778 (4th Cir. 2001); *Talbert v. City Mortg. Serv.*, 344 F.3d 555 (6th Cir. 2003); *Laskin v. First Nat'l Bank of Keystone*, 222 B.R. 872 (B.A.P. 9th Cir. 1998).
4 *Id.* at 1541.
5 *McNeal* at 5.
6 *Id.*

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Trust or Debtor – You Decide

by David S. Jennis and Kathleen L. DiSanto
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Section 109 of the Bankruptcy Code provides that "only a person that resides or has a domicile, a place of business, or property in the United States, or a municipality may be a debtor under this title." Section 101(41), in turn, includes individuals, partnerships, and corporations in the definition of "person." Section 101(9), however, limits the definition of "corporation" to certain business entities – one of which is a business trust.

Whether a trust is eligible for relief under the Bankruptcy Code is a fact-intensive question that often must be decided on a case-by-case basis, but this was not always the case.[1] Prior to 1978, the Bankruptcy Code did not include "business trusts" in the definition of "corporation."[2] Although the Bankruptcy Reform Act of 1978 added the term "business trust" to the definition of "corporation," Congress did not define the term "business trust."[3] As a result, courts have applied a variety of factors in analyzing whether a trust qualifies as a business trust, but no definitive or all-inclusive list of such characteristics exists.[4]

While the issue of whether an entity qualifies as a business trust is litigated in bankruptcy courts across the nation and is currently pending before the Eleventh Circuit,[5] the case law on the issue from bankruptcy courts in Florida is fairly well-developed, as a result of the intricacies of Florida law regarding business organizations. Section 609.02 of the Florida Statutes requires business trusts to register with the state. Notwithstanding the fact that modern case law acknowledges that the failure to register the trust under Section 609.02 of the Florida Statutes does not cause the trust to fail as a business trust *ab initio* and is simply one factor a court may consider in determining whether a trust is a business trust eligible for relief under the Bankruptcy Code,[6] creditors often take the position that a trust's failure to comply with Section 609.02 renders the trust ineligible for relief under Section 109 of the Bankruptcy Code, even if the trust otherwise operates a business and does not merely hold property for probate avoidance or asset protection.

Florida bankruptcy courts focus their analysis on the trust documents and the totality of the circumstances in analyzing whether a trust qualifies as a business trust which is eligible to seek protection under the Bankruptcy Code pursuant to Section 109.[7] Some courts have opted to apply the "primary purpose test," which distinguishes business trusts created to transact business for profit from family trusts intended to preserve the res.[8] Other courts consider multiple factors in analyzing whether a trust is eligible for relief under Section 109 of the Bankruptcy Code. In the Middle District of Florida, both Judge Glenn and Judge Corcoran adopted a six factor balancing test first articulated in *Morrissey v. Commissioner of Internal Revenue*[9] to evaluate whether a trust is a business trust, which include the following factors:

a. Created and maintained for a business purpose;
b. Title to property held by trustee;
c. Centralized management;
d. Continuity uninterrupted by death among beneficial owners;
e. Transferability of interest; and
f. Limited liability.[10]

More recently, when faced with the issue of determining whether a trust qualified as a business trust in the *Shuaney Irrevocable Trust* case, Judge Shulman[11] adopted the "primary purpose test" articulated by the Sixth Circuit, and an appeal of his ruling denying the creditor's motion to dismiss is currently pending before the Eleventh Circuit. In applying the "primary purpose test," Judge Shulman concluded that the trust, which owned undeveloped real estate, in addition to operating and leasing multiple residential commercial properties, for the purpose of creating business opportunities

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1 Tr. of Hr'g, 16:24-17:2, *In re Shuaney Irrevocable Trust*, Case No. 11-31887-WSS (Bankr. N.D. Fla. May 3, 2012).
2 *Brady-Morris v. Schilling (In re Kenneth Allen Knight Trust)*, 303 F.3d 671, 679 (6th Cir. 2002).
3 *Id.*
4 *Id.*
5 *See Beach Community Bank v. Shuaney Irrevocable Trust (In re Shuaney Irrevocable Trust)*, 3:12-cv-296, (N.D. Fla. 2013) (affirming the bankruptcy court's determination that the trust at issue, which had not been registered as a business trust with the State of Florida was nevertheless eligible for relief under the Code).
6 *In re Star Trust*, 237 B.R. 827, 832 (Bankr. M.D. Fla. 1999).
7 *In re William Pace Trustee of Pace Irrevocable Trust*, 376 B.R. 334, 336 (Bankr. M.D. Fla. 2007); *In re Star Trust*, 237 B.R. at 831; *In re St. Augustine Trust*, 109 B.R. 494, 496 (Bankr. M.D. Fla. 1990).
8 *In re Kenneth Allen Knight Trust*, 303 F.3d at 676; *In re Metro Palms I Trust*, 153 B.R. 922, 923 (Bankr. M.D. Fla. 1993); *In re Treasure Island Land Trust*, 2 B.R. 332, 334 (Bankr. M.D. Fla. 1980).
9 296 U.S. 344, 56 S.Ct. 289, 80 L.Ed 263 (1935).
10 *In re Star Trust*, 237 B.R. at 831; *In re St. Augustine Trust*, 109 B.R. at 496.
11 Judge Shulman, a bankruptcy judge for the Northern District of Alabama, sits by designation and also hears bankruptcy cases for the Bankruptcy Court for the Northern District of Florida.

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for the settlor's children, was eligible for relief under the Bankruptcy Code, even though (i) the trust had not registered in accordance with Section 609.02 of the Florida Statutes, (ii) the settlor's children were the beneficiaries, (iii) the trust contained a spendthrift provision, (iv) the debtor had no occupational licenses, (v) the trust was not registered as a fictitious name, and (vi) the trust had no employees.[12] In affirming Judge Shulman's decision, the district court acknowledged there are few bright line rules on the issue of whether an unregistered trust is eligible for relief under the Bankruptcy Code, and whether a trust was "created as a business trust [or] registered as such in the State of Florida . . . . is not alone determinative of the matter."[13]

While no one factor is dispositive, given the equitable nature of the balancing test and the Bankruptcy Code itself, a trust that is engaged in actively operating a business, even a smaller business, should qualify as a business trust and be eligible for relief under the Bankruptcy Code. Creditors, particularly lenders who chose to conduct business with the trust and surely evaluated its assets in providing financing, should not be given unfair leverage over the reorganization process by seeking dismissal of the case, where the debtor trust has simply not satisfied the technical requirements of Section 609.02 of the Florida Statutes.

Several of the decisions where bankruptcy courts have concluded that a trust is not eligible for relief under the Bankruptcy Code are easily distinguishable from situations where the trust operates a business but may not satisfy every factor of the balancing test adopted by various Florida bankruptcy courts. For example, while over twenty (20) years ago, Judge Paskay determined that a trust was not a business trust because it had failed to register in compliance with Section 609.02, Judge Paskay also considered the fact that the debtor did not have transferable certificates, employees, or business activities, did not buy or sell merchandise or provide a

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12 Tr. of Hr'g, 7:813, 8:4-6, 9:17-23, 10:5, 12:9-11, *In re Shuaney Irrevocable Trust*, Case No. 11-31887-WSS (Bankr. N.D. Fla. May 3, 2012).
13 *Beach Community Bank v. Shuaney Irrevocable Trust (In re Shuaney Irrevocable Trust)*, 3:12-cv-296/LAC, Order Affirming Bankruptcy Court's Order (Doc. No. 23), p. 9 (N.D. Fla. Mar. 7, 2013).

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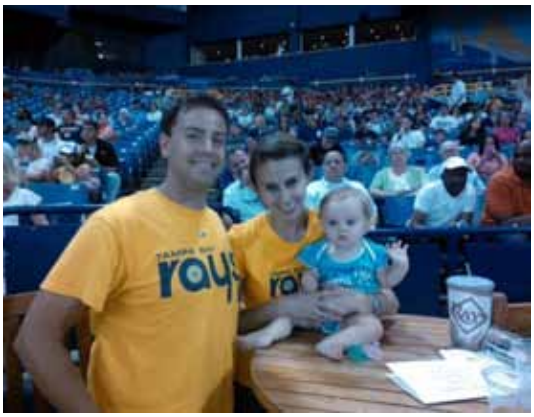
service, and did not file tax returns in concluding that the debtor was not a business trust.[14] The Court also seized on the fact that the trust did not hold the license to operate the adult congregate living facility; rather it was held by an entity controlled by Kutty. While the result of the Court's ruling was somewhat draconian in the *Mohan Kutty* case, the result was supported by other indicia of bad faith associated with the filing.

The procedural posture in which the issue of whether a trust is a business trust eligible for relief under the Bankruptcy Code is litigated raises an interesting procedural issue as well. As noted above, creditors (or the United States Trustee) are typically the parties who will challenge whether a debtor is qualified as a business trust under Section 101(9) of the Bankruptcy Code, often through a motion to dismiss, which presents an interesting procedural question – who bears the burden of proof? While typically the party seeking dismissal bears the burden of proof, debtors also bear the burden of establishing that they are eligible for relief under Section 109.[15] The case law on point is not particularly instructive. At least one court has opined that the burden is on the moving party seeking dismissal, but another court has placed the burden of proof on the debtor.[16] Still a third court created a shifting burden of proof, in requiring the creditor to make a prima facie showing that the trust was not a business trust, but imposing the ultimate burden of persuasion on the debtor.[17]

In hopefully creating controlling precedent that provides a definitive answer as to what a business trust is, the Eleventh Circuit should encourage bankruptcy courts to liberally apply the primary purpose test or six-factor balancing test in assessing whether a trust is eligible for relief under the Bankruptcy Code to avoid the harsh (and arguably inequitable) result of requiring a trust to comply with Section 609.02 of the Florida Statutes to satisfy Section 109's requirements. Trusts which may not comply with Section 609.02 of the Florida Statutes but operate businesses and exhibit other indicia akin to corporations or limited liability companies should not be deprived of the opportunity to seek the protections and relief afforded by the Bankruptcy Code based on a mere technicality.

Tampa Bay Bankruptcy Bar Association's 5th Annual Rays Summer Fund Raiser
June 28, 2013, Tropicana Field

Members attend annual Rays' event. Kathleen DiSanto, Jennifer McPheeters, and Suzy Tate were the winners of Judge McEwen's contest for most spiritedly dressed in Rays gear. In keeping with the baseball theme, Judge McEwen treated the winners to lunch at Nathan's hotdogs in downtown Tampa.



14 *In re Mohan Kutty Trust*, 134 B.R. 987, 989 (Bankr. M.D. Fla. 1991) (citing In re Treasure Island Land Trust, 2 B.R. 332 (Bankr. M.D. Fla. 1980)).
15 *In re City of Bridgeport*, 129 B.R. 332, 334 (1991).
16 *In re Charles St. African Methodist Episcopal Church of Boston*, 478 B.R. 73, 83 (Bankr. D. Mass. 2012) (when an entity is considered a corporation under state law, presumption arises in favor of debtor that entity is a corporation for purposes of Section 101(9) and the burden of proof is on the party challenging the entity's status as a corporation); *but see In re General Growth Props., Inc.*, 409 B.R. 43, 70 n.43 (Bankr. S.D.N.Y. 2009) (burden of proof on debtor to establish eligibility as a business trust under Section 109).
17 *In re Gulfcoast Irrevocable Trust*, 2012 WL 6005716, at *3 (Bankr. D.P.R. Nov. 30, 2012).

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Both Debtors and Creditors Lack Solid Ground as to Whether the "Absolute Priority Rule" Applies to Individual Chapter 11 Debtors

by: Jennifer Hayes Pinder,
Foley & Lardner LLP

The revisions to Bankruptcy Code Section 1129 and the addition of Section 1115 to the Bankruptcy Code by the Bankruptcy Abuse and Consumer Protection Act of 2005 ("BAPCPA") have caused inconsistent rulings on whether the so-called "absolute priority rule" still applies to chapter 11 cases of individual debtors. Although the Eleventh Circuit Court of Appeals has not addressed this issue, other circuit courts have reached varying and inconsistent rulings and there appears to be a split among the bankruptcy judges of the Middle District of Florida.

The absolute priority rule, initially a judicially created concept to prevent equity interest holders and senior creditors from reaching a deal that would impose unfair plan terms on junior unsecured creditors, is codified in 11 U.S.C. § 1129(b)(2)(B)(ii).[1] Generally, in order to confirm a non-consensual chapter 11 plan of reorganization, often referred to as a "cramdown" plan, the plan must be "fair and equitable" with respect to each class of claims or interests that is impaired under the plan and has not accepted the plan. In turn, to be "fair and equitable" with respect to a class of unsecured creditors, the plan must provide either that (i) each holder of a claim of such class receive or retain on account of such claim property of a value equal to the allowed amount of the claim -- i.e. full payment; or (ii) no junior claims or interests, such as equity interest holders, are to receive any property on account of those claims or interests. These provisions encompass the absolute priority rule.

Prior to BAPCPA, courts almost uniformly held that the absolute priority rule applied in individual chapter 11 cases, but bankruptcy courts, including bankruptcy judges within the Middle District of Florida, were split as to whether an individual chapter 11 debtor could keep property without paying his or her unsecured creditors in full. For example, in *In re Yasparro*,[2] Bankruptcy Judge Baynes held that an individual chapter 11 debtor must devote all of his property, both exempt and non-exempt property, to the chapter 11 plan in order to comply with the absolute priority rule. To the contrary, in *In re Henderson*,[3] Bankruptcy Judge Paskay rejected the holding in *In re Yasparro*, and held that an individual chapter 11 debtor does not have to forfeit exempt property in order to satisfy the requirements of the absolute priority rule. After the BAPCPA amendments, the focus shifted from whether an individual chapter 11 debtor could keep exempt property and not violate the absolute priority rule, to whether the absolute priority rule even applied to individual chapter 11 debtors.

BAPCPA's Revisions to the Absolute Priority Rule

Generally speaking, the modifications to Section 1129(b)(2)(B)(ii) and the adoption of Section 1115 amended the absolute priority rule to provide for an exception in a chapter 11 case of an individual debtor. More specifically, BAPCPA added the italicized language below to Section 1129(b)(2)(B)(ii):

> the holder of any claim or interest that is junior to claims of such class will not receive or retain under the plan on account of such junior claim or interest any property, *except that in a case in which the debtor is an individual, the debtor may retain property included in the estate under section 1115, subject to the requirements of subsection (a)(14) of this section.*

Section 1115(a) states:

> (a) In a case in which the debtor is an individual, property of the estate includes, in addition to the property specified in section 541 - (1) all property of the kind specified in section 541 that the debtor acquires after the commencement of the case but before the case is closed, dismissed, or converted to a case under chapter 7, 12, or 13, whichever occurs first; and (2) earnings from services performed by the debtor after the commencement of the case but before the case is closed, dismissed,

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1 *In re Friedman*, 466 B.R. 471, 478 (B.A.P. 9th Cir. 2012).
2 *In re Yasparro*, 100 B.R. 91, 95 (Bankr. M.D. Fla. 1989).
3 *In re Henderson*, 321 B.R. 550, 561 (Bankr. M.D. Fla. 2005), *aff'd, Van Buren Indus. Investors v. Henderson (In re Henderson)*, 341 B.R. 783 (M.D. Fla. 2006).

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> or converted to a case under chapter 7, 12, or 13, whichever occurs first.

The controversy created by the above statutes, as modified, turns on the reference in Section 1129(b)(2)(B)(ii) to "the debtor may retain property included in the estate under section 1115…" and whether the reference in Section 1115(a) to "in addition to the property specified in section 541…" is to be read in conjunction with Section 1129 to permit the debtor to retain *all* property of the estate – both the pre-petition property as well as post-petition service earnings and other post-petition property – or to retain just post-petition earnings and property.

Since the modifications to the absolute priority rule through BAPCPA went into effect, bankruptcy court rulings have been inconsistent and only three Circuit Courts of Appeals – the Fourth, Tenth and Fifth Circuits – have addressed the issue.

The Courts' Inconsistent Interpretation and Application of the Revised Absolute Priority Rule

The interpretation of the phrase "the debtor may retain property included in the estate under section 1115" causes the discord in deciding whether the absolute priority rule still applies to individual chapter 11 debtors. Generally, the courts have interpreted this phrase in two ways.

The first interpretation, referred to as the "broad view," interprets Section 1115 as including, in addition to the more specific property referred to in Section 1115, all of the property referenced in Section 541, thereby allowing the debtor to retain the property defined in Sections 1115 and 541, even where creditors' claims are not paid in full. This interpretation abrogates the absolute priority rule as applied to an individual chapter 11 debtor.

The second interpretation, which is referred to as the "narrow view," is that even where creditors' claims are not paid in full, an individual chapter 11 debtor may retain only the property that is added to the estate by Section 1115 -- i.e., the post-petition earnings and property -- but the absolute priority rule still applies to the pre-petition property as defined in Section 541.

Of particular interest and also creating controversy in the cases, are the divergent bases for the courts' varying interpretations.

The Broad View

The most common analysis supporting the "broad view" is that the statutory language is clear and unambiguous, and that the "property of the estate" referred to in Section 1115 includes not only post-petition property and earnings, but also the property described in Section 541. Therefore, reading Sections 1115 and 541 together, the absolute priority rule no longer prevents an individual chapter 11 debtor from retaining pre- or post-petition property, even when there are unsecured creditor classes not accepting the plan and their claims are not paid in full. In *SPCP Group, LLC v. Biggins*, the District Court for the Middle District of Florida affirmed Bankruptcy Judge Williamson's holding that the "broad view" of the phrase "property included in the estate under section 1115" is correct, thereby abrogating the absolute priority rule as applied to an individual chapter 11 debtor.[4] The Bankruptcy Appellate Panel for the Ninth Circuit also adopted this view in *Friedman v. P+P, LLC (In re Friedman)*,[5] as have other bankruptcy courts.[6]

And yet, other courts adopting the "broad view" have taken a different approach and found that the statutory language is in fact ambiguous, and therefore they turned to the legislative intent of BAPCPA. These decisions have relied upon the notion that BAPCPA's changes to individual chapter 11 debtors "were part of an overall design of adapting various chapter 13 provisions to fit in chapter 11."[7]

The Narrow View

Although numerous courts adopting the "broad view" have found that the statutory language is clear, many courts, including the Fifth Circuit Court of Appeals in *In re Lively*,[8] have also concluded that the statutory language is clear and unambiguous, but then reached the opposite ruling -- that Section 1115 *merely adds* property to an individual chapter 11 estate that is not already included under Section 541, and that Section

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4 *SPCP Group, LLC v. Biggins*, 465 B.R. 316, 321-22 (M.D. Fla. 2011) (affirming an unpublished bankruptcy opinion written by Bankruptcy Judge Williamson).
5 *In re Friedman*, 466 B.R. at 482.
6 *In re Tegeder*, 369 B.R. 477, 480 (Bankr. D. Neb. 2007); *see also In re Bullard*, 358 B.R. 541, 544 (Bankr. D. Conn. 2007).
7 *In re Shat*, 424 B.R. 854, 868 (Bankr. D. Nev. 2010); *see also In re Roedemeier*, 374 B.R. 264, 275 (Bankr. D. Kan. 2007).
8 *In re Lively*, 717 F.3d 406, 409 (5th Cir. 2013).

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1115 does not entirely substitute Section 541. Under this reasoning, Section 1129(b)(2)(B)(ii), as amended, only acts as an exception to the absolute priority rule as to an individual debtor's post-petition property or earnings; therefore, the absolute priority rule otherwise still applies to the debtor's pre-petition property.[9]

Some courts adopting the narrow rule have found that Section 1129(b)(2)(B)(ii) is itself ambiguous, but there is not a clear legislative intent giving rise to a complete abrogation of the absolute priority rule. Bankruptcy Judge Jennemann adopted this view in *In re Gelin*, and held that the "property included in the estate under section 1115" refers only to the property the debtor acquired post-petition, and therefore, the absolute priority rule still applies to the pre-petition property.[10] Interestingly, in *In re Bakke*, Bankruptcy Judge May held, in an unpublished opinion, that the absolute priority rule applied to individual chapter 11 debtors, but allowed the debtors to retain exempt property even though the plan failed to pay unsecured creditors in full.[11] Judge Jennemann's interpretation was also adopted by both the Fourth Circuit Court of Appeals in *Maharaj v. Stubbs & Perdue, P.A. (In re Maharaj)*,[12] and the Tenth Circuit Court of Appeals in *Dill Oil Co. v. Stephens (In re Stephens)*,[13] as well as many bankruptcy courts.[14] Courts taking this position note that if Congress intended to abrogate the well-established absolute priority rule, it would have done so more clearly and that a legislative repeal by implication is not favored. Courts adopting this approach have also disputed the conclusion that BAPCPA's amendments were designed to make chapter 11 cases more like chapter 13 cases; rather, that such provisions were designed to ensure a greater payout to creditors,[15] or to restore personal responsibility and integrity in the bankruptcy system.[16]

The Aftermath of the Revisions to the Absolute Priority Rule

Due to the conflicting interpretations of Section 1129(b)(2)(B)(ii), debtors in most jurisdictions currently lack a firm grasp on whether the bankruptcy court handling their cases will find that the absolute priority rule has been completely abrogated, or whether it still applies to an individual chapter 11 debtor's pre-petition property. To further compound this uncertainly, some bankruptcy courts in the same district have ruled inconsistently on the issue, including bankruptcy judges within the Middle District of Florida. This is evidenced by the divergent rulings by Judge Williamson, Judge Jennemann, and Judge May, as further discussed above.

Inconsistent interpretations of Sections 1115 and 1129 are not isolated to the Middle District of Florida. Similarly, in the Ninth Circuit, in *In re Kamell*, Bankruptcy Judge Albert, in the Central District of California, held that the absolute priority rule is still mandatory in individual chapter 11 cases.[17] Subsequently, the Ninth Circuit Bankruptcy Appellate Panel in *In re Friedman* held that a plain reading of Sections 1115 and 1129(b)(2)(B)(ii), "mandates that the absolute priority rule is not applicable in individual chapter 11 cases."[18] However, approximately two months after the Friedman decision, Bankruptcy Judge Kwan, also in the Central District of California, held in In re Arnold that the absolute priority rule still applies to individual chapter 11 cases with respect to pre-petition property.[19] The *Arnold* court noted that it was unclear if the *Friedman* decision was binding on it, and the court only considered, but would not be bound by, the Bankruptcy Appellate Panel's holding in *Friedman*. Subsequently, the *Arnold* court granted the debtors' request to certify a direct appeal to the United States Court of Appeals for the Ninth Circuit.[20] Therefore, the Ninth Circuit Court of Appeals may be ruling on this issue in the near future.

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9 *In re Karlovich*, 456 B.R. 677, 681 (Bankr. S.D. Cal. 2010); *In re Draiman*, 450 B.R. 777, 821 (Bankr. N.D. Ill. 2011); *In re Walsh*, 447 B.R. 45, 49 (Bankr. D. Mass. 2011); *In re Stephens*, 445 B.R. 816, 820-21 (Bankr. S.D. Tex. 2011); *In re Mullins*, 435 B.R. 352, 360 (Bankr. W.D. Va. 2010); *In re Steedley*, No. 09-50654, 2010 Bankr. LEXIS 3113, *5-6 (Bankr. S.D. Ga. Aug. 27, 2010); and *In re Borton*, No. 09-00196-TLM, 2011 Bankr. LEXIS 4310, *15 (Bankr. D. Idaho Nov. 9, 2011).
10 *In re Gelin*, 437 B.R. 435, 441-42 (Bankr. M.D. Fla. 2010).
11 *In re Bakke*, No. 8:10-bk-28972-KRM (Bankr. M.D. Fla. May 5, 2011).
12 *Maharaj v. Stubbs & Perdue, P.A. (In re Maharaj)*, 681 F.3d 558, 571 (4th Cir. 2012).
13 *Dill Oil Co. v. Stephens (In re Stephens)*, 704 F.3d 1279, 1287 (10th Cir. 2013).
14 *See In re Gbadebo*, 431 B.R. 222, 229 (Bankr. N.D. Cal. 2010); *In re Lee Min Ho Chen*, 482 B.R. 473, 482 (Bankr. D. P.R. 2012); *In re Kamell*, 451 B.R. 505, 510-11 (Bankr. C.D. Cal. 2011); *In re Lindsey*, 453 B.R. 886, 903 (Bankr. E.D. Tenn. 2011).
15 *In re Gbadebo*, 431 B.R. at 229.
16 *In re Lindsey*, 453 B.R. 886, 904 (Bankr. E.D. Tenn. 2011).
17 *In re Kamell*, 451 B.R. 505, 510-11 (Bankr. C.D. Cal. 2011).
18 *In re Friedman*, 466 B.R. 471 (B.A.P. 9th Cir. 2012).
19 *In re Arnold*, 471 B.R. 578, 606-07 (Bankr. C.D. Cal. 2012).
20 *In re Arnold*, 2012 Bankr. LEXIS 4187 (Bankr. C.D. Cal. July 25, 2012).

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The Fifth Circuit Court of Appeals in *In re Lively*,[21] recently adopted the "narrow view" and held that the absolute priority rule still applies to individual chapter 11 debtors and that the "exception to the absolute priority rule plainly covers only the individual debtor' post-petition earnings and post-petition acquired property." This case reached the Fifth Circuit Court of Appeals after the Bankruptcy Court for the Southern District of Texas certified its opinion to the Fifth Circuit while noting that "[a]lthough lower courts within the Fifth Circuit have not reached conflicting decisions, there have been conflicting decisions issued by lower courts elsewhere."[22]

Ultimately, it appears that the inconsistent rulings on this issue will likely lead to additional appellate decisions, and perhaps a ruling by the United States Supreme Court. Until this issue is more definitively decided, however, individual chapter 11 debtors will continue to have uncertainty as to whether their pre-petition property is subject to the absolute priority rule. This is an issue that needs to be considered carefully by debtors and their counsel before filing a chapter 11 case. Similarly, this uncertainty may also impact the negotiations between creditors and individual chapter 11 debtors on plan treatment.

Jennifer Hayes Pinder is a senior counsel with the law firm of Foley & Lardner LLP, and is a member of the firm's Bankruptcy & Business Reorganizations Practice Group.

Do you want to write an article for *The Cramdown*? Please send an e-mail to Suzy Tate, suzy@suzytate.com, for more information.

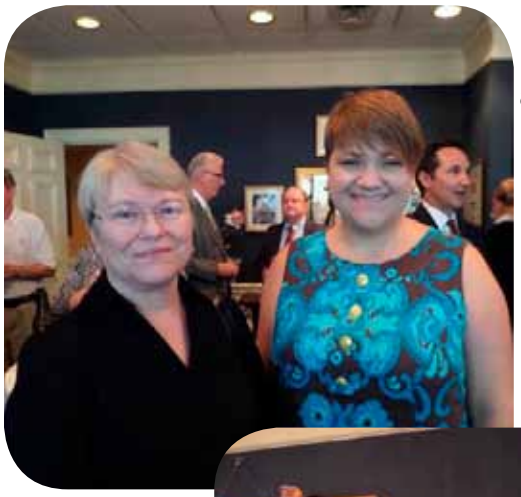
21 *In re Lively*, 717 F.3d at 409.
22 *In re Lively*, 467 B.R. 884, 886-87 (Bankr. S.D. Tex. 2012) (holding that the absolute priority rule still applies to chapter 11 individual debtors).

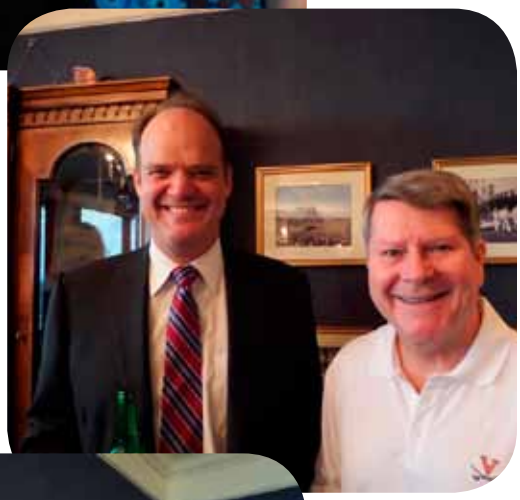
Past Presidents' Cocktail Party

July 16, 2013

University Club of Tampa

TBBBA's new board members meet with past presidents and bankruptcy judges to discuss upcoming association activities.





How to Tank a Mediation Without Even Trying

by James P. S. Leshaw

Every so often, you may want to tank a mediation. Maybe you know in advance it can't settle. Maybe the blood is so bad between lawyers or clients that you just want to teach a lesson to the other side. It could be that you think the judge is really enjoying all of the discovery disputes or doesn't have enough to do. Whatever the reason, based on my experience as a mediator, here are the top ten ways to blow a mediation (as well as some light reading).

1. Promise your client (preferably in writing) that there is no way he can lose at trial. Also, be sure to under-estimate the cost of the litigation both in terms of the cost of fees and expenses as well as the client's expected time-commitment and anticipated loss of sleep. This should sufficiently reduce the client's incentive to settle at mediation.

2. Do not submit a mediation statement to either the mediator or the other side. The reality is that the mediation statement serves very little purpose other than to educate the mediator and the other side to the strengths of your case. If you do decide to deliver a mediation statement anyway, consider using it as an opportunity to educate the mediator on how unreasonable the other side is (though this should be obvious to any experienced mediator as the other side has not yet caved to your demands). You may also choose to inundate the mediator and other side with copies of pleadings you have already filed in the case, with no explanation as to their relevance.

3. Do not personally attend the mediation – your attendance might send the message that you are serious about settling. Instead, send a junior associate who has had little or no involvement with the litigation, who does not know the factual or legal issues and who does not have the confidence or trust of the client. This will help to ensure that the mediation is not successful.

4. Be efficient when preparing for the mediation (assuming you decide to attend). Do not focus on the law or the facts – the other side must already be familiar with these or be too dense to understand your version of the law or the facts. Focus on the important stuff like making the mediation personal. Be prepared to embarrass opposing counsel by talking about their procedural gaffes in this case or their losses in other cases. This is really just constructive criticism.

5. Do not make an opening statement at the mediation – simply state that your position is already clear. Should you decide to make an opening statement, be sure to point out how unreasonable the other side has been for not simply giving in, explain you are not prepared to compromise in any way, but have a "take it or leave it" offer. Also, don't forget to remind the other side and the mediator that you have scheduled only one hour for the mediation because you need to be back at your office to take a phone call.

6. Do not bring your client to the mediation. Instead tell the other side that the client is available by telephone or that you already have settlement authority. Should your client inconveniently decide to show up at the mediation, make sure he does not participate in the mediation. You're being paid to attend the mediation so you should respond to any questions or comments made to your client by the mediator or the other side. This is your case after all.

7. If your client is the defendant, cry poverty but do not provide any financial information to support the claim.

8. Do not admit that your case has any weaknesses at all, including in a private session with the mediator. So long as you bury your head in the sand, neither the mediator nor the other side will realize there is a potential chink in your client's armor.

9. Yell, scream and pound on the table so everyone in the room knows you really mean what you are saying.

10. If it looks like the case may settle despite your best efforts, be prepared to pack your bag and leave. The best exit is a dramatic exit.

About Jim Leshaw: *Jim Leshaw is a lawyer based in Miami and Key Biscayne, Florida who spends about half of his time as a professional mediator and arbitrator.*

Tampa Bay Bankruptcy Bar Association's Annual Dinner
June 6, 2013
Palma Ceia Golf and Country Club

David Linton and Harley Riedel present annual Judge Alexander L. Paskay Award scholarship award.

Rose Paskay and Chuck Kilcoyne

Judge Caryl E. Delano, Chief Judge Karen S. Jennemann, Judge Michael G. Williamson and Stephenie Biernacki Anthony

People on the Go

Congratulations to Kim Koleos Dionisio and David Dionisio on the newest addition to their family! Peyton David Dionisio was born on Saturday, August 31, weighing in at 9 lb 4 oz.

Megan W. Murray joined Trenam Kemker in 2013 as an associate in the Bankruptcy, Creditors' Rights & Insolvency Practice Group. Prior to joining the firm, she clerked for the Honorable Karen S. Jennemann, Chief Judge of the Middle District of Florida for two years. She served as a Judicial Extern for the Honorable Judge Thad Collins of the Northern District of Iowa and as a Judicial Intern for the Honorable Judge Jeff Bohm of the Southern District of Texas. Prior to law school, Megan worked in the private sector at Aegon USA Realty Advisors for six years in various roles from Real Estate Analyst to Acquisitions Officer.

Stephanie (Crane) Lieb was recently named a shareholder at Trenam Kemker. She practices in the firm's Bankruptcy, Creditors' Rights & Insolvency group. Stephanie is a graduate of Tulane University and Loyola University New Orleans School of Law. Before joining Trenam, Stephanie served as a judicial law clerk to Judge Catherine Peek McEwen and Judge Michael G. Williamson. Her practices in bankruptcy court includes representation of secured and unsecured creditors, Chapter 11 liquidation/ distribution agents, defendants in avoidance actions, asset purchasers, and Chapter 7 trustees. She currently serves as a member of the TBBBA's board.

Lauren L. Lewis has joined the Tampa office of Shutts & Bowen LLP as an associate in the Business Litigation Practice Group. Ms. Lewis focuses her practice on bankruptcy and complex commercial litigation. She has experience representing creditors and bankruptcy trustees in litigation, reorganization, and liquidation matters. While at Stetson University College of Law, Ms. Lewis received the Judge Alexander L. Paskay Scholarship Award and served as a Federal Judicial Intern to the Honorable Caryl E. Delano.

The Cramdown is looking for information to add to its **"People on the Go"** section. Please send any personal and career updates by e-mail to Suzy Tate, suzy@suzytate.com.

The Cramdown
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