

OVERVIEW OF BANKRUPTCY WITH THE EMPHASIS  
BEING ON ISSUES FOR NON-BANKRUPTCY PRACTITIONERS

The Bankruptcy Code often preserves creditors' entitlements under nonbankruptcy law, but not always. This outline attempts to highlight:

- the principal areas where the Bankruptcy Code alters nonbankruptcy law entitlements, and
- the pitfalls that a non-bankruptcy practitioner might encounter when a bankruptcy case intervenes.

The debtor generally can receive certain benefits by way of filing bankruptcy:

- **Automatic Stay, Ch. 13 Co-Debtor Stay, and Discharge.**
- **Exemptions** for individual debtors.
- Power of individual debtor to **redeem** in chapter 7.
- In chapters 11, 12, and 13, a **confirmed plan** binding on all creditors.

And as discussed later, the trustee (or in some instances the debtor) is vested with certain **avoidance powers** and the power to **reject** executory contracts or unexpired leases.

I. THE STRUCTURE OF THE BANKRUPTCY CODE (NOT BANKRUPTCY ACT)

- A. Types of cases filed (Chapter 7, 11, and 13 cases being the ones most frequently filed), and some pertinent powers in each chapter, are:

- **Chapter 7: Liquidation** (the chapter 7 trustee administers the estate for the benefit of creditors, and an individual debtor receives a discharge). Chapter includes:
  - § 722      **Redemption.**
  - § 724      **Avoidance of liens for non-pecuniary loss penalties; utilizing tax lien to pay certain priority claims.**
  - § 726      **Distribution of property of estate.**
  - § 727      **Discharge.**

Chapter 9:  
Municipality

**Chapter 11: Reorganization** (debtor acts as debtor-in-possession unless displaced by appointment of a trustee; upon confirmation of a plan, creditors' rights are altered, and debtor usually receives a discharge). Chapter includes:

§ 1113 Rejection of collective bargaining agreement.

§ 1114 Treatment of retiree insurance benefits.

**§ 1129 Confirmation of plan** (including standards for confirmation when all classes of claims have accepted a plan (§ 1129(a)); and additional standards required for so-called "cramdown" when a class has rejected a plan (§ 1129(b)).

Chapter 12: Family Farmer With Regular Income

**Chapter 13: Individual With Regular Income** (debtor makes payments to the chapter 13 trustee for her to distribute to creditors under a confirmed plan that alters creditors' rights; debtor receives discharge upon completing plan payments). Chapter includes:

§ 1301 Stay of action against codebtor.

§ 1322 &  
§ 1325 Standards for confirming a ch. 13 plan.

§ 1328 Discharge (so-called "super discharge," unless it's a so-called "hardship discharge," because its effect is more extensive than § 524 generally provides)

- Chapter 15 - Ancillary and Other Cross-Border Cases
- B. Provisions Applicable in Each Chapter. In every case, the three other Bankruptcy Code chapters apply:
  - Chapter 1 (General Provisions)
  - Chapter 3 (Case Administration), including:
    - §§ 327 through 331 (employment and compensation of attorneys and other professionals to assist in administering estate):
      - a failure of a professional (working for the debtor-in-possession or for a trustee) to obtain court approval of the employment can lead to a denial of any compensation;
      - a failure to disclose all connections to the debtor and creditors can lead to an order requiring such a professional to disgorge fees
    - **§ 362 (automatic stay);**
    - **§ 365 (executory contracts and unexpired leases)**
  - Chapter 5 (Creditors, the Debtor, and the Estate), including:
    - § 502 (allowance of claims)
    - § 507 (priorities)
    - § 510 (subordination)
    - **§ 522 (exemptions)**
    - § 523 (exceptions to discharge)
    - **§ 524 (effect of discharge):**  
discharge injunction is enforceable via court's contempt powers
    - § 525 (protection against discriminatory treatment--including discriminatory treatment by an employer)
    - § 541 (property of the estate)
    - **Avoidance Powers of a Trustee or, in Chapter 11 or 12, a Debtor in Possession:**
      - § 544 (trustee as lien creditor and as successor to certain creditors and purchasers)

§ 545 (avoidance of statutory liens)

**§ 547 (preferences):**

be aware that payments of antecedent debts within 90 days of bankruptcy may be recoverable as preference

§ 548 (fraudulent conveyances)

§ 549 (postpetition transactions)

II. SOME COMMON PITFALLS AND ADVERSE CONSEQUENCES THAT ARISE WHEN A BANKRUPTCY CASE INTERVENES

A. Differences in Rules of Procedure:

- Federal Rules of Bankruptcy Procedure incorporate vast amounts of the Federal Rules of Civil Procedure. See Christopher M. Klein, *Bankruptcy Rules Made Easy (2001): A Guide to the Federal Rules of Civil Procedure that Apply to Bankruptcy*, 75 Am. Bankr. L.J. 35 (2001):
  - **Adversary proceedings** are commenced by a complaint and handled procedurally almost exactly like a District Court civil action.
  - **Contested matters** are commenced by a motion or in some instances by an objection (e.g., objection to claim; objection to exemptions). But aside from not requiring pleadings (complaints, counterclaims, etc.), the Federal Rules of Civil Procedure largely apply (including discovery). See Rule 9014.
- However, there are special rules that apply in bankruptcy, the so-called **bar date rules**, often applied harshly with no opportunity after the bar date has passed to seek an enlargement of time. Bar dates are set for:
  - Filing proofs of claim (usually no enlargement is available other than in chapter 11).
  - Objecting to exemptions. Once the bar date passes, the property claimed exempt *is* exempt. 11 U.S.C. § 542(1); *Taylor v. Freeland & Kronz*, 503 U.S. 638 (1992).
  - Objecting to confirmation of plan:

--confirmed plan binding on all creditors even if it violates the Bankruptcy Code (see *United Student Aid Funds, Inc. v. Espinosa*, --- U.S. ----, 130 S.Ct. 1367 (2010));

--confirmed plan can wipe out a lien if the lienor failed to object.

- Filing complaint to determine nondischargeability of certain debts.
- Objecting to debtor receiving a discharge at all ("objection to discharge" pursued via complaint objecting to discharge).
- Seeking revocation of discharge as procured by fraud.

B. Effect of Automatic Stay.

Acts taken in violation of stay are void (or at least voidable).

Sanctions for violation: contempt and, if debtor is an individual, § 362(k) award (including punitive damages).

C. Trustee's Power to Reject Under § 365.

Destroys right to specific performance.

Leaves other party with only a damage remedy, and liquidated damages clause will be given effect even though specific performance would have been worth much more.

D. Loss of Right to Jury Trial.

Claim asserted against estate: equitable claim with no right to jury trial. See *Katchen v. Landy*, 382 U.S. 323 (1966).

Counterclaim filed by estate against a filed claim: creditor may lose right to jury trial if resolution of counterclaim is necessary to determine whether the claim asserted against the estate is owed. See *Langenkamp v. Culp*, 498 U.S. 42 (1990). However, *Stern v. Marshall*, --- U.S. ----, 131 S.Ct. 2594, 180 L.Ed.2d 475 (2011), makes clear that the right to a jury trial continues with

respect to a bankruptcy estate's counterclaim that is unnecessary to resolution of the creditor's claim.

E. Jurisdiction is Limited.

Just because a debtor is in a bankruptcy case does not mean that the court has jurisdiction over a claim by or against the debtor. See:

*Ostroff v. Am. Home Mortg. (In re Ostroff)*, 433 B.R. 442 (Bankr. D.D.C. 2010) (no jurisdiction to adjudicate debtor's state law claim of lien invalidity on exempt property);

*Virginia Hosp. Center-Arlington Health Sys. v. Akl (In re Akl)*, 397 B.R. 546, 550 (Bankr. D.D.C. 2008) (no jurisdiction over malicious prosecution claim arising from acts in bankruptcy case).

F. Effect on Attorney-Client Privilege.

Corporation's privilege becomes the trustee's to waive when the corporation files a chapter 7 bankruptcy case. *CFTC v. Weintraub*, 471 U.S. 343 (1985).

### III. COLLATERAL ESTOPPEL

The doctrine of collateral estoppel (issue preclusion) applies in bankruptcy proceedings. But when attorneys obtain a judgment in a non-bankruptcy forum, they frequently give little attention to the possibility that they will want the judgment to have collateral estoppel effect in proceedings in the bankruptcy court, and fail to have the jury instructions set up so that the jury's verdict will have collateral estoppel effect.

An example is a judgment for which punitive damages were awarded but the jury instruction allowed punitive damages to be awarded for reckless or willful infliction of injury. Such a judgment will not have collateral estoppel effect with respect to the issue of whether there was "willful . . . injury by the debtor to another entity or the property of another entity" under 11 U.S.C. § 523(a)(6).

IV. COMPENSATION OF ATTORNEYS REPRESENTING A DEBTOR OR TRUSTEE;  
RULES RE "DEBT RELIEF AGENCY"

If an attorney:

- is in the midst of representing a client when that client commences a bankruptcy case, or
- undertakes representation of a debtor in some matter after the debtor's bankruptcy case has commenced,

that attorney needs to be aware of the special rules relating to representation of a debtor.

Necessity That the Employment Have Been Authorized by the Bankruptcy Court Before the Work Sought to be Compensated Was Performed. An attorney representing a debtor in possession (a chapter 11 debtor in a case in which no trustee has been appointed) or a trustee is required have the employment approved pursuant to a Rule 2014(a) application. If a Rule 2014(a) application to authorize the postpetition employment has not been filed when the work at issue was performed, the bankruptcy court may deny compensation for that work and order a disgorgement of any retainer paid.

Necessity that a Rule 2014(a) Application Disclose All Connections With the Debtor, Creditors, and Their Attorneys and Accountants Have Been Disclosed . If in her verified statement accompanying a Rule 2014(a) application to approve employment, an attorney fails to disclose a connection the attorney has with the debtor or a creditor (or with their attorneys and accountants), the court may deny compensation based on the lack of disclosure.

Necessity to File an Accurate Rule 2016(b) Statement. An attorney for a debtor (whether or not the debtor is a debtor in possession) is required to file a Rule 2016(b) statement disclosing compensation received or agreed to be received in connection with the case. If that Rule 2016(b) statement is inaccurate (e.g., it fails accurately to disclose the source of compensation), the court may deny all compensation to the attorney and require a disgorgement of fees.

Rules Relating to a "Debt Relief Agency". When an attorney:

- represents a debtor who is an "assisted person" (a term defined in 11 U.S.C. § 101(3) to mean "any person whose debts consist primarily of consumer debts and the value

of whose nonexempt property is less than \$175,750"),<sup>1</sup>

- in a proceeding related to a bankruptcy case (whether in the bankruptcy court or elsewhere), and
- does so for compensation,

that attorney arguably:

- is "appearing in a case or proceeding on behalf of [the debtor] or providing legal representation with respect to a case or proceeding under this title" within the meaning of the definition of "bankruptcy assistance" in 11 U.S.C. § 101(4A), and
- is thus a "debt relief agency" within the meaning of 11 U.S.C. § 101(12A).

Special statutory obligations apply to a debt relief agency. See 11 U.S.C. §§ 526 to 528 (imposing, e.g., disclosure obligations and advertising restrictions).

#### V. BANKRUPTCY JUDGE'S LIMITED AUTHORITY.

Referral to Bankruptcy Court. Pursuant to 28 U.S.C. § 157(a), the district court generally refers to the bankruptcy court all of the proceedings falling within the district court's bankruptcy subject matter jurisdiction under 28 U.S.C. § 1334.

Limitations on the Bankruptcy Judge's Deciding Such Referred Proceedings. The bankruptcy court does not always have authority under 28 U.S.C. § 157 to decide such a referred proceeding:

- Section 157 itself places limitations on such authority. See:
  - § 157(b)(5) (personal injury tort and wrongful death claims);
  - § 157(c)(1) (so-called non-core proceedings for which jurisdiction exists only because the proceeding is

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<sup>1</sup> The debt relief agency provisions do not apply to an attorney representing a creditor, *Milavetz, Gallop & Milavetz, P.A. v. United States*, 559 U.S. 229, 252, 130 S.Ct. 1324, 1341 (2010) (the provisions "govern only professionals who offer bankruptcy-related services to consumer debtors").

"related to" the bankruptcy case).

- § 157(d) (certain proceedings requiring consideration of U.S. laws regulating organizations or activities affecting interstate commerce)
- Under *Stern v. Marshall*, 131 S.Ct. 2594 (2011), Article III of the Constitution sometimes invalidates authorization in § 157(b) for a bankruptcy judge to decide a proceeding as a "core proceeding."

Nevertheless, in such instances:

- Consent of all parties arguably can result in the bankruptcy court being authorized to decide the proceeding by way of § 157(c)(2) (authorizing the bankruptcy judge "with the consent of all the parties to the proceeding . . . to hear and determine and to enter appropriate orders and judgements" subject to review only by way of appeal).<sup>2</sup>
- Even without consent, the bankruptcy court usually can hear the proceeding and make a proposed ruling for the district court to consider de novo. See 28 U.S.C. § 157(c)(1); *Executive Benefits Ins. Agency V. Arkison*, \_\_\_ S.Ct. \_\_\_, 2014 WL 2560461\_ (June 9, 2014) (a core proceeding that cannot be heard and decided by a bankruptcy judge will be treated as a non-core proceeding under § 157(c)(1) for which the bankruptcy court may issue a proposed ruling).
- If the bankruptcy judge decides the matter, but review on appeal is de novo because the decision was a grant of summary judgment, the appellant has obtained the Article III adjudication to which it was entitled. *Id.*
- Alternatively, the district court can withdraw the reference and hear and decide the proceeding. 28 U.S.C. § 157(d).

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<sup>2</sup> But see *BP RE, L.P. v. RML Waxahachie Dodge, L.L.C.* ( *In re BP RE, L.P.* ), 735 F.3d 279, 286-87 (5th Cir. 2013) (under Article III, affirmative consent does not permit a bankruptcy judge to decide a non-core proceeding); *Wellness Intern. Network, Ltd. v. Sharif*, 727 F.3d 751 (7th Cir. 2013) (right to have an Article III judge decide a matter may not be forfeited), pet. for cert. filed, 82 USLW 3496 (Feb. 5, 2014).

S. Martin Teel, Jr.  
United States Bankruptcy Judge  
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