

Recent Developments in Single Asset Real Estate[©]

State Bar of Arizona
Annual Convention

June 2012

J. Henk Taylor
Lewis and Roca, LLP

Meruelo Maddux and the Roll Up Strategy.

On January 27, 2012, the Ninth Circuit spoke for the first time in a published decision on the meaning of “single property or project,” in the Bankruptcy Code’s definition of “single asset real estate,” (“SARE,”) in Bankruptcy Code § 101(51B). *In re Meruelo Maddux Properties, Inc.*, 667 F.3d 1072 (9th Cir. 2012). In *Meruelo Maddux*, the Ninth Circuit rejected the debtor developer’s argument that its multiple single-asset subsidiaries should be viewed jointly as a “whole business enterprise,” to avoid the SARE requirements of Bankruptcy Code § 362(d)(3).

In light of *Meruelo Maddux*, debtors similarly-situated to the debtor in that case—holding multiple properties in single-asset subsidiary entities—may consider an alternate strategy to get their properties into bankruptcy but avoid the SARE label. A case currently pending in Nevada may provide such a roadmap. In *In re Whitton Corporation*, 10-32680-bam (Bankr. D. Nev.), the debtor’s principal orchestrated the merger of fifteen single-asset entities into the debtor Whitton Corporation just 3 days prior to Whitton Corporation filing Chapter 11. This “roll up,” strategy worked—at least for now. The bankruptcy court rejected the lender’s motion for stay relief based on the SARE provisions of the Bankruptcy Code.

Meruelo Maddux.

In *Meruelo Maddux*, the debtor Meruelo Maddux Properties, Inc. (“MMPI,”) was a developer of multiple commercial and residential properties in and around Los Angeles, California. Title to the real properties and real estate projects being developed by MMPI was held by single-asset, “property-level,” entities. These property-level entities were, in turn, indirectly owned by MMPI. MMPI and 53 of its subsidiaries filed Chapter 11 petitions in 2009. As of the petition date, one of the subsidiary debtors, Meruelo Maddux Properties—760 S. Hill Street, LLC (“MMP Hill,”), held title to real estate securing a loan from Bank of America (“B of A,”). *Meruelo Maddux*, 667 F.3d at 1074-75.

B of A and the debtors relatively quickly contested the issue of whether the real estate owned by MMP Hill was SARE under the Bankruptcy Code. *Id.* at 1074. The debtors won that argument in bankruptcy court. *Id.* While the bankruptcy court noted that MMP Hill “appears to have the characteristics of a [single asset real estate case],,” the court nonetheless concluded MMP Hill’s real estate should not be viewed as SARE under the Bankruptcy Code because it was part of a “whole business enterprise,” of MMPI and its subsidiaries. *Id.* at 1076. On appeal to the Ninth Circuit, the debtors argued that MMPI and its subsidiaries exhibited the following attributes:

- A consolidated cash management system in which deposits made into individual entities’ accounts are swept into a single concentration account, and then each of the entities’ expenses are paid from comingled funds;
- A history of using funds received by the individual property level entities for the benefit of the overall enterprise;

- A consolidated internal management team;
- Enterprise-wide loan facilities and programs;
- A history of preparing and filing financial statements and other required reports with the SEC on a consolidated basis;
- A history of preparing and filing tax returns on a consolidated basis;
- A history of marketing itself as a unified enterprise in connection with MMPI's pre-petition initial public offering;
- Guaranties given by upstream debtors such as MMPI for the benefit of property level subsidiaries; and
- Debts secured by loans that were cross-collateralized.

B of A appealed the bankruptcy court's ruling to the District Court. The District Court, in turn, reversed the bankruptcy court's SARE ruling. *Id.* at 1074. The debtors then appealed to the Ninth Circuit.

The Ninth Circuit affirmed the District Court's ruling that MMP Hill's property was SARE. The Ninth Circuit did not quibble with the bankruptcy court's findings regarding how MMPI, MMP Hill and the rest of MMPI's property-level entities operated as a single, integrated enterprise. Instead, in a rather succinct opinion, the Ninth Circuit noted that the real estate owned by MMP Hill satisfied the three elements of SARE property under the Bankruptcy Code: (a) a single property or project, other than residential real property with fewer than 4 residential units; (b) the property or project generates substantially all of the gross income of a debtor that is not a family farmer; and (c) no substantial business is being conducted by the debtor other than the business of operating the real property and activities incidental thereto. *Id.* at 1076. Looking at the plain language of Bankruptcy Code § 101(51B), the Ninth Circuit concluded the statute did not allow for a "whole business enterprise," exception to the SARE definition and the requirements of Bankruptcy Code § 362(d)(3). *Id.* at 1077.

The Ninth Circuit was careful to note, at several points, that the bankruptcy estates of MMPI and its subsidiaries had not been substantively consolidated. *Id.* at 1075 n. 1 and 1077. In the Ninth Circuit's view, corporate identity matters when it comes to determining whether a property is SARE:

Absent a substantive consolidation order, we must accept MMP Hill's chosen legal status as a separate and distinct entity from its parent corporation and sister subsidiaries, and look only to its assets, income, and

operations in determining whether [MMP Hill's property] is single asset real estate.

Id. at 1077.

Lenders, bond rating companies and investors in commercial mortgage backed securities will no doubt take heart in the Ninth Circuit's decision to uphold the sanctity of a single-asset, property-owning entity in *Meruelo Maddux*.

Whitton Corporation.

But the good news that lenders and investors received in *Meruelo Maddux* may be undercut by developments in the *Whitton Corporation* case in Nevada.

In Whitton Corporation¹, the debtor is the owner and manager of multiple commercial real estate properties in and around Las Vegas, Nevada. Prior to December 3, 2010, most of these properties and projects were owned by property-level, single-asset entities. Whitton Corporation and the property-level entities were all controlled by a single individual. The property-level entities were borrowers under separate loans from various banks. Each of these loans were secured by the real estate owned by the property-level entity.

On December 3, 2010, the individual principal of Whitton Corporation and the property-level entities caused these property-level entities, as well as several other affiliates, to be merged into Whitton Corporation. This was accomplished by the execution and filing of articles of merger with the Nevada Secretary of State. As a result of this series of mergers, the assets of 21 separate entities were merged into Whitton Corporation. This included 16 separate real estate properties or projects that were previously owned by property-level, single-asset entities.

Immediately after the merger, also on December 3, 2010, Whitton Corporation entered into a "lock up," agreement with Bank of Las Vegas. The Bank had loans with one or two of the pre-merger entities. Under the lock up agreement, the Bank agreed to certain impaired treatment of its secured claims under a future Chapter 11 plan and agreed to vote in favor of a plan providing this treatment.

Two days later, on December 5, 2010, Whitton Corporation filed a Chapter 11 petition.

Several lenders, including Wells Fargo Bank, sought stay relief. Among other things, Wells Fargo argued that:

¹ The following summary of the facts and ruling in the Whitton Corporation case is taken from the briefs filed by Wells Fargo Bank and the debtors on Wells Fargo's motion for stay relief, and the bankruptcy court's ruling on the motion stated on the record at a hearing on June 8, 2011.

- The pre-petition merger that violated covenants in the pre-petition loan and security documents, combined with the lock up agreement with Bank of Las Vegas, amounted to “cause,, for terminating the automatic stay under Bankruptcy Code § 362(d)(1);
- These same factors demonstrated the Chapter 11 was filed in bad faith thereby justifying stay relief under Bankruptcy Code § 362(d)(1) based on the precedent of *Matter of Little Creek Development Co.*, 779 F.2d 1068 (5th Cir. 1986) and its progeny; and
- Notwithstanding the pre-petition merger, the bankruptcy court should treat Whitton Corporation’s properties as SARE properties and grant stay relief under Bankruptcy Code § 362(d)(3).

The bankruptcy court rejected each of these arguments and denied stay relief under Sections 362(d)(1) and (d)(3).

The bankruptcy court acknowledged that Wells Fargo had advanced the loans at issue in contemplation that its borrowers would be single asset entities and that in the event of a borrower bankruptcy the bank could take advantage of the SARE provisions of the Bankruptcy Code. The bankruptcy court further acknowledged that the pre-petition merger violated loan covenants.

The bankruptcy court, however, reasoned that a mere violation of loan covenants is not sufficient “cause,, or evidence of bad faith to justify stay relief under section 362(d)(1). The court acknowledged that the pre-petition merger was intended to avoid having the properties at issue subject to the SARE provisions of the Bankruptcy Code. But in the court’s view, the merger was permitted under Nevada corporate law; and the debtor was allowed to restructure itself pre-bankruptcy in order to take advantage of reorganization under Chapter 11.

In the bankruptcy court’s view, the issue of bad faith turned largely on whether the pre-petition merger affected any of the lender’s rights under state law—not the Bankruptcy Code. The bankruptcy court noted that the merger of the various property-level entities into Whitton Corporation did not affect Wells Fargo’s lien or other collection rights existing under the loan documents and state law. Those rights and remedies remained intact—albeit stayed and subject to modification as allowed under the Bankruptcy Code.

While Wells Fargo may have expected it could avail itself of the SARE remedies should one its borrowers file bankruptcy, in the bankruptcy court’s view, Wells Fargo did not go far enough in structuring the pre-bankruptcy loans to protect this expectation. Specifically, the bankruptcy court noted that Wells Fargo did not require its borrowers to adopt corporate governance conditions such as a lender-elected director and unanimous consent for a bankruptcy filing. By not insisting on such protections, the bankruptcy court reasoned that Wells Fargo “took the

risk,, that its borrowers would restructure themselves to avoid the SARE restrictions. Thus the bankruptcy court concluded there was no “cause,, for relief under Section 362(d)(1)—whether based on bad faith or otherwise.

As for the bank’s motion under Section 362(d)(3), the court did not hesitate to conclude that Whitton Corporation’s properties were not SARE properties. The bankruptcy court reasoned that no one could “un-ring the bell,, of the pre-petition mergers into Whitton Corporation. And once in bankruptcy, the re-constituted Whitton Corporation was plainly not a single-asset entity and thus was not subject to the Bankruptcy Code’s SARE provisions.

The bankruptcy court’s ruling in the *Whitton Corporation* case is consistent with the Ninth Circuit’s ruling in *Meruelo Maddux*. Unlike MMP Hill in *Meruelo Maddux*, the debtor Whitton Corporation was clearly not a single-asset entity and thus failed the SARE test. Like the Ninth Circuit in *Meruelo Maddux*, the bankruptcy court in the *Whitton Corporation* honored the corporate structure of Whitton Corporation.

The import of the court’s decision to deny stay relief in *Whitton Corporation* is the court’s refusing to consider the debtor’s pre-petition corporate maneuvering to avoid the SARE provisions as evidence of bad faith. Apparently, the *Whitton Corporation* court did not consider these pre-petition mergers and the resulting Whitton Corporation to be akin to the “new debtor syndrome,, cases of the past where courts have granted stay relief or dismissed petitions based on bad faith.

Perhaps equally notable is that the court in *Whitton Corporation* essentially condoned a pre-petition substantive consolidation of multiple single asset entities with little comment. That would not have been the case if such a merger had been attempted post-bankruptcy. In that case, the debtors would have had to satisfy the test for substantive consolidation set forth in *Alexander v. Crompton (In re Bonham)*, 229 F.3d 750 (9th Cir. 2000). Whether the *Whitton Corporation* entities could have passed this test is debatable. But because the consolidation took place pre-bankruptcy, the bankruptcy court never asked the question.

Loop 76 and Classification of Lender Deficiency Claims.

The bankruptcy court decision in *In re Loop 76, LLC*, 442 B.R. 713 (Bankr. D. Ariz. 2010) regarding the separate classification of a lender’s deficiency claim has been a hot topic in the Arizona bankruptcy bar since it came out in November 2010. That decision became even more notable this past February when the Ninth Circuit Bankruptcy Appellate Panel affirmed the bankruptcy court’s classification ruling in *In re Loop 76, LLC*, ____ B.R. ____, 2012 WL 603812 (B.A.P. 9th Cir. 2012).

Included with these materials is an article authored by Dale Schian and Trent Trueblood of Schian Walker P.L.C. on bankruptcy court’s decision in *Loop 76*.

In its opinion, the BAP agreed with the trial court's analysis of Bankruptcy Code § 1122(a)'s legislative history and the import of the Ninth Circuit's earlier decision in *In re Johnston*, 21 F.3d 323 (9th Cir. 1994). *In re Loop 76, LLC*, 2012 WL 603812, at *7-*13. The BAP rejected the lender's argument that "substantial similarity,, among claims can only be measured based on the nature and priority of those claims vis-à-vis the assets of the debtor. *Id.* at *10-*12. Instead, the existence of an alternative source of payment on a lender's claim such as non-estate collateral (*Johnston*) or a third-party guaranty (*Loop 76*) is a factor that can justify finding a lender's deficiency claim not substantially similar to other unsecured claims thereby necessitating separate classification under the dictate of Bankruptcy Code § 1122(a). *Id.* at *13.

In what is perhaps a notable tweak to the Bankruptcy Court's ruling, the BAP commented in a footnote on the relevance of a guarantor's solvency. *Id.* at *13 n. 11. The bankruptcy court considered it relevant whether the lender could ultimately collect its claim from the third-party guarantors of Loop 76, LLC's loan. *In re Loop 76, LLC*, 442 B.R. at 724. If the guarantors were insolvent, then this might weigh against finding the lender had a real outside source of collection and a finding that its deficiency claim was substantially dissimilar to the claims of other unsecured creditors. *Id.* The bankruptcy court invited the lender and the debtor to present evidence of the guarantors' solvency at the confirmation hearing, *id.*, which they did. The bankruptcy court ultimately concluded that the guarantors were solvent and thus the lender had a bona fide, non-estate source of repayment of its deficiency claim. *In re Loop 76, LLC*, 2012 WL 603812, at *13 n. 11. Hence, the deficiency claim needed to be separately classified.

The lender contested the evidence of the guarantors' solvency on appeal to the BAP. *Id.* The BAP, however, did not find this argument relevant. The BAP noted that the ability of the creditor to actually collect its debt from the non-estate source was "never discussed,, by the Ninth Circuit in *Johnston*. *Id.* This lead the BAP to "question,, whether the collectability of the debt from the non-estate source (*e.g.*, a guarantor) "is even a factor to consider,, *Id.*

At this point, the import of the BAP's comment on the relevancy of a guarantor's solvency is debatable. Notably, the comment appears to be dicta. Apparently the lender failed to provide the BAP with an adequate record to review the issue of the guarantors' solvency; and the BAP affirmed the bankruptcy court's solvency ruling on this basis. *Id.*

Nonetheless, the BAP's comment suggests an opening for debtors to argue that the mere fact that a lender has the right to seek collection of a deficiency claim from a third-party guarantor is enough to make this a factor requiring separate classification of the lender's claim. Given that many individual guarantors of commercial real estate loans are themselves insolvent, avoiding a solvency test for the guarantor will often help the debtor's case for separate classification.

**Bankruptcy Court for the District of Arizona Holds Separate Classification of Undersecured Creditor's
Deficiency May Be Required By § 1122(a)**

Written by:
Dale C. Schian
Trent S. Trueblood
Schian Walker, P.L.C.
Phoenix, AZ 85012
dschian@swazlaw.com
ttrueblood@swazlaw.com

Introduction

To confirm a chapter 11 plan under the so-called "cramdown option," at least one impaired class of creditors must accept the proposed plan.¹ For a class to accept a plan, more than one half (in number) of the voting claimants in a class, representing at least two-thirds of the total dollar amount of voting claims in such class, must vote to accept.² In single-asset real estate cases,³ the lienholder frequently holds a deficiency claim larger than one third of the total dollar amount owed to unsecured creditors,⁴ giving it an effective veto on the plan unless the lienholder's deficiency claim is classified separately from the claims of other unsecured creditors.

Section § 1122 of the Bankruptcy Code, *Classification of claims or interests*, does not restrict a debtor's ability to separately classify similar claims in a plan of reorganization.⁵ However, nearly all courts place some restrictions on the debtor's freedom to classify claims separately.⁶ The prevailing view follows the "one clear rule," that debtors may not "gerrymander" substantially similar claims into separate classes for the purposes of confirming a plan.⁷ It requires that a debtor establish a

¹ 11 U.S.C. § 1129(a)(10).

² 11 U.S.C. § 1126(c).

³ See 11 U.S.C. § 101(51B).

⁴ See, e.g., *Phoenix Mut. Life Ins. Co. v. Greystone III Joint Venture (In re Greystone III)*, 995 F.2d 1274, 1280 (5th Cir. 1991) (single asset property creditor asserted a deficiency claim of \$3.5 million. General unsecured creditors were owed \$10,000).

⁵ 11 U.S.C. § 1122 provides:

(a) Except as provided in subsection (b) of this section, a plan may place a claim or an interest in a particular class only if such claim or interest is substantially similar to the other claims or interests of such class.

(b) A plan may designate a separate class of claims consisting only of every unsecured claim that is less than or reduced to an amount that the court approves as reasonable and necessary for administrative convenience.

⁶ *In re U.S. Truck Co. Inc.*, 800 F.2d 581, 586 (6th Cir. 1986).

⁷ *In re Greystone III*, 995 F.2d at 1279 (announcing the "one clear rule"); *contra* Bruce A. Markell, *Clueless on Classification: Toward Removing Artificial Limits on Chapter 11 Claim Classification*, 11 BANKR. DEV. J. 1, 1 (1995) (criticizing the use of terms like "gerrymandering" or "artificial" impairment as a tactic to generate emotional support for disallowing certain forms of classification).

credible business or economic justification to separately classify unsecured claims from the deficiency claims.⁸

I. *In re Loop 76 LLC*

In *In re Loop 76 LLC*, the United States Bankruptcy Court for the District of Arizona held that if a guaranty by a non-debtor provides the lienholder an alternative source of repayment for a deficiency claim, then the deficiency claim is not necessarily "substantially similar" to other unsecured claims. If the evidence presented at a confirmation hearing established that the guarantee was a significant factor in determining the creditor's vote (for example, by showing that the guarantee had value), § 1122 requires the "guaranteed" deficiency claim be classified separately from non-guaranteed unsecured claims.⁹ Issues of "gerrymandering" would not arise because § 1122 precludes placing dissimilar claims in the same class.¹⁰

The court based its holding on *In re Johnston*.¹¹ *Johnston* had affirmed the separate classification of a deficiency claim where, unlike other unsecured creditors, the undersecured creditor (1) was partially secured by the collateral of a non-debtor; (2) was engaged in litigation with the debtor that might result in the reduction or elimination of its deficiency claim; and (3) might recover before any of the other unsecured creditors if it prevailed in the litigation.¹² The *Loop 76* court observed that only the first factor provided a "basis on which to ascertain dissimilarity,"¹³ the starting point in applying § 1122. The court found that, like third-party collateralization in *Johnston*, the third-party guaranty provided the deficiency creditor with an alternative source of payment.¹⁴ Thus, *Johnston* and *Loop 76*

⁸ *In re Bakarat*, 99 F.3d 1520, 1524 (9th Cir. 1996) (collecting cases); *contra In re ZRM-Oklahoma P'ship*, 156 B.R. 67, 68 (Bankr. W.D. Okla. 1993) (permitting plan to separately classify deficiency claimant from trade creditors based on the plain language of § 1122).

⁹ *In re Loop 76 LLC*, 2:09-bk-16799-RJH, 2010 WL 5544491 at *1 (Bankr. D. Ariz. Nov. 22, 2010).

¹⁰ *Id.* at *8, n. 5.

¹¹ *Steelcase Inc. v. Johnston (In re Johnston)*, 21 F.3d 323 (9th Cir. 1994).

¹² *Id.* at 328.

¹³ *Loop 76*, 2010 WL at *3.

¹⁴ *Id.*

hold that it is permissible for a bankruptcy court to find, as a matter of fact, that a non-debtor source of repayment may render a claim substantially dissimilar from other unsecured claims for purposes of § 1122, requiring that it be separately classified.¹⁵

The deficiency claimant in *Loop 76* argued that *Johnston* was no longer controlling,¹⁶ given the Ninth Circuit Court of Appeals' decision in *In re Bakarat*, which rejected separate classification as a means to "gerrymander" an impaired accepting class absent a "legitimate business or economic reason to do so."¹⁷ The *Loop 76* decision observed that *Bakarat* had only addressed the legal limits on separately classifying claims that had already been determined to be substantially similar. It found that *Bakarat* did not analyze whether the claims were substantially similar in fact,¹⁸ but that *Bakarat* had simply distinguished *Johnston* and could not have overruled it.¹⁹ Therefore, the *Loop 76* decision found *Bakarat* to be inapposite, leaving the court to determine whether the *Johnston* factors applied.

Based upon authority under chapter X of the Bankruptcy Act,²⁰ *Loop 76*'s deficiency creditor further argued that the Code requires the common classification of "all creditors of equal rank with claims against the same property." The court also rejected this view. First, it observed that relying on jurisprudence under chapter X to interpret § 1122 was not appropriate and that chapter 11 of the Code more closely resembles chapter XI of the Bankruptcy Act rather than chapter X.²¹ In chapter XI of the Act, the classification rule was intended to be flexible. Chapter XI of the Act did not permit courts to

¹⁵ *Id.*

¹⁶ *Id.* at 4.

¹⁷ *In re Bakarat*, 99 F.3d 1520, 1526 (9th Cir. 1996); see also *In re Tucson Self-Storage Inc.*, 166 B.R. 892, 898 (B.A.P. 9th Cir. 1994); *Montclair Retail Center LP v. Bank of the West (In re Montclair Retail Center LP)*, 177 B.R. 663, 664 (B.A.P. 9th Cir. 1995).

¹⁸ *Loop 76*, 2010 WL at *4, citing *Bakarat*, 99 F.3d at 1523 (distinguishing factual issue of substantial similarity, which had already been decided by the bankruptcy court, from the legal issue of whether similar claims could be separately classified).

¹⁹ *Id.* ("one panel of the Ninth Circuit cannot reverse a prior panel's holding absent an intervening change in the law").

²⁰ *Id.*, citing *In re Los Angeles Land and Investment Limited*, 282 F.Supp. 448, 453-54 (D. Hawaii 1968), *aff'd*, 447 F.2d 1366 (9th Cir. 1971) (additional citations omitted).

²¹ *Id.* at *5, citing 5 NORTON BANKRUPTCY LAW AND PRACTICE 3D § 91:5, at 91-18 (2009) ("The new Chapter 11 bears features of all of its predecessors, but on the whole it leans more toward the informality and flexibility of old Chapter XI than the formal structure of old Chapter X").

order reclassification from what the debtor had proposed.²² Moreover, had the Code's drafters intended to forbid the separate classification of claims with the same priority, they could have easily substituted the term "priority" for "similarity" in § 1122, eliminating any ambiguity.²³

The *Loop 76* court further noted that the interpretation of § 1122 that the deficiency creditor proposed would contradict the purpose of classification. Under either chapter of the Act, separate classification was only important to determine how claims were treated and which claims were required to be treated alike.²⁴ Under the Code, classifying dissimilar claims in a single class became a concern because classes can waive the absolute priority rule, perhaps to the frustration of dissenting members within the class.²⁵ Therefore, it would be inappropriate to permit a class to waive the absolute priority rule to the detriment of a creditor whose claim did not belong in that class and that wished to receive the benefits of that rule.²⁶

Separately classifying similar claims was not a concern until Congress enacted § 1129(a)(10), which requires at least one impaired consenting class for confirmation if any class is impaired.²⁷ However, the history of § 1129(a)(10) demonstrates that it was intended only to ensure "some indicia of creditor support" for the plan, not to require unanimity or to give veto power to any unsecured creditor simply because it held more than a third of the total amount of unsecured claims in an impaired class.²⁸ Thus, the classification rules under the Code now serve the additional function of determining whether there is some creditor support for the plan.²⁹ According to the *Loop 76* court, it

²² *Id.* at *5, citing 9 Collier on Bankruptcy ¶ 7.01[3], at 8-10 (14th ed. 1978).

²³ *Id.* at *6.

²⁴ *Id.*

²⁵ *Id.*

²⁶ The concern is not limited to unsecured creditors. Secured creditors and interest holders also are entitled to "fair and equitable" treatment as described in § 1129(b); however, those protections are only available to them if the class in which they are placed has not voted to accept the plan. Additionally, classification of secured creditors is expressly implicated whenever the § 1111(b)(1) election is available.

²⁷ *Id.* at *7; see also Markell, *supra* note 7 (citing the Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353).

²⁸ *Id.* at *7, citing P. Murphy, CREDITOR'S RIGHTS IN BANKRUPTCY, Section 16.11, at 16-20 (1980).

²⁹ *Id.*

would defeat the purpose of § 1129(a)(10) “to allow a single creditor with an entirely unique interest, because it can be assured of payment from non-debtor sources, to prevent other creditors from demonstrating their approval of the plan and therefore its satisfaction of § 1129(a)(10).”³⁰

II. Implications of the *Loop 76* Decision

At its heart, the *Loop 76* decision simply requires a comprehensive inquiry into whether claims are in fact “substantially similar,” but in doing so it expands the scope of the inquiry far beyond mere superficial similarity. It is a treasure trove in considering whether particular claims may or must be separately classified under a proposed plan of reorganization. Relying on *Johnston*, which it describes as perhaps the only Circuit decision that has definitively considered the meaning of substantial similarity under the Code,³¹ the *Loop 76* decision considers whether claims of equal priority are factually dissimilar and therefore must be separately classified.³² As in *Johnston*, the *Loop 76* court concluded that a creditor who is able to recover all or part of its claim from non-debtor assets is factually dissimilar from creditors who may not recover beyond the assets of the bankruptcy estate.³³ *Loop 76* noted that “[c]reditors may favor a plan because it provides future jobs in the community, because they will be able to do business with the reorganized debtor, or because the reorganized debtor will provide a useful product or service to the community,” and stated “[i]t is entirely appropriate to define classification . . . with the creditors’ various and conflicting interests in mind.”³⁴

Today, few courts have adopted the plain language of § 1122, which contains no prohibition upon separate classification, but rather only a prohibition of overinclusiveness.³⁵ Some courts have suggested that separate classification may be permissible if it is not done for an improper

³⁰ *Id.* at *8.

³¹ *Id.* at *2.

³² *Id.*

³³ *Id.* at *8.

³⁴ *Id.* at *7; see also *In re Woodbrook Associates*, 19 F.3d 312, 318 (7th Cir. 1994) (“The voting incentive rationale is worthy of careful study . . .”).

³⁵ *Id.* at *2.

purpose such as gerrymandering.³⁶ Other courts have suggested that separate classification may be appropriate if supported by a sufficient business justification.³⁷ Finally, the Ninth Circuit decision in *Johnston* may be read for the proposition that differing treatment of claims otherwise having the same priority may justify separate classification.³⁸

Although the *Loop 76* decision acknowledged each of these lines of authority, its resolution of the dispute before it made reaching those arguments unnecessary. Instead, relying upon canons of statutory construction and the Ninth Circuit's *Johnston* decision, it concluded that an issue of fact existed as to whether the personal guarantees that supported the unsecured deficiency claim caused that claim to be factually dissimilar from the claims of other general unsecured creditors who lacked the benefit of personal guarantees. In so doing, *Loop 76* appears to have rejected a narrow mechanical determination in favor of considering the broad range of factors that actually motivate the holders of superficially similar claims.

³⁶ See, e.g., *Phoenix Mut. Life Ins. Co. v. Greystone III Joint Venture (In re Greystone III)*, 995 F.2d 1274 (5th Cir. 1991).

³⁷ See, e.g., *Boston Post Road Ltd. vs. Federal Deposit Insurance Corp. (In re Boston Post Road)*, 21 F.3d 477 (2d Cir. 1994).

³⁸ *Loop 76*, 2010 WL at *3.

Essentials of the Infamous 1111(b)(2) Election and One Emerging Issue[©]

State Bar of Arizona
Annual Convention

June 2012

Jordan A. Kroop
Partner, Restructuring & Insolvency
Squire Sanders (US) LLP

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Under Bankruptcy Code §§502 and 506, an under-secured creditor (that is, a secured creditor whose claim is in an amount greater than the value of the collateral securing the claim) usually has a “bifurcated” claim—a secured claim to the extent of the value of the collateral (allowed secured claim) and an unsecured claim to the extent of any remaining debt (unsecured claim). In Chapter 11 cases, the treatment of the secured creditor's claim—and the debtor's ability to confirm a cramdown plan over the secured creditor's objection—may be affected by an election the secured creditor can make under Bankruptcy Code §1111(b). That section provides two things:

1. If a secured debt is nonrecourse, it will be treated as recourse against the debtor for purposes of plan distributions if the collateral is not being sold under the plan;¹ and
2. An under-secured creditor can elect to have its entire debt treated as a secured claim for plan confirmation purposes unless: (i) the allowed secured claim is “inconsequential”; or (2) the debt is already a recourse debt and the collateral has already been sold or is proposed to be sold under the plan.

This is referred to as the “§1111(b)(2) election.” The secured creditor must make this election before the end of the hearing on approval of the disclosure statement.² Once made, the §1111(b)(2) election may not be revoked unless there is a material change in the plan.

The primary purpose of an §1111(b)(2) election is to give the under-secured creditor the benefit of any post-confirmation appreciation in the collateral. The trade-off, however, is that the creditor waives any deficiency claim otherwise available under §1111(b)(1). Each of these considerations have their own strategic implications, some of which follow below.

Example of §1111(b)(2) Election

To put the advantages and disadvantages of the §1111(b)(2) election into a practical context, assume the following scenario:

Unfortunate Hospitality Corp. (Debtor) owns one asset, a motel. Motel is worth \$1,000,000. Bank is owed \$1,500,000, secured by a lien on the motel. The Debtor owes unsecured trade creditors a total of \$100,000.

¹ 11 U.S.C. §1111(b)(1). If collateral is to be sold, this feature does not apply. The lienholder is deemed protected by its right to credit bid up to the full amount of its debt at any sale, and any deficiency cannot be asserted. *See* 11 U.S.C. §363(k).

² *See* Bankruptcy Rule 3014.

Bank's loan is nonrecourse. Because the bank has a first lien for a debt of \$1,800,000 on an asset worth \$1,000,000, the bank is obviously under-secured. The Debtor's Chapter 11 plan proposes essentially this:

Classification and Treatment of Claims:

- | | |
|----------|--|
| Class 1: | Administrative claims. Paid in full in cash on Effective Date. |
| Class 2: | Priority claims. Paid in full in cash on Effective Date. |
| Class 3: | Bank's secured claim (listed at \$1,000,000). Bank retains its lien on the motel for a debt of \$1,000,000, payable interest-only at 4% over 10 years, balloon principal payment at end of tenth year. |
| Class 4: | Unsecured trade claims. Payable 25% over 5 years with no interest. |
| Class 5: | Bank's unsecured deficiency claim (listed at \$800,000). Payable 25% over 10 years with no interest. |
| Class 6: | Equity Interests. Shareholders retain shares in reorganized Debtor. |

If the bank does not make its §1111(b)(2) election, it receives a total of \$1,600,000 after ten years:

- | | |
|----------|--|
| Class 3: | 10 payments @ \$40,000 + Principal @ \$1,000,000 = \$1,400,000 |
| Class 5: | \$200,000 |

If the bank does not make the election, the bank controls the votes in Classes 3 and 5. By rejecting the plan as illustrated, the plan is put into a cramdown posture and may only be confirmed under Bankruptcy Code §1129(b). As such, the only way the Debtor's shareholders can retain their interest in the Debtor is to either: (1) pay all claims in Classes 4 and 5 in full (thus satisfying the "absolute priority rule" of §1129(b)(2)(B)); or (2) put in new capital and use the judicially-created "new value exception" to the absolute priority rule.

The principal disadvantage of not making the §1111(b)(2) election is that if the Debtor defaults under its plan in, say, year four, the bank may foreclose

on the motel (since the bank has retained its lien under the plan) but only for a \$1,000,000 debt. If another entity bids, say, \$1,300,000 at the foreclosure sale, the \$300,000 belongs to the Debtor. Likewise, if the Debtor refinances or sells the motel six years into the plan, the bank can only recover \$1,000,000, and any appreciation belongs to the Debtor. Either way, if the motel appreciates over the life of the plan, the bank does not receive any benefit. For this reason, whether the bank believes its collateral will appreciate over time is one of the most important considerations for the bank in deciding whether to make the §1111(b) election.

If the bank *does* make the §1111(b)(2) election, it must receive payments over the life of the plan aggregating the full amount owed (\$1,800,000), and the plan must provide for payment of the present value of the bank's allowed secured claim (\$1,000,000). That is not to say that the bank must receive \$1,800,000 plus interest over the life of the plan. Rather, all payments received under the plan must aggregate \$1,800,000. This means that, if the bank makes the §1111(b)(2) election, the Debtor must (1) increase the interest rate being paid, or (2) increase the length of time interest will be paid, or (3) pay down some principal before the balloon, or (4) do some combination of all these, to ensure that the bank receives at least \$1,800,000 by the end of the plan period.

In this example, the Debtor could either pay 8% on the principal rather than 4%, or pay 4% for 20 years rather than 10 years. Doing either of these may have serious implications for the Debtor's post-confirmation operations and cash flow and may make it far more difficult for the Debtor to demonstrate sufficient plan feasibility for confirmation. The bank has waived its deficiency claim (and, therefore, its ability to oppose the plan on grounds associated with the unsecured claim, such as improper classification and unfair discrimination), but the bank may also have made the Debtor's evidentiary burden on plan feasibility far more difficult to satisfy.

There are essentially three advantages to making the §1111(b)(2) election:

1. If the Debtor defaults under the plan, the bank has a lien for the full \$1,800,000, not just \$1,000,000, but this is important only if the motel appreciates over time. If the motel does not appreciate and is still only worth \$1,000,000 when the plan default occurs, the additional \$800,000 of debt is hardly a real benefit because it is nonrecourse.
2. If the Debtor sells or refinances the motel, the full \$1,800,000 debt lien is still on the motel and must be paid.

3. If the bank wants to block confirmation of the plan, making the §1111(b)(2) election can frustrate confirmation, primarily by making feasibility under §1129(a)(11) more speculative, either because a longer payout or a higher interest burden on operating cash flow creates greater risk of default, especially over some 20 years with an aging motel.

There are disadvantages to making the §1111(b)(2) election. The bank gives up its right to participate in and possibly to control the class of unsecured creditors and will receive nothing on its unsecured claim. The bank also gives up the ability to assert other legal bases to deny confirmation of the plan. If the Debtor attempts to separately classify the bank's unsecured deficiency claim from other unsecured claims, the bank can argue both that the classification is improper and that disparate treatment between the two classes of unsecured claims is unfairly discriminatory under §1129(b)(1). If the Debtor does not attempt such a separate classification of the bank's unsecured claim, the bank's vote in the one class of unsecured claims may block confirmation of the plan for lack of an accepting impaired class under §1129(a)(10) and (b).

Other Considerations

1. Does the creditor think the collateral will appreciate over the life of the plan?
2. What is the likelihood of either: (a) a default under the plan (such that the lender will take the collateral back in foreclosure); or (b) a sale or refinance before the payout under the plan?
3. Is the distribution to unsecured creditors uncertain or of doubtful value?
4. Will a rejecting vote by the unsecured creditors' class create a legal hurdle for the debtor (such as violation of the absolute priority rule, unfair discrimination, no accepting impaired class)?
5. How much has the creditor written the debt down on its books? If the debt has been written down substantially, perhaps the creditor's return resulting from an §1111(b)(2) election will be adequate.
6. Will the §1111(b)(2) election create tactical benefits for the creditor?

Possible Limit on 1111(b) Election

A recent case before the U.S. Bankruptcy Court for the District of Arizona (Judge Haines), *In re Red Mountain Machinery Co.*, presented a novel issue in connection with the secured lender's 1111(b) election.

Shortly after the debtor in that case filed its Chapter 11 petition, the debtor moved for authorization to sell approximately half its equipment to a third party. The secured creditor, Comerica Bank, had a perfected first-priority lien on the equipment proposed to be sold, and exercised its right under Bankruptcy Code §363(k) to credit bid on that equipment. The bankruptcy court authorized Comerica's purchase of the equipment for a credit bid of \$7 million. Comerica reduced its claim by its credit bid of \$7 million, to approximately \$24 million from the approximately \$31 million claim amount that existed at the time of the bankruptcy filing (the "**Credit Bid Sale**"). Comerica retained a perfected, first-priority security interest in substantially all the debtor's remaining assets.

The debtor's plan bifurcated Comerica's claim into two classes: Class 2, containing Comerica's secured claim; and Class 7, containing Comerica's unsecured claim. Within the plan itself and in the associated disclosure statement, the debtor objected to Comerica's potential 1111(b) election, arguing that because Comerica had purchased some of the debtor's equipment in the Credit Bid Sale, Comerica was not entitled to make an election under §1111(b) to have its remaining claim treated as fully secured. The debtor relied on the language of § 1111(b)(1)(B)(ii) and argued that Comerica had effectively "waived" its right to an 1111(b) election by purchasing some of its collateral in the Credit Bid Sale:

(B) A class of claims may not elect application of paragraph (2) of this subsection if — ... (ii) the holder of a claim of such class has recourse against the debtor on account of such claim and such property is sold under section 363 of this title or is to be sold under the plan.

Thus, the issue is whether the collateral sold in the Credit Bid Sale fell within the purview of the "such property is sold" language in § 1111(b)(1)(B)(ii).

The bankruptcy court sustained the debtor's objection only partially. The court limited Comerica's 1111(b) election by creating a formula that attempted to take into account the Credit Bid Sale. The formula: (a) calculated the ratio of the \$7 million value of the collateral sold in the Credit Bid Sale to the presumed value of all the collateral at the beginning of the bankruptcy case; (b) multiplied that ratio by the total amount of

Comerica's claim (the "**Discount**"); and (c) permitted Comerica's 1111(b) election only on the claim amount remaining after deducting the Discount. Because the formula required a finding of the remaining collateral's value, the debtor and Comerica stipulated to a value of the remaining collateral of \$10 million. Applying the formula, the Discount was approximately \$9.8 million, and Comerica's total secured claim under the 1111(b) election was reduced to \$15.9 million. The parties stipulated to the math for purposes of plan confirmation but Comerica reserved its objection to the use of the formula, which resulted in Comerica's losing a substantial part of its secured claim.

The bankruptcy court's formula is not found in either the Bankruptcy Code or in any reported decision. Because the court believed that the principal purpose of §1111(b) is to give a secured creditor the right to capture future appreciation of its collateral, the court created the formula to account for the fact that Comerica had the ability to reap the benefit of any appreciation of some of its collateral because it had purchased some of that collateral at the Credit Bid Sale. The bankruptcy court's rationale is set forth in its decision denying Comerica a stay pending appeal.³ Applying the formula to Comerica's 1111(b) election gave Comerica a partial benefit of an 1111(b) election but reduced Comerica's secured claim by nearly \$10 million, greatly easing the feasibility burden on the debtor. The formula was hardly a complete victory for the debtor because the court also preserved Comerica's unsecured deficiency claim, entitling Comerica to make classification and unfair discrimination arguments that debtors would usually be able to avoid once the secured creditor makes the 1111(b) election.

Comerica argued that the bankruptcy court simply invented the formula and its entire approach to the §1111(b) question without any basis in the Bankruptcy Code and without any supporting case law. Comerica believed that the bankruptcy court's interpretation of §1111(b) would create absurd results at odds with Congressional intent, would deprive lenders of the benefit of their bargain (by ignoring the blanket lien the lender has on all the debtor's assets, not separate liens on separate pieces), and would enable cunning debtors to deprive a secured lender of its right to an 1111(b) election by simply selling a small portion of a lender's collateral early in the case. The debtor argued that it would have been unfair for Comerica to use the 1111(b) election to foist on the debtor the deficiency associated with the equipment sold at the Credit Bid Sale in connection with the 1111(b) election

³ *In re Red Mountain Machinery Co.*, 451 B.R. 897 (Bankr. D. Ariz. 2011).

under the plan and that the formula was an equitable way of avoiding that result.

Comerica appealed on several grounds the bankruptcy court's order confirming the debtor's plan. The 1111(b) election issue is perhaps the most significant of the issues on appeal. As of the time of this writing, the District Court has not yet ruled on Comerica's appeal.

EVOLUTION OF BUSINESS PRACTICE: THE LEGENDS

Speakers

Susan G. Boswell

Gary G. Keltner

Hon. George B. Nielsen, Jr.

Lowell E. Rothschild

State Bar Convention 2012

Materials for Evolution of Business Practice: The Legends

Proper Preparation of Schedules

By Lowell E. Rothschild

Appeared in the *Arizona Bar Journal*, March 1967
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Update on the Bankruptcy Section

From the Annual Meeting held April 29, 1972

Appeared in the *Arizona Bar Journal*, Spring 1973
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Update on the Bankruptcy Section

By James M. Marlar, Chairman

Appeared in the *Arizona Bar Journal*, Spring 1976
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The New Chapter 13: Haven for the Small Debtor, Headache for the Creditor

By John B. Stewart

Appeared in the *Arizona Bar Journal*, December 1979
(reprinted with permission)

Update on the Bankruptcy Section

From the State Bar of Arizona Committee and Section Annual Reports

Appeared in the *Arizona Bar Journal*, April 1983
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Subdivision Trusts and the Bankruptcy Act

By William H. Rehnquist

Appeared in the *Arizona Law Review*, Volume 3, Number 2, Winter 1961
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Newspaper clippings from 1957 regarding formation of the bankruptcy law section; "Judge Voids Transfer of Property,," and the election of officers for the bankruptcy law section

Agenda for *A Bankruptcy Seminar* from December 17, 1966

PROPER PREPARATION OF SCHEDULES

By **LOWELL E. ROTHSCILD, Tucson***

There have been a number of judicial opinions to the effect that the preparation of bankruptcy schedules and Statement of Affairs involves primarily clerical work. However, the judicial opinions must be considered in the context in which they were made, and generally the statements were made when the Court was considering the amount of fees to be allowed counsel for the bankrupt.

It is my belief that the most simple of schedules, when done properly, demand many legal judgments. The writing of answers in the blanks is a menial chore, but knowing what to write is the work of an attorney. Bankrupts, who are ordinarily in dire financial circumstances, can ill afford the mistakes of their attorneys. Poorly drafted schedules can result in liability for debts, and possibly criminal punishment.

If, in the beginning, the schedules and Statement of Affairs are completed properly, the lawyer can save himself substantial effort at later dates. Many attorneys feel that bankruptcy cases are not good business, because they cannot economically handle them on account of the paper work. The specialist, on the other hand, is convinced that the undertaking of a bankruptcy

matter is worth while. I believe that if a good procedure is worked out, the practice can be economically sound.

A voluntary proceeding requires that there should be filed a Petition, Schedules of debts and assets, and a Statement of Affairs. The schedules denominated A-1 to A-5 inclusive require a detailed listing of all the bankrupt's debts, and schedules B-1 to B-6 inclusive require a listing of all the bankrupt's assets. It cannot be overemphasized that these schedules must be drawn with the utmost care. The preparation cannot be properly done until the attorney has a complete list of all the bankrupt's debts and assets, and a history of his financial situation. An interview with a prospective bankrupt is a waste of time without this information, and the bankrupt should be immediately so advised. I believe the most helpful way to the client is to give him an information sheet which elicits the facts contained in the schedules and Statement of Affairs. Attached hereto and made a part hereof is an exhibit called a "Bankruptcy Information Sheet."

In addition, the client should be directed to bring in all of the papers, letters, bills, legal documents, pleadings, and other records pertaining to his financial affairs. Counsel frequently turns up creditors, assets or transfers which the

*Partner in the firm of Mesch, Marquez & Rothschild, Tucson, Arizona.

client cannot recall from memory. If the matter is a business bankruptcy, it is advisable to consult with the bankrupt's accountant. Very often they have a broader understanding than the client, particularly as to contingent liabilities (A-4), maintenance of books and records (B-6), financial statements (Statement of Affairs, item 3), and inventories (Statement of Affairs, item 4).

The proper forms for the petition, Statement of Affairs, and schedules are found in the official forms. General Order 38 provides that the official forms are to

"be observed and used, with such alterations as may be necessary to suit the circumstances of any case."

General Order 5 provides in part, "All petitions and schedules shall be printed or written out plainly without abbreviation or interlineation, except where such abbreviation and interlineation may be for the purpose of reference."

Obviously, the wording of the above indicates that handwritten petitions and schedules are permissible. I believe that a Referee has the inherent power to return petitions and schedules which are illegible.

The Petition, Statement of Affairs, and Schedules should be completed in quadruplicate, three copies to be filed, and one copy is for the bankrupt's attorney's file.

A voluntary petition is a statement by a debtor to the Court, showing essential jurisdictional facts, indicating a willingness to surrender his assets to his creditors, and requesting that he be adjudicated bankrupt under the law. That statement must be made under oath. The statement of affairs basically is a set of questions about the past and present financial condition of the bankrupt. Two forms of Statement of Affairs are used, one for debtors engaged in business, and the other for debtors not engaged in business. The Statement of Affairs asks questions as of the date of the petition. Time should be measured backward from the contemplated date of the filing of the petition. Full disclosures should be made, so that where there are transfers which might be avoided, the information is not hidden from the trustee or his attorney. The attorney for the bankrupt must protect his client from the pitfalls of false oaths, even if they are unintentional ones. When values of inventories are required, make sure that you verify how the inventory was taken and the whereabouts of the inventory documents. Where the Statement of Affairs talks about transfer of property as contained in Item 10, this is a broad term, and should be read in connection with the definition of "transfer" in the Act.

Loans repaid within a year should be completely listed. An expression such as "Debtor repaid these loans as appears more fully

on its books" is not a full answer. Every question should be answered, or the failure to answer should be explained. If the answer is "none," this should be stated. If additional space is needed for the answer to any question, a separate sheet should be added and attached. If the bankrupt or debtor is a partnership or corporation, the statement should be verified by a member of the partnership or a duly authorized officer of the corporation.

Many of the official forms are, to a large extent, couched in the language of legal conclusions. If put to the debtor verbatim, they are likely to be answered incorrectly. For example, often the question relating to transfer of property is misunderstood, because the layman only considers property to be real estate, and transfer to mean only something voluntary. They do not think in terms of repossessions or foreclosures. It is your responsibility, as the interviewing lawyer, to rephrase the question in the simplest possible manner.

In completing the schedules of debts and assets, the attorney for the bankrupt should realize that the listing of property as an asset in one of the B schedules will not suffice as a listing of a debt in the A schedule, even if the B schedule contains a statement that ownership of the asset is subject to the claim of a certain creditor. Likewise, the listing of a debt to a certain creditor in the A schedule is not a listing of a certain asset, even

if the debt listing reference refers to the debt being for the purchase of a named asset. The schedule of debts requires that the name and address of the creditor be stated, and the amount owed to him. The amount owed should be stated to the best of the debtor's knowledge, but error here is not serious. The creditors are not bound by the figure listed by the bankrupt.

The A schedule requires the listing of the place where the debt arose. By and large practice has come to disregard this requirement, but the bankrupt could be required to furnish this information. Often the schedules call for information as to time when the debts arose. This is very often omitted from the schedules. However, in some cases these dates are important. Some times this information is demanded as a possible basis for exception of the debt from discharge. Creditors are entitled to have the schedules amended; accordingly, I recommend that where available, the dates be used. This has many practical difficulties. The bankrupt's memory is more often than not inadequate. Another difficulty with determination of when a debt arose is in the case of multiple transactions and a running account. The advent of what is called revolving accounts has aggravated this. I cannot stress too strongly that bankrupts have a natural aversion to listing debts they dispute or question, and this should be guarded against. All debts must be listed, whether dis-

puted, unliquidated, or contingent — even though the debtor may think that the claim is groundless.

List all claims, even if the debtor states that he intends to pay certain creditors when he gets on his feet again. Failure to schedule may constitute a false oath. Claims barred by the Statute of Limitations should be scheduled, and the fact indicated. When the claim has been assigned, and that fact known, the assignee is the creditor and should be listed. The same holds true of a note negotiated to a third party. The best practice would be to also list the payee of the note as a contingent creditor in Schedule A-4. If the address of the creditor is unknown, the debtor should list the creditor and so indicate. After notices have been mailed by the Referee's office, it is good practice to check with the Clerk to ascertain if any notices have been returned. As to those that are returned, if you can find the correct address, send a certified letter to the creditor so he will have notice of the proceedings, and will have time to participate.

Schedule B requires the bankrupt to list his assets. The schedules should be prepared with the knowledge that the failure to list assets can be a source of serious trouble for the bankrupt. Any doubts should be indicated in the Schedule. The remaining document that must be completed is a summary of debts and assets. This summary is very deceptive to the inexperienced. Creditors think they can in-

dicating the possible percentage they will receive by a comparison of total assets and liabilities. Many of the debt figures are estimates, and many of the assets figures are based on appraisals some time prior to the filing, and may have no relationship to the true liquidation value. The assets may be exempt or heavily encumbered, so that the trustee will not attempt to administer them. I believe a conservative figure should be used for the stating of assets.

The need for the signatures on each bankruptcy paper is unfortunate, but the requirement exists. There is a total of eighteen (18) signatures required, if additional schedules are not used. They must be executed in triplicate, so the bankrupt is required to affix his signature 54 times. Obviously, this provides an opportunity for error. In Arizona our practice is to file separate schedules for the wife, although the schedules may be identical. In assembling the papers, there is no provision in the law regulating the order in which the papers are to be placed. If the pauper's oath is used, that is generally placed on top. Custom has it that it is followed by the Petition, Statement of Affairs, Schedules and Summary of debts and assets.

Thorough preparation of the Schedules and Statement of Affairs will enable counsel to represent the client competently at the first meeting of creditors. At the first meeting, the scope of the examination can be broad, and there is no

excuse for being surprised when preparation would have avoided it.

BANKRUPTCY INFORMATION SHEET

Please fill out this sheet as completely as you possibly can, and bring it with you to this meeting. Remember that it is very important to list everyone who may think you owe him anything. Do not leave out those whose claims are wrong or those you intend to pay. Names and addresses of creditors must be complete and correct.

1. Do you owe any taxes? This includes income taxes, property taxes, withholding or any other kinds. If you do, answer the following:

- (a) The name and address of each tax agency owed:
- (b) What is the amount owed?
- (c) For what year or other time period is the tax owed?

2. Do you owe anyone who has worked for you? If so, give the name, address, amount owed, and dates the unpaid work was done.

3. Do you owe anyone who holds a mortgage on any of your property or a conditional sales contract (installment contract) or who has any other kind of collateral or right to sell or repossess any of your property if you do not pay? If so, list the name, address and the total balance owed whether it is now due or not. Please bring all documents regarding these with you.

4. List all your other debts. Give the names and addresses of the creditors, the amount owed, and when you first owed anything on the debts.

5. Are there any debts you must pay if someone else does not pay? If so, list the name and address of the person who must be paid, the amount which would have to be paid, and the name and address of the person who should pay. This question covers debts for which you have been a co-signer or which you have guaranteed.

6. Are any of the debts you have listed in any of the questions above not proper claims against you? List which ones.

In answering the following questions, list every sort of asset, property, right or claim to property which you may have even though it may seem to have no value and even though it may be partly owned by someone else. Even if property is in someone else's name, list it.

1. Do you have any interest in any land or real estate anywhere in the world? List the description of the property, its location and its value.

2. Do you have any cash on hand, in bank accounts or elsewhere? List location and amount.

3. Do you have an automobile, truck, tractor, trailer, motorcycle, bus, boat, or other vehicle? List make, model or type and the value.

4. Do you have any stock in trade

or equipment or fixtures of any business you were in? If so, what is its value and location?

5. Do you have any clothing or household furniture other than a normal amount or type? List type and value.

6. Do you have any farm implements or tools of any trade or machinery? List type and value.

7. Do you have any stocks, bonds or promissory notes? List type and value.

8. Do you have any patents, copy-

rights, trade marks or inventions? List type and value.

9. Does anyone owe you anything for any reason whatsoever? List the name and amount owed.

10. Is anyone holding any property of yours? Explain.

11. List the cash value and type of any insurance policies you have together with the name of the company.

12. Do you have an interest in the estate of anyone who is deceased? Explain.



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BANKRUPTCY SECTION

At the Annual Meeting of the Section held April 29, 1972, during the Annual Meeting of the State Bar of Arizona, the following persons were elected for a three (3) year term on the council:

Dennis Wortman
Elizabeth Stover
Jack Rowe

Other members of the council are:

Anthony O. Jones
Lowell E. Rothschild
Clague A. Van Slyke
Joseph K. Brinig
Robert G. Mooreman
Ronald E. Warnicke

A committee headed by Ronald E. Warnicke has been working on rules of procedure and local rules of practice. Inasmuch as the Judicial Conference of the United States has recently submitted a comprehensive set of proposed bankruptcy rules to the Congress the committee has suspended its efforts pending congressional action.

It is anticipated that these proposed rules will be approved at which time the section hopes to present a seminar covering them.

Members of the section prepared a short pamphlet on Bankruptcy which was published and distributed by the State Bar in conjunction with its efforts to better acquaint the general public with the role of the legal profession. In addition, members of the section participated in the radio program currently being presented by the State

Bar in co-operation with various radio stations.

Stanford E. Lerch is presently making arrangements to provide a program featuring nationally known authorities to be held at the 1974 State Bar Convention.

Joseph K. Brinig
Chairman

REAL PROPERTY, PROBATE AND TRUST SECTION

The Real Property, Probate and Trust Section concentrated its efforts throughout the past year on a single project — the proposed complete revision of the Arizona Probate Code.

It may be recalled that during the latter months of 1970, and throughout 1971, a committee functioning under the auspices of the Arizona Legislative Council had studied the subject and had drafted a proposed revision of the entire Arizona Probate Code. It had been hastily introduced to the Legislature in 1972, without adequate editing, whereupon the Judiciary Committee of the Senate had requested that the State Bar of Arizona review and edit the Bill with a view to its re-introduction in the 1973 session of the Legislature.

Pursuant to this request, a series of meetings was held throughout the State, which all members of the State Bar were invited to attend. During the months of July, August and September, 1972, these meetings were held in Tucson, Flagstaff, Tempe, and Yuma. Attendance at these meetings

BANKRUPTCY SECTION

James M. Marlar
Chairman

The major efforts of this section since May 1, 1975 have been to organize what has previously been, within the recent past, a dormant section. An organizational meeting was held in September, and various subcommittees were formed. The subcommittees were broken down as follows:

(1) Comparison of pending Federal Bankruptcy Acts; (2) Continuing legal education (General Bar, Section in Public); (3) Local rules; (4) Program Committees; (5) Trustee Liaison Committee; (6) State Legislation Committee; (7) Chapter XIII Committee.

Since the organizational meeting, the various subcommittees have been meeting and formulating ground rules within which their respective subsections are operating. The most important committee, at least for this year, is that which is presently comparing the pending Federal Bankruptcy Acts. This committee hopes to have recommendations available for the Board of Governors by early summer regarding the various Acts. If the Board of Governors is in agreement with the conclusions of the Bankruptcy Section, these recommendations would be forwarded to our Congressmen as the opinion of this section.

This section is currently meeting with Ilene J. Lashinsky, Assistant Di-

rector, Continuing Legal Education, with the hope of preparing a seminar for April, 1976. That seminar would take into consideration the practice in the Bankruptcy Court from a general practitioner's point of view.

CORPORATE LAW SECTION

Robert C. Kelso
Chairman

This Section has labored during the past year to prepare the Bar and the State for the transition to the Model Business Corporation Act. The adaptation of that Act to the economy and legal structure in the State of Arizona was accomplished by the Section in past years and enacted by the Legislature in 1975 to become effective July 1, 1976. As frequently happens, there were a number of grammatical or "cosmetic" errors that resulted from the Legislative process.

This Section worked on a bi-weekly basis reviewing each section of the new Code and recommended "cosmetic" alterations to 70 sections of the Act. That corrective legislation has been introduced at the time of writing this report and its prospects seem favorable in the Legislature.

To assist further in the transition to the Model Business Corporation Act, a special seminar committee has been established under the chairmanship of Professor Junius Hoffman of the University of Arizona Law School



Streich, Lang, Weeks & Cardon associates (from left to right) John B. Stewart, John J. Dawson and Donald L. Gaffney join with legal secretary and assistant Marsha Lawyer to produce three comprehensive articles on the new Bankruptcy Code.

The New Chapter 13: Haven for the Small Debtor, Headache for the Creditor

By John B. Stewart

On October 1, 1979, the Bankruptcy Act of 1978¹ became effective. The resulting new Bankruptcy Code has significantly altered many aspects of the relief available under former Chapter XIII² of the Bankruptcy Act. This article will point out some of the changes in the new Chapter 13 and how debtors and creditors may be affected by those changes.³

I. Expanded Availability

One primary alteration accomplished by the Reform Act is the expansion of the availability of Chapter 13 relief. The old Chapter XIII was limited to the "wage earner," defined as an individual whose principal income was derived from wages.⁴ Now, Chapter 13 is designed for the "individual with regular income,"⁵ meaning anyone other than a stockbroker or commodity broker whose income is sufficiently stable to make payments under a Chapter 13 plan.⁶ The difference is that non-wage earners, such as individuals on welfare, social security or pension incomes, or those who live on investment income, have Chapter 13 relief as an alternative to straight liquidation.

Perhaps more notably, a professional or sole proprietor operating a small business may also choose Chapter 13 as opposed to the more cumbersome Chapter 11. One advantage under Chapter 13 is that the appointment of a trustee does not preclude the debtor from operating the business. Others are that only the debtor may propose a Chapter 13 plan, and the

creditors need not accept the plan. A debtor's attorney should certainly become aware of the alternatives now available to the small business debtor under the Bankruptcy Code.

There are, nonetheless, limitations upon who may qualify as a debtor under Chapter 13. Neither a corporation nor a partnership may use Chapter 13. A husband and wife may file jointly, but if they operate a small business as a partnership, they will not qualify under Chapter 13, whether the partnership agreement is formal or informal.⁷

The Code also provides debt limitations in order to restrict Chapter 13 to the relatively small debtor; *i.e.* individuals that own noncontingent, liquidated, unsecured debts of less than \$100,000 and noncontingent, liquidated, secured debts of less than \$350,000.⁸ If a husband and wife file joint petitions, their combined debts must meet the same limitations. The ceilings are high enough, however, to encompass many small businesses that would otherwise be relegated to Chapter 7 liquidation or Chapter 11 reorganization.

*"Creditors need not accept the Chapter 13 plan.
A debtor's attorney should certainly become aware of the
alternatives now available to the small business
debtor under the Bankruptcy Code."*

Another facet of the broader access to Chapter 13 is that a prior discharge is no longer a bar to Chapter 13 relief. A primary inquiry by a debtor's attorney before recommending recourse to the Bankruptcy Act should be whether the debtor will be eligible for a discharge.

Under Chapter XIII, the court could not confirm a plan if within six years prior to filing his petition the debtor had commenced a proceeding under the Bankruptcy Act and had obtained a discharge or had a wage earner's plan by way of a composition confirmed.⁹ There is no comparable six-year rule in the new Chapter 13. Although the rule is retained in Section 727(a) for Chapter 7 liquidation cases,¹⁰ it is not made applicable to Chapter 13. Thus, a debtor that obtains a discharge under Chapters 7, 11 or 13 of the Code will still have access to Chapter 13 relief. Similarly, prior relief under the Bankruptcy Act does not impede accessibility to Chapter 13, and recently discharged debtors may now look to Chapter 13 rather than waiting six years as required by prior law.

Although successive discharges under Chapter 13 are permissible, a debtor that has obtained a discharge under Chapter 13 or Chapter XIII must wait six years before seeking a liquidation under either Chapter 7 or Chapter 11,¹¹ unless the debtor paid 100% of the unsecured claims or he paid 70% under a good faith plan that was his best effort.¹² Consequently, if the debtor uses Chapter 13 to pay less than 70% of the unsecured claims, he will foreclose the availability of liquidation relief for six years.

II. The Automatic Stays

The automatic stay provision of Section 362 is applicable to Chapter 13 and all cases filed under Title 11.¹³ The stay effectively prohibits any act or proceeding to collect or enforce pre-petition claims against the debtor or property of the estate.¹⁴ The stay does not apply to criminal proceedings, the collection of alimony, the exercise of the police power, certain acts to perfect a lien, commodity setoffs, or certain foreclosures by H.U.D.¹⁵

To obtain relief from the stay, a creditor or other party in interest must commence an adversary proceeding.¹⁶ The court will grant relief for cause shown, including lack of adequate protection of the creditor's interests in property. If the creditor wishes to proceed against property in which the debtor has no equity, the court must grant relief if the property is unnecessary to a reorganization.¹⁷

The Code attempted to expedite relief from the stay by requiring that a final hearing be commenced no later than sixty days after the creditor requested relief.¹⁸ The obvious gap is

that a bankruptcy court could continue the final hearing ad infinitum, or otherwise delay entering its judgment. Interim Bankruptcy Rule 4007, adopted by the Federal District Court of Arizona, limits the delay to maximum of 90 days by terminating the final hearing 30 days after it is commenced.¹⁹ The new Code thus provides a significant procedural protection for the creditor who was previously at the mercy of a dilatory debtor or unsympathetic judge. The aggressive attorney who promptly asserts his client's interest before the court can thereby secure a result within three months.

A novel and unique feature of Chapter 13 is that in addition to the automatic stay of Section 362, there is an automatic "co-debtor stay".²⁰ As long as the Chapter 13 is in progress, Section 1301 restrains a creditor from pursuing certain co-obligors on consumer debts of the Chapter 13 debtor. Before outraged consumer lenders revolt, it should be pointed out that the Section 1301 stay is drafted and designed to serve a limited function: to protect the Chapter 13 debtor from indirect pressures exerted by creditors through the debtor's friends or relatives that cosigned his obligation.²¹ Consequently, there are notable restrictions upon the reach of the co-debtor stay.

First, the stay applies only to consumer debts, those "incurred by an individual primarily for a personal family or household purpose."²² Thus, the business debtor, even the sole proprietor who diverts funds from his business account for personal use, should derive no protection from the co-debtor stay. Secondly, the co-debtor stay operates only with respect to co-debtors that are individuals. Creditors may proceed with immunity against a corporate guarantor. Third, a creditor is not stayed from pursuing sureties, guarantors, or other co-obligors that became liable in the ordinary course of business.²³

Finally, upon request by a creditor, a court must grant relief from the co-debtor stay if the co-debtor received the actual consideration for the claim, if the debtor's Chapter 13 plan does not propose to pay the creditor's claim, or if the creditor's interest would be irreparably harmed.²⁴ Unfortunately, the co-debtor stay provision does not detail the creditor's procedural protections with respect to expedited hearings and burden of proof found in Section 362. Nonetheless, the legislative history indicates that if the creditor has reason to believe that his debt from the co-debtor may be impaired by absconding, encumbrance or rapid depreciation of the co-debtor's property, the creditor will be entitled

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to relief.²⁵ Another mitigating influence upon the effect of the Section 1301 stay will occur when the creditor can exert additional leverage for his claim. For example, a bankruptcy court should be inclined to lift the stay and allow a secured creditor to collect from co-debtors if the creditor would otherwise reclaim essential collateral or demand adequate protection of his security interest.²⁶

III. The Powers of the Debtor

In the new Chapter 13, a debtor retains significant rights and powers, even though there will always be a trustee appointed to the case.²⁷ Generally, the debtor will remain in possession of all "property of the estate."²⁸ In Chapter 13, property of the estate includes all legal or equitable interests of the debtor in property as of the commencement of the case, all such property acquired during the Chapter 13, and all earnings from services performed by the debtor during the Chapter 13.²⁹

Only the Chapter 13 debtor has the power to use, sell or lease property of the estate *other* than in the ordinary course of business.³⁰ The statute makes it clear that this is a right "exclusive of the trustee, but subject to the same limitations on the trustee."³¹ If the debtor is engaged in business, he will have the additional exclusive power, unless the court orders otherwise, to operate the business, to use, sell or lease property in the ordinary course of business, and to obtain credit.³² The Code does not define what is "in the ordinary course of business," except to state that a self-employed debtor who incurs trade credit in the production of income from such employment is engaged in business.³³

The power of a Chapter 13 debtor to use, sell or lease property is subject to the limitations set forth in Section 363. When not in the ordinary course of business, the debtor may dispose of estate property only after notice and a hearing.³⁴ If the debtor is engaged in business, he may dispose of property in the ordinary course of that business *without* notice or a hearing, unless the property is "cash collateral."³⁵ A debtor may not dispose of cash collateral unless all parties with interests therein consent, or the court authorizes the disposition after notice and a hearing.³⁶ At any time, a secured creditor or other party with an interest in estate property may request court intervention to prohibit or condition the disposition as is necessary to provide adequate protection³⁷ of his interests, and the debtor's disposition of property may not be inconsistent with such relief.³⁸

One caveat for the secured creditor is not to be lulled into complacency by the procedural requirement of "notice and a hearing" before the debtor may dispose of collateral. The Code defines that phrase very amorphously to mean whatever is appropriate under the circumstances, including notice without a hearing if "not requested timely by a party in interest."³⁹ Conceivably, a secured creditor's first awareness of a particular Chapter 13 case may be a telephone "notice" that the debtor intends to sell collateral. Consequently, a secured creditor's first tactic in all cases under the new Code should be to immediately request written notice and a hearing for all acts affecting his interests. The secured creditor should simultaneously request relief under Sections 362(d) and 363(e) in order to trigger the procedural protection of an expedited hearing on adequate protection of his interests.

Another power of the Chapter 13 debtor is that he retains the absolute right to convert his case to a Chapter 7 liquidation at any time.⁴⁰ He may also have his Chapter 13 dismissed if it was not previously converted from Chapters 7 or 11.⁴¹ The debtor can not waive his rights to dismiss or convert. Creditors, however, may still force a dismissal or a conversion to Chapter 7 for unreasonable and prejudicial delay, nonpayment of fees, failure to file a plan timely,

denial of confirmation, material default of performance in the plan, revocation of confirmation, or termination under the plan's terms.⁴² Creditors may also request conversion to a Chapter 11 proceeding.⁴³

IV The Plan

Changes in the new Code have made the Chapter 13 plan an extremely effective instrument for debtor relief from creditors. Moreover, as under Chapter XIII, the debtor retains the exclusive right to propose a plan.⁴⁴ This in itself is a distinct advantage over Chapter 11, in which any party in interest may file a plan if a trustee is appointed to the case.⁴⁵ The debtor will generally have ten days to file a plan.⁴⁶ The plan must satisfy the mandatory provisions of Section 1322(a) and may include provisions allowed by Section 1322(b).⁴⁷

A radical departure from prior law has essentially emasculated an unsecured creditor's ability to influence the plan. The debtor no longer has to obtain majority creditor acceptance of his plan as a condition to confirmation.⁴⁸ There is no voting on the plan. Instead, creditors must voice their objections at the confirmation hearing, but the bankruptcy court makes the sole decision whether the plan will become effective as proposed.

The court's decision will be governed by the prerequisites for confirmation set forth in Section 1325. With respect to unsecured claims, the plan need only pass the "best interest of creditors" test: the present value of the payments to be received by the unsecured creditor must be at least as great as what he would receive for his claim if the debtor's estate were liquidated in a Chapter 7.⁴⁹ It is for this reason that Chapter 13 poses such an attractive alternative to Chapter 7 liquidations. The debtor is only required to pay liquidation dividends, and it matters not that the unsecured creditors unanimously oppose his plan. Yet, the debtor has the flexibility to choose which property he will liquidate and which he will retain for use, while he extends the payments (if any), to his unsecured creditors over a period of three years.⁵⁰

For example, the typical consumer bankruptcy is a no-asset case: the only substantial, non-exempt property is subject to valid liens and encumbrances, and the cost of administration consumes the remainder. Under the best interest test, the unsecured claims would receive nothing in a liquidation. Thus, the debtor's plan could propose paying a nominal amount upon unsecured claims over a short period of time, such as a dollar per month for six months, and the court would be required to confirm the plan. Meanwhile, the debtor could use the remainder of his regular income to deal with his secured creditors, a result now possible under Chapter 13.⁵¹

Secured creditors, too, will experience a decrease in the leverage they can exert over the Chapter 13 plan under the Bankruptcy Code. The Reform Act has already removed one weapon from the secured creditor's arsenal by expanding the jurisdiction of the Bankruptcy Court.⁵² No longer can the secured creditor argue the lack of summary jurisdiction as a basis for withholding his collateral from bankruptcy administration. A second major departure from the Bankruptcy Act is that Chapter 13 now has a "cramdown" provision: the plan may deal with a secured creditor without his consent.⁵³ The only claim exempted from such dealing is the claim secured solely by an interest in the debtor's principal residence.⁵⁴

Section 1325(a)(5) provides three alternative ways in which a plan may deal with allowed secured claims and still be confirmed by the bankruptcy court. First, the secured creditor may accept his treatment under the plan. Secondly, the debtor may simply surrender the collateral to the secured creditor. Finally, if the debtor wishes to keep the collateral,

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the plan may provide that the secured creditor retains his lien and receives property or payments, the present value of which is at least equal to the allowed amount of the secured claim as determined under Section 506.⁵⁴

For example, the debtor may owe \$5,000 to a creditor who has a security interest in an automobile worth only \$3,000. Under Section 506, the creditor would have an allowed secured claim of \$3,000 and an allowed unsecured claim of \$2,000. Under the Chapter 13 plan the payments on the secured claim must have a present value equaling \$3,000, but the present value of the payments on the unsecured claim need only equal the expected liquidation dividend for a \$2,000 unsecured claim. The secured creditor's monthly payments under the plan could easily be far less than the installments due pursuant to the loan contract.

Under the new Chapter 13 there is a potential for abuse by the inpecunious debtor whose future brightens with a new and substantial source of regular income. He could jilt his creditors with a Chapter 13 plan that pays only liquidation values while he pockets his excess income. This scenario could not occur if a proposed amendment to Section 1325(a)(3) is enacted into law. Section 188 of the technical amendments bill recently passed by the U.S. Senate,⁵⁵ would require the bankruptcy court to find, as a condition of confirmation, that the proposed Chapter 13 plan represents the debtor's best effort. The amendment is specifically designed to prevent misuse of the liberal provisions of Chapter 13.⁵⁷

The other Section 1325(a) prerequisites to confirmation have their counterparts in prior law: the plan must comply with Section 1322 and other applicable Code provisions, the proper fees must be paid, and the plan must be proposed in good faith. In addition, the Court must find that the debtor will be able to comply with the proposed plan.⁵⁸ The latter appears to be the equivalent of the feasibility test of former Chapter XIII, but one commentator has suggested that it may be different.⁵⁹

IV. Discharge

A debtor who completes all payments under a confirmed plan is automatically entitled to a discharge under Section 1328(a). The Code does not provide any grounds for a creditor to object to such a discharge,⁶⁰ and only the following debts are nondischargeable: certain long term debts payable after completion of the plan;⁶¹ alimony or support payments;⁶² and certain post-filing consumer debts.⁶³

Additionally, if the payments under the plan are not completed, the Chapter 13 debtor may receive a more restricted "hardship discharge" under appropriate circumstances. The debtor must have already paid the equivalent of a liquidation dividend,⁶⁴ the reasons for his failure to complete the payments must be excusable,⁶⁵ and a modification of the plan must be impractical.⁶⁶ A hardship discharge has the same exceptions as Section 1328(a), but is more limited. It applies only to unsecured debts and does not apply to the nondischargeable debts listed in Section 523(a).⁶⁷ An advantage over prior law is that a debtor who qualifies for the hardship discharge does not have to wait three years after confirmation as was required under Chapter XIII.⁶⁸

V. Conclusion

One of the objectives of the Bankruptcy Code drafters was to promote greater use of Chapter 13. With its scope expanded to individuals with regular income, Chapter 13 is now available to small business debtors, as well as a large segment of consumer debtors who did not qualify as wage earners. The Chapter 13 debtor has the power to cram down secured creditors and to enforce a plan in spite of unanimous objection by unsecured creditors. Additionally, the debtor retains control over the plan and the disposition of his property. With so many changes favoring the debtor, and the

consumer debtor in particular, it would be an indictment of the bar if Chapter 13 does not replace Chapter 7 liquidation in a substantial number of cases.

1. Pub. L. No. 95-598, 92 Stat. 2549 *et seq.* (Nov. 6, 1978) (hereinafter cited as 11 U.S.C. 101 *et seq.* and referred to in text as the "Code" or "Bankruptcy Code").
2. Bankruptcy Act §601 *et seq.*, 11 U.S.C. §1001 *et seq.* (1977).
3. For additional treatment of Chapter 13, see Lee, *Chapter 13: A New Chapter XIII*, 53 Am. Bankr. L. J. 303 (1979); Merrick, *Chapter 13 of the Bankruptcy Reform Act of 1978*, 56 Den. L. J. 585 (1979); Note, *A New Chapter 13 - Help for the Consumer Debtor*, 48 Cin. L. Rev. 406 (1979).
4. Bankruptcy Act §1(32); 11 U.S.C. §(32) (1977).
5. 11 U.S.C. §109(e).
6. 11 U.S.C. §101(24).
7. See H.R. Rep. No. 595, 95th Cong., 1st Sess. 320 (1977) (hereinafter cited as "House Report").
8. 11 U.S.C. §109(e).
9. Bankruptcy Act §656(a)(3), 14(c)(5); 11 U.S.C. §§1056(a)(3), 32(c)(5) (1977).
10. 11 U.S.C. §727(a)(8), (9).
11. 11 U.S.C. §1141(d)(3).
12. 11 U.S.C. §727(a)(9).
13. 11 U.S.C. §103(a).
14. 11 U.S.C. §362(a).
15. 11 U.S.C. §362(b)(1)-(b)(8).
16. 11 U.S.C. §362(d); Interim Bankruptcy Rule 4001.
17. 11 U.S.C. §362(d).
18. 11 U.S.C. §362(e).
19. Interim Bankruptcy Rule 4001.
20. 11 U.S.C. §1301.
21. House Report, *supra* note 7, at 426.
22. 11 U.S.C. §101(7) (emphasis supplied).
23. 11 U.S.C. §1301(a)(1).
24. 11 U.S.C. §1301(c).
25. S. Rept. No. 95-989, 95th Cong. 2d Sess. 139 (1978) (hereinafter cited as "Senate Report").
26. For additional treatment of stays under the Bankruptcy Code, see Kennedy, *Automatic Stays Under the New Bankruptcy Law*, 12 J. L. Ref. 3 (1978).
27. 11 U.S.C. §1302(a).
28. 11 U.S.C. §1306(b).
29. 11 U.S.C. §§1306(a), 541.
30. 11 U.S.C. §1303, 363(b).
31. House Report, *supra* note 7, at 427.
32. 11 U.S.C. §§1304(b), 363(c), 364.
33. 11 U.S.C. §1304(a).
34. 11 U.S.C. §363(b).
35. 11 U.S.C. §363(c). "Cash collateral" is defined as "cash, negotiable instruments, documents of title, securities, deposit accounts, or other cash equivalents in which the estate and an entity other than the estate have an interest." 11 U.S.C. §363(a).
36. 11 U.S.C. §363(c)(2).
37. Section 361 sets forth the Code's amorphous concept of "adequate protection."
38. 11 U.S.C. §363(d).
39. 11 U.S.C. §102.
40. 11 U.S.C. §1307(a).
41. 11 U.S.C. §1307(d).
42. 11 U.S.C. §1307(c).
43. 11 U.S.C. §1307(d).
44. 11 U.S.C. §1321; Senate Report, *supra* note 25, at 141.
45. 11 U.S.C. §1121(e).
46. Bankruptcy Rule 13-201. The Reform Act does not specify a time limit, so the present bankruptcy rules control. Bankruptcy Reform Act of 1978, §405(d).
47. 11 U.S.C. §1322(a), (b).
48. Compare Bankruptcy Act §652(a); 11 U.S.C. §1052(l) (1977) with 11 U.S.C. §§1325.
49. 11 U.S.C. §1325(a)(4).
50. 11 U.S.C. §1322(c). The court may allow a maximum of five years for cause shown. *Id.*
51. See text at notes 52 to 55, *infra*.
52. Bankruptcy Reform Act of 1978, §243; 28 U.S.C.A. §1471 (1979); See House Report, *supra* note 7, at 445.
53. 11 U.S.C. §§1325(a)(5), 1322(b)(2).
54. 11 U.S.C. §1322(b)(2). But see 11 U.S.C. §1322(b)(5).
55. 11 U.S.C. §506(a). A secured creditor's claim is bifurcated into a secured claim to the extent of the value of the collateral and an unsecured claim for the deficiency.
56. S. 658, 96th Cong. 1st Sess. §188 (1979). The bill has been referred to the Committee on the Judiciary in the House of Representatives.
57. Report of Technical Amendments to Bankruptcy Reform Act of 1978, Sen. Report No. 96-305, 96th Cong., 1st Sess. 14 (1979).
58. 11 U.S.C. §1325(a)(1), (2), (3), (6).
59. Note, *A New Chapter 13 - Help for the Consumer Debtor*, 48 Cin. L. Rev. 406, 417 (1979). One difference is that in determining the feasibility of the plan, the court should consider the primary obligation of the debtor to support his dependants. House Report, *supra* note 7, at 124.
60. Cf. 11 U.S.C. §727(a), which is not made applicable to Chapter 13. See text accompanying notes 9 to 10 *supra*. Of course, the implication of 11 U.S.C. §1328(e) is that a party in interest may object to a discharge based upon fraudulent grounds.
61. 11 U.S.C. §§1328(a)(1), 1322(b)(5).
62. 11 U.S.C. §§1328(a)(2), 523(a)(5).
63. 11 U.S.C. §§1328(d), 1305(a)(2).
64. 11 U.S.C. §1328(b)(2).
65. 11 U.S.C. §1328(b)(1).
66. 11 U.S.C. §1328(b)(3).
67. 11 U.S.C. §1328(c)(2).
68. House Report, *supra* note 7, at 431.

Concepts and Problem Areas Relevant to Creditors Under the New Bankruptcy Code

By John J. Dawson

"The objective of a creditor's lawyer is maximum recovery for the client realized in an economically feasible manner."



JOHN J. DAWSON is a native of Binghamton, New York, and was admitted to the Bar in 1971. He received his preparatory education at Siena College, Albany, New York, where he received his B.A., magna cum laude, in 1968; and in 1971, he received his J.D. from the University of Notre Dame Law School, where he served as Note and Comment Editor, *Notre Dame Lawyer*, 1970-71. Mr. Dawson served as bankruptcy lecturer, Arizona Chapter of Robert Morris Associates in 1974, and as lecturer in training sessions for Trustees in Bankruptcy in 1975. Each year since 1976, he was a member of the faculty for various State Bar of Arizona Bankruptcy Seminars. Mr. Dawson also lectured regarding bankruptcy at the Arizona State University School of Law. Recently, Mr. Dawson has lectured extensively on the new Bankruptcy Code to the American Institute of Banking, Arizona Savings and Loan League, International Association of Credit Unions and other business and professional organizations. Mr. Dawson has previously served as the Chairman of the Bankruptcy Section of the State Bar of Arizona. He has practiced law in Arizona since 1971 and is a member of the law firm of Streich, Lang, Weeks & Cardon.

On November 6, 1978, the President of the United States signed the Bankruptcy Reform Act of 1978, H.R. 8200, which implements a comprehensive restructuring of the federal bankruptcy laws. Title I of the statute enacted a new Title 11 of the United States Code, which contains the new substantive law of bankruptcy and is known to practitioners as the "Bankruptcy Code."¹ All cases filed on or after October 1, 1979 will be governed exclusively by the Bankruptcy Code;² cases filed on or before September 30, 1979, no matter what their duration, will be governed by the former Act of 1898 and its successive amendments, known to practitioners as the "Bankruptcy Act."³

In this same issue, two of my colleagues have presented scholarly dissertations regarding the history of bankruptcy law and certain provisions of the Bankruptcy Code. When discussing creditor representation in bankruptcy, I shall dispense with scholarship. The objective of a creditor's lawyer is maximum recovery for the client realized in an economically feasible manner. Statutory provisions and procedural rules are merely the parameters within which this goal is achieved by aggressiveness, logic, and imagination. As will be demonstrated in this article, such a philosophy is essential to effective creditor representation under the new Bankruptcy Code.

1. Expanded Jurisdiction and Injunctive Power of the Bankruptcy Court

Formerly, under the Bankruptcy Act, both the general jurisdiction and injunctive power of the Bankruptcy Court were subject to distinctions between "summary jurisdiction"

and "plenary jurisdiction."⁴ The Bankruptcy Court was vested with "summary jurisdiction" to determine rights and to enjoin enforcement proceedings pertaining to property within the Court's administrative control.⁵ Otherwise, the party adverse to the bankruptcy estate was entitled to litigate in the court of "plenary jurisdiction," sometimes federal district court but usually the state court of general original jurisdiction.⁶ The principal exception to the adversary's right to a plenary proceeding was the Bankruptcy Court's power to exercise summary jurisdiction based upon the adversary's express or implied consent, which arose from the filing of a claim or any other action seeking affirmative relief from the Bankruptcy Court.⁷ Under this jurisdictional scheme, a threshold strategic question for creditors and others dealing with parties in bankruptcy proceedings was whether relief should be sought in the Bankruptcy Court, thus invoking its summary jurisdiction, or whether the bankruptcy case should be avoided like the plague. Sometimes the question was not easy to answer.

Title II of the Bankruptcy Reform Act of 1978 has enacted and added general jurisdictional provisions to Title 28 of the United States Code, the most pervasive of which is 28 U.S.C. §1471.⁸ Similarly, §362 of the Bankruptcy Code creates new injunctive power for the Bankruptcy Court applicable throughout all chapters and remedies provided by the statute.⁹ Distilled to their essentials, these provisions confer the following general jurisdiction and injunctive powers upon the Bankruptcy Court in proceedings under the Bankruptcy Code:

1. Pursuant to 28 U.S.C. §1471, the Bankruptcy Court has original jurisdiction over every controversy between the estate of the debtor and any adverse party. Theoretically, this jurisdictional grant is just as broad as it sounds. Wherever the debtor's estate is a party, the Bankruptcy Court is empowered to hear and determine collection cases, foreclosure cases, antitrust cases, personal injury cases, and every other kind of controversy imaginable. As a practical matter, it is likely that, pursuant to subsection (d) of §1471, the Bankruptcy Court will exercise discretion to abstain from certain types of cases which simply are not conducive to orderly administration of the court's workload (e.g., an antitrust case or personal injury case).¹⁰ However, the decision of the Bankruptcy Judge regarding whether or not to abstain "is not reviewable by appeal or otherwise."¹¹ It should be assumed, therefore, that the Bankruptcy Court will be reluctant to abstain, and that, absent unusual circumstances, the Court will retain jurisdiction over most controversies of a contractual nature which customarily arise between debtors and their creditors or obligors.

2. Pursuant to §541 of the Bankruptcy Code,¹² as well as subsection (e) of §1471, the Bankruptcy Court is vested with exclusive jurisdiction over all property of the debtor as of the commencement of the case; and §362 automatically enjoins the enforcement of claims against the debtor and such property without the permission of the Bankruptcy Court. In short, the Bankruptcy Court's automatic stay provision encompasses the court's injunctive powers under prior law and extends them to include setoff rights¹³ and, arguably, even exempt property remaining in the debtor's custody.¹⁴

It is self-evident that the Bankruptcy Court's expanded jurisdiction and injunctive powers create new strategies for creditors and other parties adverse to the debtor's estate:

1. Where it is known to the adverse party that a bankruptcy is imminent, pre-bankruptcy planning is usually important and often essential. For example, given the automatic stay against setoffs or disposition of pledged collateral, the creditor holding any significant amount of cash or other liquid property of the debtor almost certainly should try to enforce its rights before the petition is filed.

2. There should be no reluctance on the part of a creditor to file a claim or seek affirmative relief in the Bankruptcy Court. Whether the creditor proceeds affirmatively or not, it is

Continued . . .

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already subject to the Bankruptcy Court's jurisdiction insofar as it has any dispute with the debtor. The same philosophy may be of service to an obligor who expects to be sued in Bankruptcy Court as soon as the estate gets ready to do so. An action seeking declaratory judgment on a claim in the early stages of the bankruptcy case may be a defensive strategy worth considering.

2. The Illusory Concept of "After Notice and a Hearing"

The admonition that aggressiveness is an essential tool of the creditor's lawyer is best exemplified by the new Bankruptcy Code's use of the phrase "after notice and a hearing."¹⁴ In virtually every provision of the Bankruptcy Code empowering the debtor's estate to affect rights of creditors or other interested parties, the statute recites that action may be taken "after notice and a hearing."¹⁵ It might be assumed from such language that, wherever rights are to be affected, there will be actual notice to the target party and an actual opportunity for a hearing; and, indeed, this often will be so in actual practice. The stated assumption, however, is unwarranted under the express language of §102(1) of the Bankruptcy Code, which defines "after notice and a hearing" to include circumstances where it is appropriate to proceed with no notice, and circumstances where, after notice, no hearing will be required unless timely requested by the adverse party.¹⁶

"It is self-evident that the Bankruptcy Court's expanded jurisdiction creates new strategies for creditors and other parties."

The lesson is plain, and coincides exactly with previous comments regarding the Bankruptcy Court's expanded jurisdiction. Wherever a creditor or other interested party is concerned that rights may be affected in a proceeding under the Bankruptcy Code, there is everything to gain (and nothing to lose) by filing an appropriate pleading to seek relief from the Bankruptcy Court, and to demand prior notice and an opportunity to be heard.

3. The Concept of "Adequate Protection" and Its Use as a Creditor's Weapon

The concept of "adequate protection" articulated in the new Bankruptcy Code will be the most heavily litigated issue in bankruptcy law; and it is being publicized as a major innovation enhancing the powers of the debtor's estate to deal with recalcitrant secured creditors.¹⁷ Actually, even the term "adequate protection" was created in case law decided under the former Bankruptcy Act,¹⁸ whence (for want of concrete statutory definition) it was used against creditors in ways far more insidious than the Bankruptcy Code now permits. Indeed, what the Bankruptcy Code actually has wrought is to make "adequate protection" a sword for the aggressive creditor that can be used, together with valuation strategies evident under the Bankruptcy Code, to defeat the debtor whose primary tactic is delay.

Consider first the statutory definition of "adequate protection" under §361 of the Bankruptcy Code. Section 361 specifies the manner in which adequate protection may be provided when it is required under §362 (continuation of automatic stay), §363 (power to use, lease, or sell property), or §364 (power to obtain credit). Three alternatives are specified —

namely: (1) periodic cash payments to protect against a decrease in the value of a claim against property of the debtor's estate;¹⁹ (2) an additional or replacement lien to protect against any such decrease;²⁰ or (3) whatever other relief will result in realization of the "indubitable equivalent" of the value of the claim.²¹ Note that the statute does not equate "adequate protection" with appraised equity in property; to the contrary, it mandates affirmative conduct on the part of the debtor's estate.²² This is reinforced by subsection (d) of §362 of the Bankruptcy Code, which requires the Bankruptcy Court to grant relief from the automatic stay upon a showing of either (1) lack of adequate protection; or (2) that the debtor does not have equity in the subject property, and the property is not necessary to an effective reorganization by the debtor.

Valuation concepts under the Bankruptcy Code coincide effectively with a creditor's affirmative use of adequate protection. Pursuant to §506 of the Bankruptcy Code,²³ the extent to which a claim is secured is determined by the value of the collateral, and not by the amount of the debt. Thus, as §361 provides, realization of the value of the secured claim is what must be adequately protected. Furthermore, as noted above in the reference to subsection (d) of §362, lack of equity in property is one of the elements that will justify relief from the automatic stay based upon a theory alternative to the debtor's failure to show adequate protection. In consumer debt situations, §722 of the Bankruptcy Code permits the debtor to redeem personal property by paying to the secured creditor the value of the collateral, as determined by the Bankruptcy Court when allowing the creditor's secured claim in whatever amount.²⁴

It is readily apparent that the aggressive and imaginative creditor can synthesize all of the foregoing concepts into a litigation strategy that may hoist the debtor's estate upon its own petard. The following is a possible scenario:

1. As early as possible in the proceeding, the creditor should file both a proof of secured claim and a pleading requesting relief from the automatic stay of §362. Pursuant to subsection (e) of §362, the latter request itself exerts substantial pressure on the debtor's estate, since the stay is automatically terminated unless its continuation is ordered by the Bankruptcy Court pursuant to at least some type of hearing conducted within 30 days after relief from the stay is requested.²⁵ If that hearing is preliminary in character, a "final hearing" on the request for relief must be commenced within 30 days after the preliminary hearing.²⁶

2. Unless the strategy is factually unsupportable, both the creditor's proof of claim and request for relief from the stay should address the question of valuation to minimize the debtor's options. In most cases, there is an amount slightly less than the secured creditor's claim which the creditor would be (or should be) willing to accept in cash rather than encountering the delays and uncertainties of foreclosure and collateral liquidation. This is the amount which the creditor should consider pleading as the present realizable value of the collateral. If the debtor's estate accepts the creditor's ascribed value, it has conceded that there is no equity in the collateral; and it must be prepared to provide adequate protection for an amount nearly equal to the full sum of the creditor's debt. If the debtor's estate insists that the value is higher, it must provide adequate protection for the full amount of the creditor's debt; and it has surrendered any ability to redeem other than by payment in full to the creditor. If the debtor's estate insists that the value is lower, it has conceded the only issue on which the creditor has the burden of proof in seeking relief from the stay. There are even more interesting possibilities where a Trustee is the representative of the estate.²⁷ In those cases, the request for relief from the stay should be filed against both the debtor and the Trustee, who may have their own widely divergent views of value that the creditor can utilize.

Continued . . .

4. Seizing the Initiative

Through Chapter 11 Creditor Plans

Chapter 11 of the new Bankruptcy Code will be a highly effective tool for a solution-oriented debtor and counsel.²⁸ For the debtor whose principal strategy is delay, it will be a rude awakening.

There was no remedy of the former Bankruptcy Act more flagrantly abused than the Chapter XI proceeding for an arrangement with unsecured creditors of the debtor.²⁹ Chapter XI had been conceived in the Depression as an informal, expeditious remedy that was supposed to help the small business proprietor or entity besieged by unsecured trade creditors.³⁰ It was so limited in purpose that Congress saw no need to give anyone but the debtor the right to propose a plan.³¹ From these humble beginnings sprang the modern bad faith Chapter XI, wherein debtors with minuscule amounts of unsecured debt frequently have used the arrangement proceeding to restrain secured creditors indefinitely, while retaining the exclusive right to file a plan (and to prevent anyone else from doing so).

As an actual remedy for the debtor, Chapter 11 of the new Bankruptcy Code melds everything that was available under Chapters X, XI, and XII of the Bankruptcy Act,³² and is more potent than any of those former chapters. However, debtor exclusivity no longer exists. Subsection (c) of §1121 permits any "party in interest," including any creditor, to file a plan when and if a Trustee is appointed, or the debtor has failed to file a plan within 120 days after the date of the Chapter 11 order for relief, or any plan filed by the debtor has not been accepted by each affected class of creditors within 180 days after the date of the order for relief.³³

In nearly every case, the major creditors know precisely what can be accomplished separate and independent from the debtor's self-serving strategies. Imaginative use of the creditors plan vehicle in Chapter 11 will neutralize and eliminate the recalcitrant debtor as a factor.

5. The Involuntary Petition Becomes a Realistic Weapon

Under the Bankruptcy Act, involuntary proceedings were a virtual Catch-22 for creditors. In order to prosecute an involuntary case successfully, the petitioning creditors had to prove one of the six "acts of bankruptcy" listed in §3 of the Bankruptcy Act, which usually meant establishing all of the elements of a preferential transfer or fraudulent conveyance to someone in collusion with the debtor.³⁴ Obviously, little help could be expected from the co-conspirators having first-hand knowledge of the act of bankruptcy; yet, for a "deep pocket" type of petitioner, there was almost certainly damage exposure if the involuntary petition failed.

Section 303 of the new Bankruptcy Code codifies extensive sanctions available against the bad faith petitioner, including consequential and punitive damages;³⁵ but the standard of proof to be borne by good faith petitioners under the new statute make the involuntary proceeding a realistic and effective weapon. Pursuant to subsection (h) of §303, the petitioning creditors are entitled to prevail if they can prove either the appointment of a receiver or other custodian, within 120 days prior to the filing of the petition, for the purpose of enforcing a lien upon "substantially all" of the debtor's property, or that "the debtor is generally not paying such debtor's debts as such debts become due."³⁶

With the expanded (and nationwide) jurisdiction of the Bankruptcy Court under the new Bankruptcy Code, the involuntary proceeding is, among other things, one of the most effective possible collection devices.

6. Conclusion

The practicing bar and public have been, and will be, inundated with commentary describing the new Bankruptcy Code as a debtor-oriented statute inhospitable to most of the vested rights of creditors. For the creditor who persists in a hide-bound and passive approach to bankruptcy, this characterization will be painfully accurate. For the creditor and counsel willing to seize the initiative, there are clearly the tools to cope and to prevail.

1. An Act to establish a Uniform Law on the subject of Bankruptcies, Publ. No. 95-598, 92 Stat. 2549 (Nov. 6, 1978).

2. Bankruptcy Reform Act §402(a) (Title IV).

3. Bankruptcy Reform Act §402(a) (Title IV).

4. Bankruptcy Act, §§2, 23, 11 U.S.C. §§11, 46 (1978). See generally Treister, *Bankruptcy Jurisdiction, Is It Too Summary?*, 39 S. Cal. Rev. 78 (1966).

5. 2D. Cowans, *Bankruptcy Law and Practice* §576 (2d ed. 1978). See also Seidman, *Summary or Plenary Jurisdiction?*, 77 Com. L. J. 73 (1972).

6. Sometimes called "jurisdiction by ambush". See Brodeur, *Jurisdiction and Venue Under the Bankruptcy Act of 1973*, 48 Amer. Bankr. L.J. 231, 233 (1974). See generally 2 Collier on Bankruptcy §23.08 (14th ed. 1976).

7. Pub. L. 95-595 (appeared as §241 (a) of the Bankruptcy Reform Act).

8. Sections 101 through 109, 301 through 366, 501 through 554 generally apply to liquidations (Chapter 7), reorganizations (Chapter 11), and adjustments of debts by an individual with regular income (Chapter 13).

9. This is consistent with the line of cases under the Bankruptcy Act that recognized abstention by the Bankruptcy Court on issues particularly related to State law. See, e.g., *Thompson v. Magnolia Petroleum Co.*, 309 U.S. 478 (1940). See House Report. 95-595, 15th Cong., 1st Sess. 446 (1977).

10. 28 U.S.C.A. §1471(d) (1979).

11. 11 U.S.C.A. §541(a) (1979) ("Property of the estate").

12. 11 U.S.C.A. §362(a)(7)(1979) (automatic stay of set off). A specific provision, 11 U.S.C.A. §553 (1979), states the substantive law of setoff. See generally Ahart, *Bank Setoff Under the Bankruptcy Reform Act of 1978*, 53 Amer. Bankr. L.J. 205 (1979); Note, *Setoff in Bankruptcy: Is the Creditor Preferred or Secured?*, 50 U. Colo. L. Rev. 511 (1979).

13. See Gaffney, *Bankruptcy Exemptions: A Comparison and Application of the Arizona Property Statutes and the Federal Bankruptcy Code*, infra, 15 Ariz. B.J. (1979).

14. 11 U.S.C.A. §102(l) (1979).

15. E.g., 11 U.S.C.A. §363(b)(1979) ("The trustee, after notice and a hearing, may use, sell, or lease, other than in the ordinary course of business, property of the estate.").

16. See 124 Cong. Rec. H 11, 090 (Sept. 28, 1978); S 17,407 (Oct. 6, 1978).

17. See generally J. Trost, G. Treister, L. Forman, K. Klee, R. Levin, *The New Federal Bankruptcy Code* 227-89 (1979).

18. See, e.g., *In re Penn Central Transp. Co.*, 494 F.2d 270 (3d Cir. 1974); *In re Bermec*, 455 F.2d 267 (2d Cir. 1971); *In re Yale Express Systems, Inc.*, 384 F.2d 990 (2d Cir. 1970).

19. 11 U.S.C. §361 (1) (1979).

20. 11 U.S.C. §361 (2) (1979).

21. 11 U.S.C. §361 (3) (1979).

22. In a request for relief from the automatic stay, Section 362 (g) (1) places the burden on the "requesting" party (i.e. the creditor) to prove the debtor's equity — or lack thereof — in the property. Section 362 (g)(2) places the burden of "all other issues", on the debtor, thereby placing the burden of demonstrating "adequate protection" under §361 on the debtor. Accord, 2 Collier on Bankruptcy §362.10, at 362.56 (15th ed. 1979). See also, Levin, *Use and Disposition of Property Under Chapter 11 of the Bankruptcy Code: Some Practical Concerns*, 53 Amer. Bankr. L.J. 275, 285-89 (1979).

23. 11 U.S.C.A. §506 (1979) ("Determination of Secured Status"). See generally, Orr & Klee, *Secured Creditors Under the New Bankruptcy Code*, 11 U.C.C.L.J. 312, 315-17 (1979).

24. 11 U.S.C.A. §723 (1979). "Redemption" is a new wrinkle in bankruptcy law and is broader than redemption under the Uniform Commercial Code.

"It authorizes an individual debtor to redeem tangible personal property intended primarily for personal, family, or household use, from a lien securing a dischargeable consumer debt. It applies only if the debtor's interest in the property is exempt or has been abandoned."

House Report No. 95-595, 95th Cong., 1st Sess. 380 (1977).

25. "The subsection sets a time certain within which the bankruptcy court must rule on the adequacy of protection provided of (sic) the secured creditor's interest." House Rep. No. 95-595, 95th Cong., 1st Sess. 444 (1977).

26. Interim Rule 4001(a) of the Bankruptcy Courts for the Federal District of Arizona states that this "final" hearing on the stay must conclude within 30 days after the final hearing is commenced, or the §362 stay expires automatically.

27. The Federal District of Arizona is a non-pilot district and does not have an Office of the United States Trustee, as do several pilot-program districts. See 11 U.S.C.A. §1501 (1979).

28. 11 U.S.C.A. §§1101 through 1174 (1979). Subchapter IV of Chapter 11 sets out special provision that apply only to a reorganization of a railroad. 11 U.S.C.A. §§1161 through 1174 (1979).

29. Although Chapter XI could only deal with unsecured debts, secured creditors were often stayed for years during a Chapter XI proceeding. See generally Festersen, *Equitable Powers in Bankruptcy Rehabilitation: Protection of the Debtor and the Dismal Principle*, 5 Creighton L. Rev. 221 (1971). See also 3 D. Cowan, *Bankruptcy Law & Practice* §901, at 83 (2d ed. 1978) ("The attitude of the federal courts is quite hospitable to Chapter XI proceedings . . . Some persons, particularly some secured creditors, feel that the hospitality towards debtors goes too far").

30. House Report 95-595, 95th Cong., 1st Sess. 222 (1977) ("Chapter XI was originally designed for use by the nonpublic, small business.").

31. Bankruptcy Act §306(l), 11 U.S.C. §706(l) (1979).

32. See generally King, *Chapter 11 of the 1978 Bankruptcy Code*, 53 Amer. Bankr. L.J. 107 (1979).

33. 11 U.S.C.A. §1121(b) & (c) (1979).

34. See 1 Collier on Bankruptcy §3.101 through 3.601 (14th ed. 1978).

35. 11 U.S.C.A. §303(c)(2)(A) & (B) (1979).

36. 11 U.S.C.A. §303 (b)(1) (1979).

Lien Strip Procedures, Chief Judge Marlar and Judge Hollowell

Procedure and Orders on Lien Avoidance in Chapter 13 Cases -- Although an adversary proceeding may be utilized under Fed. R. Bankr. P. 7001(2), the court will permit the debtor to obtain a valuation of a secured creditor's claim by motion served upon the affected lienholder. So-called "lien stripping" may not be achieved by including a lien strip provision in the plan.

1. Notice of a lien stripping motion must comply with Fed. R. Bankr. P. 9014, including the requirement that service be made in compliance with Fed. R. Bankr. P. 7004(b) and (h).

The motion must be filed prior to plan confirmation.

Hearings will only be held on lien avoidance motions, if an objection is filed. In the event that no objection is filed, debtor may submit an order consistent with the court's form, which is included at the end of this procedures page.

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6 IN THE UNITED STATES BANKRUPTCY COURT
7 FOR THE DISTRICT OF ARIZONA
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9 In re) Chapter 13
10 KEYBOARD(),) No. KEYBOARD()-EWH
11) **ORDER AVOIDING LIEN**
12 Debtor(s).) **ON REAL PROPERTY**
13 _____)

14 On KEYBOARD(date), Debtor(s) filed a KEYBOARD(motion or complaint) to
15 value the lien of KEYBOARD(name of lienholder) (hereinafter "Lienholder") against the
16 property commonly known as KEYBOARD(street address) and more fully described in
17 Exhibit A hereto, which lien was recorded in KEYBOARD(name of county) on or about
18 KEYBOARD(date) as document KEYBOARD(number) (hereinafter the "Lien").
19

20 The court finds that notice of the KEYBOARD(motion or complaint) upon
21 Lienholder was proper. Lienholder having failed to file timely opposition to Debtor's(s')
22 motion, the court hereby orders as follows:

- 23 (1) For purposes of Debtor's(s') Chapter 13 plan only, the Lien is valued at
24 zero. LienholderKEYBOARD() does not have a secured claim and the
25 Lien may not be enforced, pursuant to 11 U.S.C. §§ 506, 1322(b)(2) and
26 1327.
27
28

1 (2) This order shall become part of Debtor's(s') confirmed Chapter 13 Plan.

2 (3) Upon entry of a discharge in Debtor's(s') Chapter 13 case or completion of
3 all payments due under the Debtor's(s') Chapter 13 Plan, the Lien shall be
4 voided for all purposes and, upon application by Debtor(s), the Court will
5 enter an appropriate form of judgment voiding the Lien.
6

7 (4) If Debtor's(s') Chapter 13 case is dismissed or converted to Chapter 7
8 before Debtor(s) obtain(s) a discharge, this order shall cease to be
9 effective and the Lien shall be retained to the extent recognized by
10 applicable non-bankruptcy law and, upon application by Lienholder, the
11 Court will enter an appropriate form of order restoring the Lien.
12

13 (5) Except as provided by separate, subsequent order of this Court, the Lien
14 may not be enforced so long as this order remains in effect.

15 Dated and signed above.

16
17 Notice to be sent through the
18 Bankruptcy Noticing Center "BNC"
to the following:

19 KEYBOARD(Debtor(s))

20 KEYBOARD(Trustee)

21 KEYBOARD(Creditor)

22
23 U.S. Trustee's Office
24 230 North First Ave. #204
Phoenix, AZ 85003
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EXHIBIT A
Legal Description

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CHAPTER 13 CASES

1. CHAPTER 13 AVOID/STRIP LIENS

Please use Judge Marlar's preferred form of order (or a version with all the specifics included), which is located as the last item on this procedure page.

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7 UNITED STATES BANKRUPTCY COURT
8 DISTRICT OF ARIZONA

9 In re:

Chapter 13

10 No. _____

11 ORDER

12 Debtors.
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14 On _____, Debtors filed a _____ to value the lien of
15 _____ ("Lienholder") against the
16 property commonly known as _____
17 and more fully described in Exhibit "A" hereto, which lien was recorded in
18 _____ County on or about _____, as document no.
19 _____ ("Second Lien"). This Second Lien is in second position and is the
20 approximate amount of \$_____. The first lien is held by _____
21 in the approximate amount of \$_____. The property is worth approximately
22 \$_____. Therefore, there is no secured value in the amount of the Second Lien.

23 The court finds that notice of the _____ upon Lienholder was proper.
24 Lienholder having failed to file timely opposition to Debtors' motion, the court hereby orders
25 as follows:

26 1. For purposes of Debtors' Chapter 13 plan only, the Second Lien is valued at
27 zero. Lienholder does not have a secured claim and the Second Lien may not be enforced,
28

1 pursuant to 11 U.S.C. §§ 506, 1322(b)(2) and 1327, provided that the Chapter 13 case is
2 completed and the Debtors' receive a discharge.

3 2. This order shall become part of Debtors' confirmed Chapter 13 Plan.

4 3. Upon entry of a discharge in Debtors' Chapter 13 case, the Second Lien shall be
5 voided for all purposes and, upon application by Debtors, the Court will enter an appropriate
6 form of judgment voiding the Second Lien.

7 4. If Debtors' Chapter 13 case is dismissed or converted to Chapter 7 before
8 Debtors obtain a discharge, this order shall cease to be effective and the Second Lien shall be
9 retained to the extent recognized by applicable non-bankruptcy law and, upon application by
10 Lienholder, the Court will enter an appropriate form of order restoring the Second Lien.

11 5. Except as provided by separate, subsequent order of this Court, the Second
12 Lien may not be enforced so long as this order remains in effect.

13 6. The Proof of Claim filed by Lienholder (Claim No. ____ on the Claims Register),
14 regarding this Second Lien, is hereby reclassified and shall be paid as a general unsecured
15 claim.

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17 DATED AND SIGNED ABOVE.
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CHAPTER 13 ATTORNEY'S FEES ORDERS

1. Please use Judge Marlar's preferred form of order (or a version with all the specifics included), which is located under Files for Download (at the bottom of this page).

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7 UNITED STATES BANKRUPTCY COURT
8 DISTRICT OF ARIZONA

9 In re:

Chapter 13

10 No. _____

11 ORDER APPROVING PAYMENT
12 OF ADMINISTRATIVE EXPENSES
13

Debtors.

14 This matter came before the court pursuant to the Chapter 13 Plan and Application for
15 Payment of Administrative Expenses and Notice of Date to File Objections to Chapter 13 Plan,
16 which was noticed to all creditors on _____, as attested to in the
17 previously filed certificate of mailing; the time for objection having expired; no objections
18 having been received; and good cause appearing,

19 1. The original fee (exclusive of costs) at the inception of the case, as specified in
20 the Chapter 13 Plan, was \$_____, of which the Debtors had paid \$_____,
21 with the balance of \$_____ to be paid by the Trustee through the Debtors' payments
22 under the Plan.

23 2. Said fee ☐ was ☐ was not a flat fee.

24 3. Counsel has already been paid:

25 A. Fees of \$_____.

26 B. Costs of \$_____ for the filing fee, plus \$_____
27 for a credit report from _____, for a
28 total of \$_____.

1 4. Counsel is currently holding \$_____ in the trust account.

2 5. Counsel is not seeking any amount for services outside of the flat fee
3 agreement in this case. The fee includes a ☐ scrape-off ☐ other _____
4 action filed on _____.

5 6. ☐ Counsel is seeking additional fees of \$_____ in excess of the flat fee
6 for the following services.

7 ☐ Counsel is not seeking anything in excess of the flat fee.

8 IT IS HEREBY ORDERED APPROVING compensation for professional services to
9 _____ of _____
10 in the total amount of \$_____, of which \$_____ has already been paid by the
11 Debtors.

12 IT IS FURTHER ORDERED that the Trustee pay \$_____ to
13 _____ from the funds (s)he is holding. Per the Trustee's
14 website, (s)he is holding funds in the amount of \$_____ as of
15 _____.

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17 DATED AND SIGNED ABOVE.

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Proposed General Order Attorney Fees in Chapter 13

**IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF ARIZONA**

**GUIDELINES FOR PAYMENT OF ATTORNEYS FEES IN CHAPTER 13 CASES
(Effective in cases filed on or after _____)**

The following are guidelines ("Guidelines") for approving flat fee arrangements as part of the chapter 13 plan confirmation process.

An attorney may decline to seek approval of compensation pursuant to the Guidelines. If an attorney so declines, his or her compensation shall be disclosed, reviewed, and approved in accordance with applicable authority including, without limitation, 11 U.S.C. § 329 and 330, Fed. R. Bankr. P. 2002, 2016, and 2017.

A. Flat Fee Guidelines

Alternatively, attorneys may have their fees approved and paid as part of the chapter 13 plan confirmation process if they comply with the Guidelines.

1. Counsel may seek approval for fees in the order confirming the plan up to the amounts set forth in Paragraph 2 without filing a detailed application if:
 - (a) Counsel provides all services listed in Paragraph 3;
 - (b) No objection to the requested fees has been raised; and
 - (c) The court has not determined, in its sole discretion, that the fees have either not been earned or are not reasonable.
2. The maximum fee which can be approved through the procedure described in Paragraph 1 is: \$4,500, but if such fee is not sufficient to fairly compensate counsel for the legal services rendered in the case, the attorney may apply for additional fees. The court will not approve additional compensation in cases in which no plan is confirmed, or for work necessary to confirm the initial plan. Further, counsel should not view the fee permitted by the Guidelines as a retainer that, once exhausted, automatically justifies a fee motion seeking additional fees. Counsel may request additional compensation only in instances where substantial and unanticipated post-confirmation work is necessary. In the event that counsel files for additional fees, time records in support of such an application must be provided and date from the inception of the case.

B. Minimum Required Services

Attorney responsibilities for a standard plan confirmation and general representation shall include, but are not limited to:

Review of financial documents and information
Consultation, planning and advice, including office visits and telephone communications
Representation and advice regarding filing of pre-filing credit briefing
Preparation/Filing of Petition, Schedules, Statement of Financial Affairs, Current Monthly Income, Payment Advice Declaration and Master Mailing List
Preparation/Filing of Chapter 13 Plan, Plan Analysis and necessary amendments
Preparation/Filing of bankruptcy notice in State Court actions
Representation at §341 meeting of creditors
Resolution of non-adversary proceeding creditor objections and any hearings related thereto
Review and analysis of creditor claims for potential objections, and attendance at related hearings
Objections to Proofs of Claim
Preparation/Filing of Affidavit of no income regarding tax claims
Notify client of unfiled tax return claims, follow up with taxing authority
Preparation of Proposed Order Confirming Plan with cover letter to Trustee addressing each issue numerically
Preparation/Filing of Motion to Extend (for each: Schedules, Stipulated Order of Confirmation, Motion to Dismiss)
Preparation/Filing of Responses to Pre-Confirmation Objections to Dismissal
Preparation/Filing of Pre-Confirmation Stipulation to Reinstate Case
Responses to motions for stay relief, and attendance at hearings
Drafting and mailing any necessary correspondence
Change of Debtor address filings
Representation regarding filing of post-filing education course
Representation regarding discharge eligibility certificate
Amendments to Schedules
Representation at continued 341 meeting

1 In Business cases, the following additional services must be provided:

2

Filing of Business Operating Statements with court
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3
4 **C. Hourly Fees**

5 All fees not covered by the Guidelines, including, but not limited to, appeals or adversary
6 proceedings, may be billed at hourly rates and will require a separate application for allowance of
compensation and reimbursement of expenses in compliance with 11 U.S.C. §330 and Fed. R.
Bankr. P. Rule 2016. Such fees are reviewable by the court for reasonableness.

7 Attorneys are not required to charge the Flat Fee and may bill at hourly rates for the
8 rendering of any and all of the professional services described in the Guidelines, but in such event
9 shall submit an application for allowance of compensation and reimbursement of expenses in
compliance with 11 U.S.C. §330 and Fed. R. Bankr. P. Rule 2016, dating from the inception of the
case.

10 **EXCEPT FOR PRE-PETITION RETAINERS AND HOURLY FEES, ALL FEES SHALL BE**
11 **PAID THROUGH THE PLAN UNLESS OTHERWISE ORDERED.** Attorneys shall file a
12 2016(b) Statement disclosing any fee(s) collected and the services performed, with a copy provided
to the Debtor.

13 **Regardless of the type of fee arrangement, attorneys shall represent the debtor(s) in all**
14 **matters in the administrative case, unless an order is entered allowing their withdrawal.**

15 **The Guidelines may be reviewed on an annual basis to determine reasonableness.**

16 Approved effective _____ for chapter 13 cases filed in the District of Arizona.

17 Dated: _____

18
19 _____
20 James M. Marlar
Chief Bankruptcy Judge

_____ Eileen W. Hollowell
Bankruptcy Judge

21
22 _____
George B. Nielsen, Jr.
Bankruptcy Judge

_____ Redfield T. Baum
Bankruptcy Judge

23
24 _____
Sarah Sharer Curley
Bankruptcy Judge

_____ Charles G. Case II
Bankruptcy Judge

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27 _____
Randolph J. Haines
Bankruptcy Judge

Indian Gaming Proceeds

FILED

OCT 29 2003

UNITED STATES
BANKRUPTCY COURT
FOR THE DISTRICT OF ARIZONA

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF ARIZONA

In re

DARRELL DUANE RUSSELL,

Debtor.

In Proceedings Under
Chapter 7

Case No. 02-06628-PHX-RJH ✓

Adversary No. 02-01215

DARRELL DUANE RUSSELL,

Plaintiff,

vs.

FORT McDOWELL YAVAPAI
NATION,

Defendant.

**ORDER DISMISSING ADVERSARY
ACTION WITH PREJUDICE AND
GRANTING SUMMARY
JUDGMENT TO DEFENDANT**

This matter, having come before the Court on the *Motion to Dismiss and Motion for Summary Judgment* (the "Motion") filed by the Fort McDowell Yavapai Nation (the "Nation") on August 7, 2003, and after hearing held on October 20, 2003, and after consideration of oral arguments, the Motion, debtor Darrell Duane Russell's (the "Debtor") *Response to Defendant's Motion to Dismiss and Motion for Summary Judgment*, the Nation's *Reply in Support of the Motion*, and all pleadings and documents contained in the record, the Court hereby

FINDS AND CONCLUDES as follows:

1 1. The Findings of Fact and Conclusions of Law as read into the Record by the
2 Court on October 20, 2003 following oral argument on the Motion are adopted and
3 incorporated herein.

4 2. The Debtor's interest in the per capita payments (the "Per Capita
5 Payments") constitutes Property of the Estate.

6 3. In 1998 the Debtor obtained a loan from the Nation in the amount of
7 \$200,000, in exchange for which the Debtor executed a Loan Application and a Note in
8 favor of the Nation.

9 4. Together, the Loan Application and the Note constitute a Security
10 Agreement.

11 5. Pursuant to the Loan Application and the Note, the Debtor granted to the
12 Nation, at a minimum, a lien in his rights to the Per Capita Payments.

13 6. The Debtor defaulted under the terms of the Note.

14 7. The Nation has a valid, enforceable security interest against the Debtor in
15 the Debtor's Per Capita Payments.

16 8. Such security interest existed as of the date of the Debtor's petition, and the
17 security interest was not avoided.

18 9. The Debtor lacks standing to object to the lien as unperfected.

19 10. The Nation's lien is unaffected by the Debtor's representation in his
20 schedules that his debt to the Nation is unsecured.

21 11. The Nation holds a properly secured debt which survives the Debtor's
22 bankruptcy and discharge in bankruptcy pursuant to 11 U.S.C. § 552.

23 12. The Nation has a valid right to set off the debt owed by the Debtor against
24 the Debtor's Per Capita Payments pursuant to 11 U.S.C. § 553.

13. The Nation is entitled to setoff as the Per Capita Payments become due and payable to the Debtor.

And good cause appearing therefore, it is hereby ORDERED as follows:

A. The Motion is GRANTED.

B. Summary Judgment under Federal Rule 56 and Bankruptcy Rule 7056 is appropriate and is granted in favor of Defendant.

C. The Complaint underlying this adversary proceeding is DISMISSED with prejudice.

DATED this 29th day of October, 2003.

Randolph J. Haines
Honorable Randolph J. Haines

PHX-SRV0111422019-01

2006 WL 6810938

Only the Westlaw citation is currently available.

NOT FOR PUBLICATION

United States Bankruptcy Appellate Panel
of the Ninth Circuit.

In re George G. BROWN; Lisa Brown, Debtors.
George G. Brown; Lisa Brown, Appellants,

v.

Jeffrey G. Locke, Trustee, Appellee.

BAP Nos. NC-06-1101-MaMeRy, 05-
13909. | Submitted Without Argument²
on July 14, 2006. | Filed Sept. 28, 2006.

Appeal from the United States Bankruptcy Court for the
Northern District of California, Honorable Alan Jaroslovsky,
Bankruptcy Judge, Presiding.

Before MARLAR, MEYERS³ and RYAN,⁴ Bankruptcy
Judges.

Opinion

MEMORANDUM¹

INTRODUCTION

*1 Debtor Lisa Brown ("Mrs. Brown") is a Native American who receives quarterly per capita distributions ("Payments") of a percentage of the net revenue from her tribe's casino gaming enterprise. She and her husband ("Debtors") filed a chapter 7⁵ bankruptcy petition and sought an order of abandonment for Mrs. Brown's interest in the Payments, asserting that it was not property of the estate. The bankruptcy trustee ("Trustee") countered with a motion for turnover. The bankruptcy court, relying on case law from other circuits, determined that the Payments were property of the estate which could be transferred. It then denied abandonment and ordered turnover of the present and future Payments to Trustee.

In this appeal, Debtors have again raised the issue of whether the Payments are property of the estate. We hold that the bankruptcy court correctly determined that Mrs. Brown's interest in the Payments is property of the estate, and AFFIRM that ruling. However, we conclude that the

bankruptcy court erred in determining that the terms of the tribal ordinance allowed Mrs. Brown's entitlement to be transferred or assigned. More importantly, the bankruptcy court did not make the necessary findings for abandonment as to whether future, contingent Payments would be of any value or benefit to the estate. We therefore VACATE and REMAND, in part, for further proceedings consistent with this memorandum decision.

FACTS

Mrs. Brown is an enrolled "Tribal Member"⁶ of the Pomo Indians of the Sherwood Valley Rancheria ("Tribe") in Willits, California. The Tribe owns and operates the "Sherwood Valley Rancheria Gaming Enterprise," also known as the "Black Bart Casino."

As a Tribal Member, Mrs. Brown is eligible to receive Payments consisting of quarterly per capita and other revenue-sharing distributions⁷, provided for and distributed in accordance with a tribal ordinance entitled "Ordinance Governing the Allocation and Disbursement of Net Revenue from Tribal Gaming Sherwood Valley Rancheria" ("Ordinance").

Debtors filed a voluntary chapter 7 petition on October 13, 2005. By November, 2005, Mrs. Brown had received approximately \$8,000 in Payments for that year. On their bankruptcy schedules, Debtors listed, as personal property, a Payment in the amount of \$1,100, and also claimed it as exempt. Debtors did not include the Payments as monthly "income," on their Schedule I.⁸ However, on their Statement of Financial Affairs, they disclosed them as "income other than from employment or operation of business."

In bankruptcy, Debtors moved for an order to compel Trustee to abandon Mrs. Brown's interest in the Payments, arguing that Mrs. Brown was the beneficiary of a valid spendthrift trust provision in the Ordinance and, therefore, that the Payments were excluded from the bankruptcy estate. *See* 11 U.S.C. § 541(c)(2).

Trustee objected, arguing there was no spendthrift trust provision for Mrs. Brown in the Tribal Ordinance.⁹ He contended that the asset was property of the estate and requested that the court order Debtors to turn over both present and future Payments.

*2 Debtors then filed a supplemental brief, contending that the Ordinance neither designated such Payments as the Tribal Member's "property" nor conferred upon Tribal Members any "right" to receive them. In addition, Debtors argued that a characteristic of a property interest, *e.g.*, the right to assign or transfer the asset, was missing from the Ordinance language.

Following a hearing, the bankruptcy court issued its memorandum decision, concluding that the Ordinance did not contain language creating a trust concerning Mrs. Brown's interest, nor did it contain any restrictions on transfer of the interest, which would be evidence of a spendthrift trust.¹⁰ It then ruled that it would follow the holdings of two published opinions from other jurisdictions that tribal gaming distributions are property of the bankruptcy estate. *See Johnson v. Cottonport Bank*, 259 B.R. 125, 130 (W.D.La.2000) and *In re Kedrowski*, 284 B.R. 439, 451–52 (Bankr.W.D.Wis.2002). It denied Debtors' motion to compel abandonment and granted Trustee's motion for turnover. Debtors timely appealed.

ISSUES

1. Whether the bankruptcy court correctly determined that the Payments were property of the estate.
2. Whether the bankruptcy court erred in determining that Mrs. Brown's entitlement to any future Payments was a transferable property interest.
3. Whether the bankruptcy court abused its discretion in denying Debtors' motion to compel abandonment.

STANDARDS OF REVIEW

The question of whether property is included in a bankruptcy estate is one of law, subject to *de novo* review. *Birdsell v. Coumbe (In re Coumbe)*, 304 B.R. 378, 381 (9th Cir.BAP2003). Issues of statutory interpretation are reviewed *de novo* by the panel. *United States v. Towers (In re Feiler)*, 230 B.R. 164, 167 (9th Cir.BAP1999), *aff'd sub nom. United States v. Sims (In re Feiler)*, 218 F.3d 948 (9th Cir.2000).

A court's decision to authorize or deny abandonment is reviewed for an abuse of discretion. *Johnston v. Webster (In re Johnston)*, 49 F.3d 538, 540 (9th Cir.1995).

DISCUSSION

A. Policy Considerations

At the outset, we note that this panel is conflicted by issues in this case which have not been directly addressed by the parties, but which concern larger principles of both justice and the intentions behind the Indian gaming laws and the Bankruptcy Code.

Debtors in this case filed a chapter 7 liquidation case. In so doing, they have potentially subjected their major asset—the stream of income derived from future tribal gaming revenues—to total loss. But their schedules, the claims filed, and their income reflect that this need not be the outcome, either as a factual matter or possibly a legal one.

Debtors' combined income, including the gaming revenues, would support a 100% payout to unsecured creditors in a chapter 13 plan, without suffering the potential loss—at a chapter 7 trustee's sale—of future tribal payouts.

*3 Debtors' ages are not set forth in the schedules, but they must be in their 30's or early 40's because their children are only three and ten. Their combined annual income, exclusive of the gaming revenue, is \$47,400. The panel notes (from the record at tab F) that in the year the bankruptcy was filed, the tribe paid Mrs. Brown \$8,220.13. Debtors scheduled their unsecured debts of only \$10,198, but the unsecured claims now on file, according to the claims register, total \$16,511.22.

This panel takes a larger view of the Tribe's intentions and the underlying purposes in the revenue-sharing aspects of gaming revenues, as they concern a Tribal Member's stream of future income. Theoretically, if Mrs. Brown is 40 years old, with a life expectancy of 80 years, that income (assuming it never increases or decreases from \$8,220 per year), is potentially worth a gross, non-discounted value of \$328,800. This panel must conclude, as a matter of *tribal* policy, that the Tribe did not intend for such valuable rights to be sold to an outside, non-tribal member, for satisfaction of only \$16,511 of a Tribal Member's unsecured debts. Yet that may very well be the result in this case.

As a matter of *bankruptcy* policy, the payment to creditors, of a debtor's available assets, is equally as important as debtor's fresh start. In a chapter 13 proceeding, both of these objectives may be achieved without any surrender, loss, or sale of a debtor's assets. Here, for example, Debtors could propose a chapter 13 plan which devotes regular future gaming revenues, as and when paid, toward payment

of filed claims, and the income therefrom could pay off those creditors, in full, within a few short years.¹¹ In doing so, Debtors could thereby reserve to themselves the valuable future income stream beyond what is necessary to repay their relatively minor outstanding debts. In this way, the overarching policies of both the Indian Tribal Gaming Ordinance and the bankruptcy laws are achieved, for the mutual benefit of all concerned.

Alternatively, Debtors could simply stipulate with Trustee that they would turn over so much of the future income stream as would be necessary to repay all filed and valid claims, plus administrative expenses, in return for retaining the future rights to the tribal stream of income. Again, such a resolution would practically solve all of the policy concerns of the competing interests.

However, the parties may elect, instead, to further litigate the complex and unpredictable outcome of the current case. In that event, we must continue our analysis of the issues presented to us, and resolve them.

B. Analysis of the Issues

The underlying motion is Debtors' request for an order compelling Trustee to abandon property of the estate, *viz*, Mrs. Brown's interest in Payments from the Tribe's net gaming revenues. Section 554(b) provides:

On request of a party in interest and after notice and a hearing, the court may order the trustee to abandon any property of the estate that is burdensome to the estate or that is of inconsequential value and benefit to the estate.

*4 11 U.S.C. § 554(b).

Trustee countered with a motion for turnover of estate property, pursuant to § 542(a). A bankruptcy trustee has the right to recover property of the subject bankruptcy estate, and any entity in possession, custody or control of such property must deliver it to the trustee "unless such property is of inconsequential value or benefit to the estate." 11 U.S.C. § 542(a); *see also* § 543(b); § 363(b)(1) (trustee may "use, sell, or lease, other than in the ordinary course of business, property of the estate").

In their bankruptcy schedules, Debtors listed the Payments as personal property and claimed an *exemption* therein. They therefore admitted that the asset was property of the estate. *Woodson v. Fireman's Fund Ins. Co. (In re Woodson)*,

839 F.2d 610, 616 (9th Cir.1988) (exempt property is initially regarded as property of the estate and the debtor may then remove it by claiming exemptions); Hon. Barry Russell, *Bankr.Evid. Manual* § 301.94 (2006 ed.) (bankruptcy schedules signed under oath constitute admissions). In addition, Debtors listed the Payments as "other income" in their Statement of Financial Affairs.

Nevertheless, the reason given by Debtors to support their motion to compel abandonment was that the Payments were *not* property of the estate. Debtors' apparent argument was that the Payments were of inconsequential value and benefit to the estate because they were not "property of the estate." Thus, Debtors mixed their legal theory with a factual dispute.

Trustee objected and moved for turnover of the asset. The bankruptcy court focused on the turnover motion and the question of whether the Payments were property of the estate. To the extent that Debtors' inconsistent argument was a defense to Trustee's turnover demand as well as a threshold requirement for abandonment, we will therefore consider the merits. Then, we will examine whether the bankruptcy court took into account whether the Payments were of any value and benefit to the estate.

I. Section 541(a): Property of the Estate

(a) Applicable Law

"Bankruptcy courts have exclusive [in rem] jurisdiction over a debtor's property, wherever located, and over the estate." *Tenn. Student Assistance Corp. v. Hood*, 541 U.S. 440, 447 (2004). The Ninth Circuit Court of Appeals has held that § 106(a)'s abrogation of sovereign immunity of "governmental units" with respect to various Code provisions, including a turnover proceeding under § 542, applies to Indian tribes. *Krystal Energy Co. v. Navajo Nation*, 357 F.3d 1055, 1060–61 (9th Cir.2004), *cert. denied*, 543 U.S. 871 (2004). Moreover, a tribe's common law sovereign immunity does not impair jurisdiction over individual tribal members who are not acting as tribal representatives or in an official capacity. *See Puyallup Tribe, Inc. v. Dept. of Game*, 433 U.S. 165, 172 (1977); *Stringer v. Chrysler (In re Stringer)*, 252 B.R. 900, 901 (Bankr.W.D.Pa.2000) (defendant tribe member could be compelled to turn over estate property). *See generally*, COHEN'S HANDBOOK OF FED. INDIAN LAW § 7.05 (2005).

*5 What comprises “property of the estate” is determined by federal law. Under the Bankruptcy Code, the commencement of a bankruptcy case creates an estate “comprised of all the following property, wherever located and by whomever held: ... [A]ll legal or equitable interests of the debtor in property as of the commencement of the case.” 11 U.S.C. § 541(a).

“Property” under § 541(a) “ ‘has been construed most generously and an interest is not outside its reach because it is novel or contingent or because enjoyment must be postponed.’ ” *United States v. Sims (In re Feiler)*, 218 F.3d 948, 955 (9th Cir.2000) (quoting *Segal v. Rochelle*, 382 U.S. 375, 379 (1966)). This definition is broad, and includes both tangible and intangible property. *United States v. Whiting Pools, Inc.*, 462 U.S. 198, 204–05 (1983).

Section 541(a), however, “ ‘merely defines what interests of the debtor are transferred to the estate. It does not address the threshold questions of the existence and scope of the debtor’s interest in a given asset.... [W]e resolve these questions by reference to nonbankruptcy law.’ ” *Suncrest Healthcare Center LLC v. Omega Healthcare Invs., Inc. (In re Raintree Healthcare Corp.)*, 431 F.3d 685, 688 (9th Cir.2005) (applying federal Medicare and state contract law) (alterations in original) (citation omitted). Even when a property interest is conceived in federal statutory law, whether or not such interest is alienable may be an issue determined by state law. *See Segal*, 382 U.S. at 381 n. 6 (holding that whether an NOL carryback refund claim could have been transferred was determined by state law, “save that on rare occasions overriding federal law may control this determination or bear upon it”).

Here, the Payments were authorized by the tribe’s Ordinance, which was promulgated under federal law, but which was also closely connected to a Tribal–State compact regarding the gaming operation. Therefore, questions as to the existence and scope of Mrs. Brown’s interest in the Payments are to be resolved by federal, state, and tribal law. *See Butner v. United States*, 440 U.S. 48, 55 (1979) (unless a federal purpose requires a different result, property rights are determined by state law); *Kedrowski*, 284 B.R. at 441 (tribal gaming “features an uneasy mixture of federal, state, and tribal rights and responsibilities”).¹²

In the absence of Ninth Circuit precedent, the bankruptcy court relied on two opinions from other circuits in reaching its conclusion that Mrs. Brown’s right to receive the Payments

was property of the estate and that future distributions should be turned over to Trustee.

In *Kedrowski*, the first case cited by the bankruptcy court, the chapter 7 trustee moved to compel turnover of future per capita distributions to which the debtor was entitled as an enrolled member of an Indian tribe. After a comprehensive examination of tribal gaming, federal and Wisconsin law, the bankruptcy court held that the debtor’s right to receive distributions from the tribe’s gaming operations constituted a “property right” within the meaning of § 541(a). 284 B.R. at 449. It further held that the per capita payments were not immune Indian trust funds, nor did the tribal ordinance contain any anti-alienation language to prevent them from being made liable for the tribal member’s debts. *Id.* at 450–51.

*6 In *Johnson*, the bankruptcy court’s second case, the debtor tribal member had given a security interest in his per capita distributions to a bank to secure a loan. In bankruptcy, the secured creditor sought to continue collecting its loan from the per capita payments and the trustee sought turnover of any surplus payments, and the bankruptcy court agreed with both.

On appeal to the district court, the debtor argued that the payments were not property of the estate because they were proceeds of postpetition “earnings.” *See* § 541(a)(6). The district court held that the payments were “income,” but not “earnings.” Therefore it held that the right to the per capita payments was a “general intangible” property interest pursuant to Louisiana law, and thus was includable in the bankruptcy estate. 259 B.R. at 129–30.

The district court in *Johnson* further held that the tribal ordinance did not restrict the member’s ability to assign the payments to another person, as long as he or she was living (no provision for devise), and that other recipients of such payments had also used them to secure debts. *Id.* at 131. Because the debtor had granted a security interest in the stream of payments to the creditor up to the amount of the debt, the district court held that such security interest applied to future, postpetition payments “as they were made,” and that the balance of payments belonged to the trustee. *Id.* at 130.

In this appeal, Debtors have attempted to distinguish these cases, and so do we.

(b) Mrs. Brown’s “Right” to Payments

The chapter 7 trustee and the estate succeed only to the title and rights in property which the debtor had at the commencement of the case: "[T]he broad scope of the estate under the § 541(a)(1) definition does not enlarge a trustee's substantive property rights beyond those existing at the commencement of the case." *Calvert v. Bongards Creameries (In re Schauer)*, 62 B.R. 526, 529–30 (Bankr. D.Minn.1986), *aff'd*, 835 F.2d 1222 (8th Cir.1987) (emphasis in original).

Debtors maintain that the Payments were not property of the estate because the Ordinance did not state that Tribal Members have a "right" to the Payments or that such Payments are the Tribal Member's "property."

The Ordinance defines per capita payments as "those payments made or distributed to Tribal Members, which are paid directly from the Tribe's Net Gaming Revenues of the Gaming Enterprise." Ordinance, art. II, sec. 1001(g). With some inapplicable exceptions, it further provides that "[e]very person who is an enrolled member of the Sherwood Valley Rancheria on the date of the Per Capita Distribution and is living on said date is eligible to receive a full Per Capita Payment...." *Id.*, art. IV, sec. 1003(1).

Such per capita payments are ordinarily based on a constant "[s]ixty-five percent (65%) of Net Gaming Revenues...." *Id.*, art. III, sec. 1002(4). While this percentage rate could not decrease, it could be increased up to 75% if net revenues exceed the Tribe's annual operational budget. *Id.* The "Payment Date" is the 15th day of the month following the last day of the preceding calendar quarter, and may precede the actual disbursement date. *See id.*, art. II, sec. 1001(p) and art. IV, sec. 1003(2).

*7 No services need be performed by individual Tribal Members in order to receive the Payments. The Payments cannot be inherited because they cease upon the Tribal Member's death. However, any Payment that has been determined, following a Payment Date, but not yet disbursed at the time of the Tribal Member's death, is an asset of the Tribal Member's probate estate. *Id.*, art. IV, sec. 1003(2).

Debtors cite to the following provision, which states that a Tribal Member does not have a "vested" interest in the revenues:

Nothing in this Ordinance is intended to vest or vests in any Tribal Member or any other person any right or interest in the Tribe's Gaming Enterprise, the revenues produced by or derived from said Enterprise, any other Tribal income

or assets, or the income produced by such assets. The General Council reserves the right to amend or repeal this Ordinance at any time, and any such amendment or repeal shall not constitute or be construed to be the taking of any vested property right.

Ordinance, art. IV, sec. 1003(4).

They contrast this language to the ordinance in *Kedrowski* which specifically provided that " 'No tribal member, nor any person claiming any right derived from a Tribal Member ... shall have any right, title, interest or entitlement in any Per Capita Share unless and until Payment of the Per Capita Distribution to which it relates occurs.' " *Kedrowski*, 284 B.R. at 450 (emphasis added). In addition, the *Kedrowski* court referred to a decision by the Ho-Chunk National Tribal Court, which had concluded that " 'the right to per capita [payments] exists so long as a member is on the rolls of the Ho-Chunk Nation.' " *Kedrowski*, 284 B.R. at 448 (citation omitted) (emphasis and alteration added). In other words, they contend that the ordinance in *Kedrowski* expressly granted a "right" upon distribution.

This is a distinction without a difference. Here, the Ordinance also uses the word "right," when it provides that a Tribal Member who fails to either claim a per capita payment check or to request a replacement check shall forfeit his or her "right to receive that Per Capita Payment." Ordinance, art. V, sec. 1004(3).

It is helpful to briefly consider the statutory history, for the genesis of the two tribal ordinances is the same Indian Gaming Regulatory Act ("IGRA"), 25 U.S.C. § 2701–2721 and accompanying federal regulations, 25 CFR § 290.1–290.26 (regulations governing "Tribal Revenue Allocation Plans"). Enacted in 1988, the purpose of the IGRA is to promote "tribal economic development, self-sufficiency, and strong tribal government," shield the tribe's enterprise from organized crime and corruption, and protect tribal gaming as a means of generating tribal revenue. 25 U.S.C. § 2702.

Casino gaming is classified as Class III gaming under the IGRA. *See* 25 U.S.C. § 2703(8). A tribe engaging in casino gaming must negotiate a "compact" with its State, which must be approved by the Secretary of the Interior. 25 U.S.C. § 2703(7)(E) and (10); *see also* 25 U.S.C. § 2710(d)(1), (3); Cal. Const. Art. 4, § 19.¹³ The tribal-state compact limits the state's jurisdiction "in matters concerning Indian gaming," to "the extent provided in the Compact." *Campo Band of*

Mission Indians v. Super. Ct., 137 Cal.App. 4th 175, 182, 39 Cal.Rptr.3d 875, 881 (2006).

*8 The IGRA specifically addresses the matter of per capita payments which are made out of the Tribe's gaming revenues. Pursuant to the IGRA, a tribe is required to adopt an ordinance, which, among other things, allocates its gaming revenues, and it must obtain its approval by the Chairman of the National Indian Gaming Commission.¹⁴ Here, the Ordinance complied with IGRA by authorizing the use of net gaming revenues:

- (i) to fund tribal government operations or programs;
- (ii) to provide for the general welfare of the Indian tribe and its members;
- (iii) to promote tribal economic development;
- (iv) to donate to charitable organizations; or
- (v) to help fund operations of local government agencies[.]

Ordinance, art. II, sec. 1000(2); 25 U.S.C. § 2710(b)(2); *see also* 25 U.S.C. § 2710(d)(2) (providing that Class III gaming is subject to the provisions of § 2710(b) regarding the disposition of net gaming revenues). The IGRA and Ordinance further provide that the net gaming revenues may be used to make per capita payments to Tribal Members, if certain conditions are met. These conditions are:

- (A) the Indian tribe has prepared a plan to allocate revenues to uses authorized by paragraph (2)(B);
- (B) the plan is approved by the Secretary as adequate, particularly with respect to uses described in clause (i) or (iii) of paragraph (2)(B);
- (C) the interests of minors and other legally incompetent persons who are entitled to receive any of the per capita payments are protected and preserved and the per capita payments are disbursed to the parents or legal guardian of such minors or legal incompetents in such amounts as may be necessary for the health, education, or welfare, of the minor or other legally incompetent person under a plan approved by the Secretary and the governing body of the Indian tribe; and

(D) the per capita payments are subject to Federal taxation and tribes notify members of such tax liability when payments are made.

25 U.S.C. § 2710(b)(3); Ordinance, art. II, sec. 1000(3).

In *Kedrowski*, as in this case, the debtor argued that the ordinance did not denominate the per capita payment as a property "right." For all practical purposes, the language of the Ho-Chunk ordinance, in *Kedrowski*, and this Ordinance are identical in that they prohibited any vesting of ownership rights other than the Tribe's in the gaming revenues before they were either determined following a Payment Period (ours) or actually distributed (*Kedrowski*). The *Kedrowski* bankruptcy court rejected the debtor's argument, stating:

It is undisputed that the debtor is an enrolled member of the Ho-Chunk Nation. Thus, if the tribe does decide to make a distribution, the debtor has a "right" to receive her share. Nothing in the IGRA, the federal regulations, or the Ho-Chunk per capita distribution ordinance would permit the tribe to exclude her from the distribution process.

Kedrowski, 284 B.R. at 446.

*9 Similarly, in *Johnson*, the district court found that the debtor's right to receive monthly per capita payments was an intangible property interest under Louisiana law, similar to a right to receive an annuity, insurance proceeds, accounts receivable, or federal program entitlements. 259 B.R. at 128–30 (citing cases).

In our case, Debtors had already received and possessed some of the Payments for 2005. Using the petition date as a benchmark, Mrs. Brown's property rights were divisible into two kinds. The actual money received became Mrs. Brown's personal property and it lost its identity as tribal funds. *See Jacobsen v. Jacobsen (In re Marriage of Jacobsen)*, 121 Cal.App. 4th 1187, 1192–93, 18 Cal.Rptr.3d 162, 166–67 (2004) (per capita distribution that was deposited into bank account or securities account lost its identity as immune Indian property); *see also* Ordinance, art. IV, sec. 1003(2); 25 C.F.R. § 290.16 (providing that the Secretary of the Interior "will not accept any deposits of payments or funds derived from net gaming revenues to any account held by [the Bureau of Indian Affairs] or [the Office of Trust Funds Management]."). In the case at bar, it is clear that the Payments that Mrs. Brown had already received as of the petition date were property of the estate.

The second form of property right was Mrs. Brown's entitlement to future Payments, which was created under the Ordinance. This was a contingent, intangible property interest to which Trustee succeeded. *Feiler*, 218 F.3d at 953 (a trustee succeeds to the debtor's interest in property).

Section 541(a)(7) provides that property of the estate includes "any interest in property that the estate acquires after the commencement of the case." The legislative history of this section states:

The addition of this provision by the House amendment merely clarifies that section 541(a) is an all-encompassing definition which includes charges on property, such as ... beneficial rights and interests that the debtor may have in property of another.

124 Cong. Rec. H11096 (daily ed. Sept. 28, 1978); S17413 (daily ed. Oct. 6, 1978). Congress intended that "property of the estate" be broadly construed. "Under [§ 541(a)(1)], the estate is comprised of ... tangible and intangible property, choses in action, causes of action, rights such as copyrights, trade-marks, patents, and processes, contingent interests and future interests, whether or not transferable by the debtor." H.R.Rep. No. 95-595, 175-176, reprinted in 1978 U.S.C.C.A.N. 5963, 6136.

California takes an expansive view of property, which is defined as follows:

The ownership of a thing is the right of one or more persons to possess and use it to the exclusion of others. In this Code, the thing of which there may be ownership is called property.

Cal. Civ.Code § 654.

"Property" is " 'all-embracing so as to include every intangible benefit and prerogative susceptible of possession or disposition ... ' "; and signifying " 'any valuable right or interest protected by law.' " *People v. Kwok*, 63 Cal.App. 4th 1236, 1251, 75 Cal.Rptr.2d 40 (1998) (citations omitted). Every kind of property that is not "real" property is "personal" property. Cal. Civ.Code § 663. Personal property may be without tangible substance, and it may be intangible in the sense that it is a right rather than a physical object. *Navistar Int'l Transp. Corp. v. State Bd. of Equalization*, 8 Cal.4th 868, 875, 35 Cal.Rptr.2d 651, 653, 884 P.2d 108, 110 (1994).

*10 California recognizes contingent property interests. See *State ex rel. Harris v. PricewaterhouseCoopers LLP*, 23

Cal.Rptr.3d 529, 566 (2005), rev'd in part on other grounds, 48 Cal.Rptr.3d 144, 141 P.3d 256 (2006); Cal. Civ.Code §§ 688, 690, 697.¹⁵ Courts, in a variety of circumstances, consistently have concluded that contingent interests are included within the bankruptcy estate. See, e.g., *DeNadai v. Preferred Capital Markets, Inc.*, 272 B.R. 21, 29 & n. 5 (D.Mass.2001) (right to exercise a stock option in the future was property of the estate); *Rau v. Ryerson (In re Ryerson)*, 739 F.2d 1423, 1425 (9th Cir.1984) (holding that postpetition termination payments were property of the estate); *Booth v. Vaughan (In re Booth)*, 260 B.R. 281, 285-87 (6th Cir.BAP2001) (collecting cases holding that various contingent interests are property of the estate).

Mrs. Brown's interest is analogous to business or stock dividends.¹⁶ She has a right to receive the distribution effective on the declared per capita Payment Date. See Ordinance, art. IV, sec. 1003(1) and (2). As long as she is an eligible Tribal Member, and the same Ordinance is in effect, her share in the net revenues cannot be excluded from the distribution process.

The interest in future Payments is contingent because the Ordinance provides: a) that the tribe may amend or repeal the Ordinance at any time at its discretion, see Ordinance, art. IV., sec. 1003(4); b) Mrs. Brown must be alive and eligible on the Payment Date, see *id.*, art. IV, sec. 1003(1) and (2); and c) there must be net revenue available for distribution.

Thus, Debtors' contention that no "right" to further payments "vested" in Mrs. Brown, does not precisely frame the issue. While paragraph 4 prohibits the vesting in any Tribal Member, or other person, of any interest in the gaming enterprise and its revenues, the vesting of later, declared and individual Payments is separately authorized in specific provisions of the Ordinance. See *Fireman's Fund Mortg. Corp. v. Hobdy (In re Hobdy)*, 130 B.R. 318, 321 (9th Cir.BAP1991) ("[a] general statutory rule usually does not govern unless there is no more specific rule.") (citing *Green v. Bock Laundry Mach. Co.*, 490 U.S. 504, 524 (1989)). Therefore, paragraph (4) generally reiterates the Tribe's sovereignty and ownership. See *Kedrowski*, 284 B.R. at 450-51 (explaining that similar provisions emphasized the tribe's sovereign status); see also 28 U.S.C. § 1360 (discussed below).

In addition, the IGRA treats per capita payments when made as personal income,¹⁷ with the consequence that the Tribe must inform the members that their Payments are subject to federal taxation. See 25 U.S.C. § 2710(b)(3)(D); *Campbell*

v. Comm'r of Internal Revenue, 164 F.3d 1140, 1142 (8th Cir.1999) (per capita distribution of casino proceeds was a dividend taxable as ordinary income). As such, per capita payments have been used to calculate an individual's income for various purposes in state courts. *See Kedrowski*, 284 B.R. at 448 (citing case law).

***11** In summary, Mrs. Brown's interest in the Payments was an intangible "right" to possess them whenever the shares of net revenues are calculated (the "Payment Date"). As Trustee contends, this was an "automatic" property interest. Appellee's Brief (May 17, 2006), at 2. Although the Tribe could elect to amend or revoke the Ordinance, which might affect the intrinsic or marketable value of Mrs. Brown's right (see discussion below), it did not alter her absolute right to a distribution, if any future distributions are made, pursuant to the extant Ordinance. *See Kedrowski*, 284 B.R. at 446.

Finally, Debtors contend that the Payments were not a property interest because they were not transferable. Debtors maintain that the Ordinance restricts and prohibits Mrs. Brown from transferring this asset because any Payment check may only be made payable to the Tribal Member.

Even intangible property must be capable of being transferred. " '[I]t is a fundamental principle of law that one of the chief incidents of ownership in property is the right to transfer it.' 'A common characteristic of a property right, is that it may be disposed of, transferred to another.' " *McTiernan v. Dubrow (In re Marriage of McTiernan and Dubrow)*, 133 Cal.App. 4th 1090, 1100, 35 Cal.Rptr.3d 287, 295 (2005) (citations omitted) (alteration in original). California recognizes the transferability of intangible property. *See, e.g.*, Cal. Civ.Code § 1044 ("Property of any kind may be transferred..."); Cal. Com.Code § 9102(2), (42) and (61) (definitions of "account," "general intangible," and "payment intangible" under Division 9—Secured Transactions); Cal. Com.Code § 9109 (noncollectionrelated secured transactions in accounts or payment intangibles); Cal. Com.Code § 9204 (security interest in after-acquired property and future advances); Cal. Civ.Code § 955.1 (requirements for assignment of payment intangibles). Thus, under California law, Mrs. Brown's property interest is transferable.

Whether or not the transferability of the Payments is restricted by virtue of the Ordinance, however, is irrelevant to the question of whether they are property of the estate. Section 541(c)(1) provides, that except in regards to a beneficial interest in a trust, "an interest of the

debtor in property becomes property of the estate under subsection (a)(1) ... of this section notwithstanding any provision in an agreement, transfer instrument, or applicable nonbankruptcy law-(A) that restricts or conditions transfer of such interest by the debtor;" 11 U.S.C. § 541(c)(1) (A). Thus, " '[p]ersonal' property interests or 'personal' rights that may not be transferred under federal or state law will nevertheless become property of the estate." 5 COLLIER ON BANKRUPTCY ¶ 541.24, at 541-100 (Alan N. Resnick & Henry J. Sommer eds., 15th ed. rev.2005). Therefore, Debtors' contention that Mrs. Brown's interest in the Payments was not property of the estate because it was nontransferable must fail.

***12** In summary, the bankruptcy court did not err in determining that Mrs. Brown had a property interest in both the present and future Payments which became property of Debtors' bankruptcy estate. On this point, then, we AFFIRM the bankruptcy court.

2. Value or Benefit to the Estate

The determination that Mrs. Brown's interest in the Payments was property of the estate was, however, only the first step in deciding the motions for abandonment and turnover. Section 554(a) also requires the bankruptcy court to determine whether the property was "burdensome" or "of inconsequential value or benefit to the estate." 11 U.S.C. § 554(a). An interest in future distributions is only of value to the estate if it can be assigned,¹⁸ sold or reached for the enforcement of judgments.

Per capita distributions of profits from tribal enterprises are a discretionary choice of the tribal government, and therefore, we look to the language of the Ordinance to determine whether Trustee may take control of future Payments for the estate's benefit, and whether there are any restrictions imposed upon that interest. *See Cohen, supra*, § 16.04[2] & n. 225 (2005); § 541(a)(6). Furthermore, the Supreme Court has admonished courts to interpret Indian treaties and applicable federal statutes by resolving any doubtful expressions in favor of the Indians' sovereignty. *McClanahan v. State Tax Comm'n of Ariz.*, 411 U.S. 164, 172-74 (1973).

In ruling on another issue (*i.e.*, spendthrift trust), the bankruptcy court concluded that the Ordinance contained no restrictions on transfer and specifically permitted transfer, citing the provision for allowing a third party to receive a Tribal Member's check upon the Tribal Member's signed and

notarized written instruction. See Memorandum Decision, *supra*, at 2. That provision reads:

Each Per Capita Payment shall be made by Tribal check, *made payable only to the Tribal Member*, except in the case of minors or legal incompetents, in which case payment shall be made as provided in Section (4). If requested in writing by the Tribal Member, the Treasurer shall mail each Per Capita Payment check to said member at the member's current address on file with the Treasurer; otherwise, Per Capita Payment checks shall be available at the office of the Treasurer during normal business hours. *Upon the signed and notarized instruction of the Tribal Member, Per Capita Payment checks may be released to another person, provided that said person provides valid picture identification and signs for the check.* If a Tribal Member who has not requested that his/her check be mailed fails to claim his/her Per Capita Payment check within 90 days after issuance, the Treasurer shall cause the check to be voided....

Ordinance, art. V, sec. 1004(3) (emphasis added).

The Ordinance does *not* provide that a Payment check may be *made payable* to a third party, nor that it would be subject to attachment or garnishment under state law. Nor does it clarify what the words "may be released to" mean. For example, the Ordinance may be contemplating a situation in which someone is authorized to pick up, then deposit, the distribution to an elderly or infirm person. Therefore, construing the Ordinance in favor of Mrs. Brown, we hold that the bankruptcy court erred in its interpretation.

*13 Moreover, in denying Debtors' motion to compel abandonment, the bankruptcy court implicitly ruled that the Payments were of some value or benefit to the estate, presumably because they could be assigned or sold by Trustee. This ruling was premature, because the bankruptcy court had neglected to analyze the "value" element of 554(a) or to make separate findings and conclusions which justified that a value could indeed be placed upon *future* distributions.¹⁹

However, the interest in future Payments may not be transferable or subject to enforcement proceedings such as garnishment.²⁰ The Supreme Court has held that Indian Nations enjoy immunity from judicial attack absent consent to be sued or express abrogation of tribal immunity. See *Kiowa Tribe of Okla. v. Mfg. Techs., Inc.*, 523 U.S. 751, 757 (1998); *Krystal Energy*, 357 F.3d at 1056 (Congress abrogated tribal

immunity in § 106(a) of the Bankruptcy Code). Federal Indian law can also preempt state law "if the balance of federal, state and tribal interests tips in favor of preemption." *Hoopa Valley Tribe v. Hongkong and Shanghai Banking Corp., Ltd. (In re Blue Lake Forest Prods., Inc.)*, 30 F.3d 1138, 1142 (9th Cir.1994). "The more the federal government and the tribe have taken control of an activity, the more likely is the state to be preempted." William C. Canby, Jr., *American Indian Law in a Nutshell* 292 (1998). "Indian law preemption ... determines which government—federal, tribal, or state—has jurisdiction in Indian country." David H. Getches, Charles F. Wilkinson & Robert A. Williams, Jr., *Cases and Materials on Federal Indian Law* 562 (5th ed.2005).

Tribal gaming is an important tribal interest which provides the sole source of revenues for the operation of a tribe's government and the provision of tribal services. *Cal. v. Cabazon Band of Mission Indians*, 480 U.S. 202, 218–19 (1987). Garnishment and other state enforcement of judgment remedies of a tribal member's per capita payments could implicate the tribe's sovereign immunity or preemption. See *North Sea Prods., Ltd. v. Clipper Seafoods Co.*, 92 Wash.2d 236, 237, 595 P.2d 938, 939 (1979); *People v. Superior Ct.*, 224 Cal.App.3d 1405, 1410, 274 Cal.Rptr. 586, 589 (1990) (noting, and citing Tenth Circuit law, that "Native Americans residing on reservations enjoy protection from compulsion of the state courts in a variety of matters such as ... garnishment....").

In California, federal law grants the state limited jurisdiction over civil actions involving Indians to the same extent that it has jurisdiction over other civil causes of action, and its general laws apply in Indian country. See 28 U.S.C. § 1360(a) ("Public Law 280").²¹ However, § 1360(b) limits the scope of such state power and jurisdiction: it provides that § 1360(a) does not authorize the "alienation, encumbrance or taxation of any real or personal property ... belonging to any Indian, or any Indian tribes, bands or community," nor does it authorize the "regulation of the use" of Indian property "in a manner inconsistent with any Federal treaty, agreement, or statute, or with any regulation made pursuant thereto."

*14 Furthermore, § 1360(b) provides that the general grant of civil jurisdiction "does not confer jurisdiction upon the State to adjudicate, in probate proceedings or otherwise, the ownership or right to possession of [Indian] property or any interest therein." 28 U.S.C. § 1360(b).

Finally, § 1360(c) provides that a tribal ordinance or custom which is not inconsistent with applicable state civil law

will "be given full force and effect in the determination of civil causes of action pursuant to this section." 28 U.S.C. § 1360(c).

Public Law 280 did not abrogate Indian sovereign immunity, nor does it deprive a tribe of concurrent subject matter jurisdiction in civil matters. See *Bryan v. Itasca County*, 426 U.S. 373, 389–91 (1976); *Getches, supra*, at 508 n. 2. Moreover, § 1360(b) precludes states from asserting jurisdiction over disputes concerning Indian trust land, even if one party is non-Indian. *Boisclair v. Super. Ct.*, 51 Cal.3d 1140, 1152, 276 Cal.Rptr. 62, 69, 801 P.2d 305, 312 (1990).

[F]or section 1360(b)'s jurisdictional preclusion to operate and its protective purpose to be fulfilled, the threshold question must be whether one possible outcome of the litigation is the determination that the disputed property is in fact Indian trust land. If that outcome is possible, then a state court is barred from assuming jurisdiction of the case.

Id. (emphasis added); see also *Lamere v. Super. Ct.*, 131 Cal.App. 4th, 1059, 1064, 31 Cal.Rptr.3d 880, 883–84 (2005), cert. denied sub nom. *Salinas v. Lamere*, 126 S.Ct. 2291, 164 L.Ed.2d 813 (2006) (Public Law 280 does not provide jurisdiction over disputes involving a tribe).

In addition, in a garnishment, the tribe is the real party in interest, and therefore, Indian sovereign immunity may be at issue. See Stephen Pevar, *The Rights of Indian Tribes* 355 (2002). Whether a judgment is obtained in a Public Law 280 state or not, Indian trust property will be protected from garnishment or execution. See Robert Laurence, *Service of Process and Execution of Judgment on Indian Reservations*, 10 AM. IND. L.REV. 257 (1982). A tribal code may govern such enforcement. *Id.* at 268–69. A leading authority on Indian law has stated: "[E]ven in Public Law 280 states, the better rule is that state court judgments should be presented to tribal courts for recognition, and not merely executed upon by state officers using state enforcement process on-reservation." Cohen, *supra*, § 7.07[2][c].

Here, the per capita shares did not become Mrs. Brown's personal property until each Payment date. Her contingent interest in future Payments, while intangible property of the estate, may or may not be protected against transfer to third parties.²² This matter was neither addressed by the bankruptcy court nor satisfactorily analyzed in either *Johnson* or *Kedrowski*.

The facts in *Johnson* are distinguishable from our case. There, the debtor had granted a bank a consensual security interest

in his stream of per capita payments in order to secure a loan, rather than absolutely assigning the payments to the bank. The debtor had remained current on the loan by using the per capita payments to pay the debt as they were distributed. See *Johnson*, 259 B.R. at 130 n. 4. The district court saw this situation as "resembling" an assignment. *Id.* In fact, there was no assignment in *Johnson* and, therefore, that case cannot support a conclusion that per capita payments are always assignable. In our case there was neither an assignment of, nor an encumbrance or lien on Mrs. Brown's interest.

*15 In addition, the *Johnson* court noted that "[o]ther Tribe members have granted security interests in the payments, and have had them garnished." *Id.* at 127. However, any conclusion regarding garnishment was *dictum* because there was no garnishment under the *Johnson* facts. The district court merely found that the ordinance contained no restrictions on the debtor's ability to encumber the per capita payments on behalf of a third party. *Id.* at 131.

Nor do we believe the *Kedrowski* opinion is persuasive on this point. There, the ordinance stated: "[T]he Nation shall not recognize or enforce any claim, garnishment, levy, attachment, assignment or other right or interest in a Per Capita Share." 284 B.R. at 450. Interestingly, the bankruptcy court concluded that the ordinance did not expressly forbid per capita distributions from being liable for the tribal member's debts. *Id.* at 451. In fact, this tribal rule could be read to treat the per capita shares as trust property, which is protected from encumbrance in Public Law 280 states, and Wisconsin is one of those states.

Moreover, we disagree with both *Johnson* and *Kedrowski* that a lack of an express prohibition as to the transferability of per capita payments in an ordinance should be construed as allowing for such transfer. We hold, therefore, that to the extent the bankruptcy court so interpreted the Ordinance, its conclusion was erroneous. We further hold that the bankruptcy court's implicit finding that Mrs. Brown's interest in the stream of future Payments was of value or benefit to the estate was clearly erroneous. See *Wall Street Plaza, LLC v. JSIF Corp. (In re JSIF Corp.)*, 344 B.R. 94, 99 (9th Cir.BAP2006) ("[W]e may regard a finding of fact as clearly erroneous not only if it is without adequate evidentiary support, but also if it was induced by an erroneous view of the law.") (citation omitted). Further evidence and support for this conclusion must be shown.

At the very least, the Ordinance is ambiguous, and more evidence is required in order for the bankruptcy court to

determine whether Mrs. Brown's interest is transferable and, if so, what it is worth. There is no evidence in the record of whether any attempt had been made to value the stream of Payments, nor any determination made as to whether the contingencies affected its marketability. Such evidence may require the testimony of tribal officers or valuation experts, or facts judicially noticed concerning tribal law and financial affairs. The issue is not purely one of law which we may review *de novo*, and therefore a remand will preserve the trial court's role as factfinder. See *Matter of MCI, Inc.*, 151 B.R. 103, 109 (B.D.Mich.1992) (determining appeal of abandonment order *de novo*). Thus, we VACATE AND REMAND for further proceedings.

CONCLUSION

The relevant legal authority to determine property of the estate for a Tribal Member requires a consideration of federal and state property law, as well as the tribal laws and the specific Ordinance. The bankruptcy court correctly concluded that Mrs. Brown's interest in the present and future Payments

was property of the estate, and its reliance on *Kedrowski* and *Johnson* for such holding was proper. This part of the order is AFFIRMED.

*16 However, the bankruptcy court ruled against Debtors' abandonment motion without analyzing and making findings and conclusions concerning whether there was any value or benefit to the estate in the stream of future Payments. Any implicit valuation determined against Mrs. Brown that was based on case law from other jurisdictions or on the absence of prohibitive language in the Ordinance was therefore an abuse of the court's discretion. Specifically, the Ordinance is ambiguous concerning the transferability of the future Payments, and more evidence is warranted. Similarly, any determination of actual value requires positive proof. We therefore VACATE AND REMAND for further proceedings on the abandonment request, including a determination of the asset's value to the estate.

AFFIRMED IN PART; VACATED AND REMANDED IN PART.

Footnotes

- 2 At the request of the parties, and with the panel's approval, this appeal was submitted without oral argument. See BAP Rule 8012-1.
- 3 Hon. James W. Meyers, United States Bankruptcy Judge for the Southern District of California, sitting by designation.
- 4 Hon. John E. Ryan, United States Bankruptcy Judge for the Central District of California, sitting by designation.
- 1 This disposition is not appropriate for publication and may not be cited to or by the courts of this circuit except when relevant under the doctrines of law of the case, *res judicata*, or collateral estoppel. See 9th Cir. BAP Rule 8013-1.
- 5 Unless otherwise indicated, all Code, chapter and section references are to the Bankruptcy Code, 11 U.S.C. §§ 101-1330, prior to its amendment by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub.L. 109-8, 119 Stat. 23 (Oct. 17, 2005).
- 6 " 'Tribal member' means any living enrolled member of the Tribe who is in good standing, and has not forfeited or waived his or her right to receive Per Capita Payments from the Tribe's Net Gaming Revenues, and who is not excluded by this Tribal Ordinance from receiving such payments." Tribal Ordinance, art. II, sec. 1001(b).
- 7 The parties have not presented any legal distinction between the "per capita" and "revenue-sharing" payments which Mrs. Brown receives. For purposes of this appeal, therefore, we will denominate and treat all as per capita payments.
- 8 We may take judicial notice of the papers which have not been provided in the excerpts of record. *O'Rourke v. Seaboard Sur. Co. (In re E.R. Fegert, Inc.)*, 887 F.2d 955, 957-58 (9th Cir.1989) (panel did not err by taking judicial notice of the underlying bankruptcy court records).
- 9 The Tribal Ordinance contains trust language concerning payments for minors and legally incompetent adults, but Debtors did not maintain that Mrs. Brown fell into either category.
- 10 Debtors have not argued, in their Opening Brief, that the Tribal Ordinance contained a provision for a spendthrift trust or that the Payments were excluded from the estate under § 541(c)(2). Therefore, they have abandoned the "trust" theory, and we will not consider it. See *Law Offices of Neil Vincent Wake v. Sedona Inst. (In re Sedona Inst.)*, 220 B.R. 74, 76 (9th Cir.BAP1998).
Compare the situation where a tribal member's funds are placed into an Individual Indian Money ("IIM") account, which is held in trust by the United States Department of Interior and is subject to anti-alienation regulations. See *Warfield v. Frank-Hill (In re Frank-Hill)*, 300 B.R. 25, 30-31 (Bankr.D.Ariz.2003) (IIM account was an interest within the scope of § 541(c)(2)).
- 11 Chapter 13 plans may last from 36 to 60 months. 11 U.S.C. § 1322(d).
- 12 Courts generally recognize the imposition of traditional federal and state property concepts in lieu of any tribal property system. See Richard A. Monette, *Governing Private Property in Indian Country; The Double Edged Sword of the Trust Relationship and Trust Responsibility Arising out of Early Supreme Court Opinions and the General Allotment Act*, 25 N.M. L.REV. 35, 50 (Winter, 1995). For a study of the Bankruptcy Code applied to Indian tribes, see R. Spencer Clift, III, *The Historical Development of American*

Indian Tribes; Their Recent Dramatic Commercial Advancement; and a Discussion of the Eligibility of Indian Tribes under the Bankruptcy Code and Related Matters, 27 AM. INDIAN L.REV. 177, 208–212 (2002–03).

- 13 In March 2000, California voters adopted Proposition 1A, which authorized the governor to negotiate tribal-state gaming compacts with federally recognized Indian tribes for the operation of slot machines and certain casino games on tribal lands in California in accordance with federal law. *See* Historical Notes, Cal. Const. Art. 4, § 19.
- 14 The IGRA established the National Indian Gaming Commission, which approved the Sherwood Valley Rancheria's Class III tribal gaming Ordinance. *See* 67 Fed.Reg. 165, 54823–54825 (Aug. 26, 2002).
- 15 In California, “[p]ossession may be proved without proof of ownership, and although ownership implies the right to possess (Civ.Code, sec.654), possession may exist entirely apart from ownership and ownership may be had of a thing not in the owner's possession.” *People v. McKinney*, 9 Cal.App.2d 523, 524, 50 P.2d 827, 828 (1935).
- 16 The court in *Kedrowski* stated:

[T]ribal per capita distributions are far more conceptually akin to an interest in a business enterprise than they are a gift, a license, or some form of public assistance. Someone who owns stock in a company, or holds a limited partnership interest in a business, may never receive a distribution on that interest. The business may encounter a poor economic climate, may find expenses outpacing revenues, and may even fail. But should the company ever issue a dividend, all stockholders receive an appropriate amount in relation to their interest. Clearly, those who hold a “right” to receive payment from the operation of a business hold some sort of intangible property right under Wisconsin law.

Kedrowski, 284 B.R. at 447.
- 17 However, this income is not “earned,” as that term is used in the exception to property of the estate for “earnings from services performed by an individual debtor after the commencement of the case.” 11 U.S.C. § 541(a)(6).
- 18 In California, an “assignment” refers to “a class of acts by which the right or title to something of value is transferred to another before the object of the transfer has become property in possession.” *Cross v. Sacramento Savings Bank*, 66 Cal. 462, 466, 6 P. 94 (1885).
- 19 We agree that the Payments that Mrs. Brown had already received, as of the petition date, were freely transferable. However, we disagree with the bankruptcy court's conclusion in regards to Mrs. Brown's interest in an ongoing and unaltered stream of future Payments. Too many unanswered questions affect that conclusion.
- 20 *See, e.g., Begay v. Roberts*, 167 Ariz. 375, 382, 807 P.2d 1111, 1118 (Ct.App.1990) (quashing justice court writs of garnishment of wages earned by a reservation Indian as being an infringement on tribal sovereignty, and on the basis of tribal law preemption). *See also McClanahan*, 411 U.S. at 173 (holding that absent explicit congressional authorization, a state acts outside its authority if it infringes on the right of reservation Indians to make their own laws and be governed by them).
- 21 Section 4 of Public Law 280, 67 Stat. 589 (1953), is codified in 28 U.S.C. § 1360. Subsection (a) provides, in relevant part:

(a) Each of the States listed ... shall have jurisdiction over civil causes of action between Indians or to which Indians are parties which arise in the areas of Indian country listed opposite the name of the State to the same extent that such State has jurisdiction over other civil causes of action, and those civil laws of such State that are of general application to private persons or private property shall have the same force and effect within such Indian country as they have elsewhere within the State:

...

California.... All Indian country within the State[.]

28 U.S.C. § 1360(a).
- 22 In addition, under California law, a contingent debt owed by the garnishee which is uncertain in the sense that it may never become due and payable is not subject to garnishment. *Javorek v. Super. Ct. of Monterey County*, 17 Cal.3d 629, 640, 131 Cal.Rptr. 768, 777, 552 P.2d 728, 737 (1976).

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446 B.R. 506
United States Bankruptcy Court,
D. Kansas.

In re Alen Ray HOWLEY and
Jeannie Marie Howley, Debtors.

No. 10-20713. | Feb. 23, 2011.

Synopsis

Background: Chapter 7 trustee objected to exemption claimed by debtor in her right, as enrolled member of Indian tribe, to receive per capita payments from tribal gaming revenues. The Bankruptcy Court, Dale L. Somers, J., 439 B.R. 535, sustained objection. Debtor filed motion to alter or amend.

Holdings: The Bankruptcy Court, Dale L. Somers, J., held that:

1 judicial economy warranted consideration of motion on its merits, and

2 debtor's contingent interest in future per capita payments from tribal gaming revenues was estate property.

Motion denied.

West Headnotes (11)

1 **Bankruptcy**

⇨ Proceedings

Judicial economy warranted bankruptcy court's consideration, on the merits, of Chapter 7 debtor's motion to alter or amend order sustaining trustee's objection to debtor's claimed exemption in right to receive per capita payments from tribal gaming revenues, even though motion was not based on grounds permitted by local rule and underlying argument, that debtor's interest in payments anticipated to be received postpetition was not estate property, was unrelated to exemption claim, since issue had been briefed and likely would be raised again by parties. 11 U.S.C.A. § 541; U.S.Dist.Ct.Rules D.Kan., Rule 7.3.

2 **Bankruptcy**

⇨ Judgment or Order

A motion to alter or amend order is not a vehicle to raise new issues which were not previously presented for consideration in the first instance.

3 **Bankruptcy**

⇨ Effect of state law in general

When defining property in determining whether it is bankruptcy estate property, courts analyze interests under state law, since Congress has generally left the determination of property rights in assets of an estate to state law. 11 U.S.C.A. § 541.

4 **Property**

⇨ Nature of right of property and acquisition in general

Kansas law recognizes contingent interests as property.

5 **Bankruptcy**

⇨ Property of Estate in General

Scope of statute defining bankruptcy estate property is broad and should be generously construed. 11 U.S.C.A. § 541.

6 **Bankruptcy**

⇨ Particular Items and Interests

Bankruptcy

⇨ Future interests

Under Bankruptcy Code, an interest may be "property of the estate" even if it is novel or contingent. 11 U.S.C.A. § 541.

7 **Bankruptcy**

⇨ Interest of debtor in general

Bankruptcy

⇨ Particular Items and Interests

Bankruptcy

⇨ Future interests

Every conceivable interest of the debtor, whether future, nonpossessory, contingent, speculative, or derivative, is within the reach of Bankruptcy

Code's definition of bankruptcy estate property.
11 U.S.C.A. § 541.

8 Bankruptcy

⚡ Future interests

Chapter 7 debtor's contingent right, based upon her status as enrolled member of Indian tribe, to receive future per capita payments from tribal gaming revenues was property interest under Kansas law and fell within Bankruptcy Code's broad definition of bankruptcy estate property, which included debtor's contingent property interests, and therefore trustee was entitled to value, as of petition date, of such postpetition payments. 11 U.S.C.A. § 541(a); Indian Gaming Regulatory Act, § 11(b)(3)(A), 25 U.S.C.A. § 2710(b)(3)(A), (d)(2)(A).

9 Bankruptcy

⚡ After-acquired property; proceeds; wages and earnings

Debtor's right to lottery proceeds to be paid postpetition as proceeds of an annuity owned by the state is "property of the estate." 11 U.S.C.A. § 541.

10 Bankruptcy

⚡ After-acquired property; proceeds; wages and earnings

Insurance renewal commissions received postpetition are "property of the estate," if all of the actions required to earn the commissions were completed prepetition. 11 U.S.C.A. § 541.

11 Bankruptcy

⚡ Tax refunds, credits, and deductions

Chapter 7 debtor's earned income tax credits (EICs) for a tax year, as prorated to date of the petition filing, are estate property regardless of whether the petition was filed prior to end of the tax year, even though debtor's interest in EIC was not finalized until the end of the tax year. 11 U.S.C.A. § 541.

Attorneys and Law Firms

*507 Mark W. Neis, Neis & Michaux PA, Topeka, KS, for Debtors.

Opinion

**MEMORANDUM OPINION AND ORDER
DENYING DEBTOR'S MOTION TO ALTER
OR AMEND MEMORANDUM OPINION
AND ORDER SUSTAINING TRUSTEE'S
OBJECTION TO DEBTOR'S EXEMPTION CLAIM**

DALE L. SOMERS, Bankruptcy Judge.

The matter before the Court is Debtor Jeannie Marie Howley's (hereafter "Debtor") Motion to Alter or Amend Judgment Sustaining Trustee's Objection to Exemption (hereafter "Motion to Amend").¹ Debtor asks the Court to amend its Memorandum Opinion and Order Sustaining Trustee's Objection to Debtor's Exemption Claim, filed on October 26, 2010, as Document 38 (hereafter "Memorandum").² In that Memorandum, the Court denied Debtor's *508 claim of exemption of her interest in per capita payments from the Prairie Band of Potawatomi Indians. Debtor now requests the Court to amend the Memorandum to include a finding that Debtor's interest, as of the date of filing of her petition, in per capita payments anticipated to be received postpetition is not property of the estate. For the reasons stated below, the Court denies the Motion to Amend and holds that Debtor's interest on the date of filing in future per capita payments is property of the estate.

FINDINGS OF FACT.

The following Findings of Fact stated in the Memorandum are applicable to the Motion to Amend. Debtors Alen and Jeannie Howley filed for relief under Chapter 7 on March 14, 2010. On Schedule C of Debtors' voluntary petition they claimed Debtor Jeannie Howley's Per Capita Income accruing from gaming revenues of the Prairie Band of Potawatomi Indians (hereafter "Prairie Band") in the amount of approximately \$400 per month (hereafter "Per Capita Payments") under § 4-10-16(H) of the Potawatomi Law and Order Code (hereafter "Tribal Code"). Since 2007, Debtor has resided in Lecompton, Kansas and from 2002 to 2007 resided in Topeka,

Kansas. She has never resided on the Prairie Band reservation located near Mayetta, Kansas.

The Motion to Amend does not attempt to supplement these facts.

PROCEDURAL CONSIDERATIONS.

1 As a preliminary matter, the Court finds the Motion to Amend could be denied based solely upon procedural grounds. The Motion to Amend does not assert grounds permitted under the applicable rule. Local Rule 7.3, Motions to Reconsider, provides that a motion to reconsider non-dispositive orders must be based on: "(1) an intervening change in controlling law; (2) the availability of new evidence; or (3) the need to correct clear error or prevent manifest injustice." Debtor's Motion is not based upon any of these permitted grounds.

2 In addition, when responding to the Trustee's objection to exemption of Per Capita Payments, Debtor did not present the argument that her right to the payments is not property of the estate. In fact, the Debtor conceded that her right to the payments is property of the estate. In note 13 of the Memorandum, the Court stated:

The first argument made by the Trustee is that the Per Capita Payments are property of the estate and not subject to the 11 U.S.C. § 541(c)(2) exclusion for beneficial interests of the debtor held in a trust. Doc. 28, pp. 3-5. He cites numerous cases, including *In re McDonald*, 353 B.R. 287, 293-94 (Bankr.D.Kan.2006), from this district. Debtor does not refute this position. Doc. 30. Indeed, by taking the position that the payments are exempt, Debtor is conceding that they are property of the estate, since it is only property of the estate which can be exempted from the estate.

As acknowledged by Debtor in her brief, the purpose of the Motion to Amend is to oppose the Trustee's claim to postpetition Per Capita Payments on the basis that the Trustee has no interest in the payments since they are not property of the estate. In other words, the Motion to Amend is unrelated to Debtor's claim that the Per Capita Payments are exempt, which was the argument addressed by the Memorandum. A motion to alter or amend is not a vehicle to raise new issues which were not previously presented for consideration in the first instance.³

*509 Nevertheless, the Court finds that judicial economy supports considering the merits of the Motion to Amend and

elects to do so. Undoubtedly, if the Court were to deny the Motion to Amend on procedural grounds, either Debtor or the Trustee would present the same issue in a different procedural context. Debtor and the Trustee have briefed the issue, and there is no just reason to require resubmission. In addition, the issue of an estate's interest in a debtor's interest in postpetition per capita distributions from Indian gaming revenues is likely to arise in other cases in this jurisdiction.

DEBTOR'S FUTURE RIGHT TO PER CAPITA DISTRIBUTIONS IS PROPERTY OF THE ESTATE.

The Court therefore addresses the issue, as framed by the Debtor, of "whether or not per capita payments not due to joint debtor Jeannie Marie Howley on the petition date are property of the estate per 11 U.S.C. § 541."⁴ This issue arises because, after the Memorandum was issued, the Trustee made demand for Per Capita Payments Debtor "has received or will receive after the petition date and which were not due and payable when the petition was filed."⁵

When answering the question of whether Debtor's interest in Per Capita Payments is property of the estate, the Court first examines the attributes of the Debtor's interest. What are Debtor's legal and equitable rights in the tribal distributions? This question is answered by examination of the federal law governing tribal gaming and the Potawatomi Per Capita Ordinance (hereafter "Ordinance") governing Per Capita Payments.⁶ The Indian Gaming Regulatory Act ("IGRA")⁷ authorizes tribes to negotiate and obtain gaming compacts with the states, which are authorized to permit and regulate casino style (Class III) gaming. The IGRA requires, in addition to a compact with the appropriate state, that the tribe adopt an ordinance regarding the disposition of gaming revenues. The ordinance must provide that the revenues from casino style gaming will be used for the following purposes: Tribal government operation; the general welfare of the tribe and its members; economic development; charitable donations; and operations of local government.⁸ The IGRA permits, but does not require, making per capita distributions to tribal members, if the tribe has prepared a plan to allocate revenues which plan is approved by federal authorities as adequate, the interests of minors and incompetents entitled to distributions are protected, and the payments are subject to federal income tax.⁹

The Potawatomi Indians have elected to allocate a portion of net gaming revenues to per capita payments and have adopted the Ordinance, which apparently was approved by federal

authorities. The Ordinance adopts an allocation plan under which net gaming revenues shall be distributed 30% to fund or supplement tribal government operations and programs; 30% for distributions to all eligible enrolled tribal members; 37% to fund tribal economic development; 1% for charitable purposes; and 2% for the general welfare of the tribe and its members. Although the *510 allocation of revenues devoted to per capita distributions and the other categories may be amended by the Tribal Council, if funds for other categories are insufficient, or by majority vote of the General Council even if such insufficiency has not occurred, there is no evidence in this case that the payment percentage has ever been amended. The Ordinance provides that “[e]very living person who is an enrolled member of the Prairie Band of Potawatomi Indians on the eligibility determination date is eligible to receive a Per Capita Payment.” Membership in the Prairie Band is defined in the tribal constitution as follows: All persons born prior to February 19, 1976 who qualified under previous membership standards; as to persons born after February 19, 1976, who possess at least 1/4 degree Indian blood who are descendants by blood of Prairie Band Potawatomi allottees of Prairie Bank Potawatomi Indian blood and whose applications were received prior to May 13, 2000; and all persons who possess at least one-fourth degree Prairie Band Potawatomi Indian blood.¹⁰ Every eligible Potawatomi tribal member receives an equal share of the funds distributed.¹¹

The foregoing describes a life-time right to distribution of gaming proceeds based upon membership status. Tribal membership status, once established based upon ancestry, is fixed and is not dependent upon future events. Although the amount of each distribution is obviously based upon the amount of net gaming revenues and the number of enrolled members on the allocation date, the right to share in each distribution is based upon status as an enrolled member, nothing else. There is no provision allowing the tribe to withhold distribution to any enrolled member. The readily apparent contingencies which could terminate Debtor's right of participation are death, the tribe's termination of Class III gaming, or the tribe's decision to revoke its election to use gaming revenues in part to fund per capita payments, none of which, in the Court's estimate, appear likely.

3 4 5 6 7 8 When defining property for purposes of § 541, courts are directed to analyze interests under state law, since “Congress has generally left the determination of property rights in assets of a bankrupt's estate to state law.”¹² Kansas law recognizes contingent interests as property.¹³

The Court has no doubt that the Kansas courts would recognize Debtor's interest in future Per Capita Payments as a property interest. The question is then whether that interest is property of the estate, as defined by federal law. Section 541(a) defines property of the estate as including all legal and equitable interests of the debtor in property as of the commencement of the case. “[T]he scope of § 541 is broad and should be generously construed.”¹⁴ “[A]n interest may be property of the estate even if it is ‘novel or contingent.’ ”¹⁵ “Every conceivable interest of the debtor, future, nonpossessory, contingent, speculative, *511 and derivative, is within the reach of 11 U.S.C. § 541.”¹⁶

9 10 11 The Court finds that the Debtor's interest in Per Capita Payments is similar to other property interests which have been recognized as being property of the estate. For example, a debtor's right to lottery proceeds to be paid postpetition as proceeds of an annuity owned by the state is property of the estate.¹⁷ Insurance renewal commissions received postpetition are property of the estate, if all of the actions required to earn the commissions were completed prepetition.¹⁸ A Chapter 7 debtor's Earned Income Tax Credits (EICs) for a tax year, as prorated to date of the petition filing, are estate property regardless of whether the petition was filed prior to end of the tax year, even though debtor's interest in EIC was not finalized until the end of the tax year.¹⁹

Several courts have ruled that per capita payments payable to debtors from Indian gaming revenues are property of the estate. Two of the decisions, *Hutchinson*²⁰ and *McDonald*,²¹ are from this district and, like this case, concern payments from the Prairie Band of the Potawatomi Tribe. In both cases, under facts undistinguishable from this case, Bankruptcy Judge Karlin held that the postpetition right of debtors, members of the Prairie Band of Potawatomi Indians, to receive payments was property of the estate. Judge Karlin relied upon the two reported cases, *Johnson*²² and *Kedrowski*²³ which found such distributions to be property of the estate. In *McDonald*, the court stated, debtors “did not deny that the property in question is property of the estate, and the Court finds that it clearly is.”²⁴ In *Hutchinson*, even though debtors did not “appear to contest” whether the per capita distributions, “including the right to receive them in the future, constitute property of the estate,” Judge Karlin held they were property of the estate.²⁵

In *Johnson*,²⁶ a bank had filed for stay relief seeking to continue collecting a loan secured by an interest in the Chapter 7 debtor-tribal member's monthly per capita distributions, and the Trustee moved that additional distributions be turned over to the Trustee as property of the estate. The bankruptcy court granted both requests, and the district court affirmed. On appeal of the second ruling, the debtor contended that the payments were not property of the estate because they "are not property at all."²⁷ The court found that the debtor's right to receive the distributions was a property right when the petition was filed. "Louisiana law recognizes intangible property, including an interest in the future income from a trust, a right to receive an *512 annuity, and a share of ownership or the right to receive payments from an entity such as the Tribe."²⁸ In addition the court noted that the debtor's right to receive the payments was freely transferable and debtors had not demonstrated that any exemption or exclusion under state or federal law prevented the payments from being considered as property of the estate.

*Kedrowski*²⁹ is a bankruptcy court decision from the Western District of Wisconsin holding the property of the estate included debtor's "right" to receive per capita distributions from the Ho-Chunk Nation. After an extensive examination of Indian gaming law and the Ho-Chunk Nation Code, the court rejected the debtor's contention that the per capita payments are not property because tribal members do not have an entitlement to gaming distributions, since the tribe is not obligated by federal law to make the distributions and various circumstances beyond the debtor's control, such as her death or a change in the tribe policy, could affect her ability to receive future distributions.³⁰ The court noted that it was undisputed that the debtor was an enrolled member of the tribe and if the tribe does make a distribution, debtor has a "right" to participate. The "right" was found similar to that of one who owns stock in a company or a limited partnership interest; if the company prospers and decides to make distributions the owner of the interest holds some sort of intangible property interest under Wisconsin law. Precedent from the HO-Chunk Nation's court evidenced that enrolled members were regarded as having a right to per capita distributions which raised them above the status of a license or a gift. The court concluded its analysis as follows:

In conclusion, the Court finds that the debtor's "right" to receive a per capita distribution from the gaming revenues of the Ho-Chunk Nation does constitute property of her bankruptcy estate. No provision of federal law, the gaming

compact between the tribe and the state of Wisconsin, or the tribe's per capita distribution ordinance suggests a contrary result. In fact, when taken together, these sources compel the result reached by the Court. Quite simply, the debtor holds an "absolute right" to receive net revenues from the operation of a tribal business. The mere possibility that the tribe might not choose to make a distribution may mean that the debtor's right does not have any intrinsic or marketable value, but it does not alter the fact that it is "representative" of value.³¹

Debtor relies primarily upon *Fess*,³² which, contrary to *Kedrowski* and *Johnson*, holds that per capita distributions are not property of the estate. Like *Kedrowski*, *Fess* concerns payments from the Ho-Chunk Nation. Unlike *Kedrowski*, *Fess* finds the Ho-Chunk Nation Code requires that the payments be excluded from the estate. The code provisions relied upon were the following:

Per Capita Distributions shall be made, when and as determined or declared in *513 accordance with Per Capita Distribution Ordinance and any and all other applicable laws of the Nation, out of assets and earnings of the Nation, and such assets and earnings shall retain their character as property of the Nation until Payment of Per Capita Shares is actually made therefrom.

No Tribal Member, nor any person claiming any right derived from a Tribal Member, including creditors of a Tribal Member, shall be entitled to compel the making of any Per Capita Distribution prior to the time of Payment thereof, and making each Per Capita Distribution, and the amount and timing thereof, shall at all times prior to Payment be subject to elimination or modification pursuant to any amendment to the then effective Per Capita Distribution Ordinance adopted in accordance with the Constitution and laws of the Nation.

No Tribal Member, nor any person claiming any right derived from a Tribal Member, including creditors of a Tribal Member, shall have any right, title, interest or entitlements in any Per Capita Share unless and until Payment of Per Capita Distribution to which it relates occurs.³³

The *Fess* court held that federal law and tribal law, not state law, applied to define property interests, and under that law debtors merely had "an expectancy to which no legal rights attach."³⁴

The Court declines to follow *Fess*. The difference in the outcomes of *Kedrowski* and *Fess* clearly rests upon differing interpretations of the Ho-Chunk Nation Code. While *Kedrowski* rejected the debtor's argument that per capita payments were not property because under the tribal law members had no right or entitlement to gaming distributions, the *Fess* court found this position determinative.

Since the Potawatomi Tribal Ordinance does not have provisions similar to those of the Ho-Chunk Nation Code which controlled the outcome in *Fess*, this Court is not faced with the same issues of construction. The Ordinance has no provision stating that the funds to be used for payments retain their character as property of the tribe until actually disbursed, there is no provision limiting rights to compel payments, and there is no provision stating that a tribal member has no right, title, or interest until disbursements are made. Rather, the Ordinance provides that "[a]ny dispute regarding this ordinance, implementation thereof, or action taken thereunder shall be first presented to the Tribal Council whose decision may then be appealed to the Potawatomi Tribal Court, whose decision shall be final." Payments are made within 30 days after the Per Capita Payment date by tribal check, except in the case of incompetents or minors. The Ordinance sets 30% as to percentage of net gaming revenues to be used for per capita distributions. Although the percentage of revenues

devoted to per capita distributions may be amended by the Tribal Council, if funds for other categories are insufficient, or by majority vote of the General Council, there is no evidence in this case that the payment percentage has ever been amended. The Ordinance states, "Every living person who is an enrolled member of the Prairie Band of Potawatomi Indians on the eligibility determination date is eligible to receive a Per Capita Payment." Entitlement to distribution is based upon status as an enrolled member, nothing else.

*514 The Court therefore concludes that on the date of filing, Debtor's estate included her contingent right to receive future Per Capita Payments. Inclusion of the property right in the estate, of course, does not determine its value. The Chapter 7 Trustee is entitled to the value of the future payments as of the petition date, which, because of the contingencies involved, may not be equal to the present value of all anticipated future payments. Valuation is a matter left for future determination.

CONCLUSION.

Debtor's Motion to Amend is denied. As of the petition date, Debtor's interest in future Per Capita Payments from the gaming revenues of the Potawatomi Nation was property of the estate.

IT IS SO ORDERED.

Footnotes

- 1 Doc. 41.
- 2 The Memorandum is published at 439 B.R. 535.
- 3 See *Comeau v. Rupp*, 810 F.Supp. 1172, 1175 (D.Kan.1992).
- 4 Doc. 47, p. 2.
- 5 Doc. 41, p. 2.
- 6 Doc. 28-2.
- 7 25 U.S.C. § 2701 et seq.
- 8 25 U.S.C. § 2710(b)(2), made applicable to class III gaming by 25 U.S.C. § 2710(d)(2)(A).
- 9 25 U.S.C. § 2710(b)(3)(A), made applicable to class III gaming by 25 U.S.C. § 2710(d)(2)(A).
- 10 Constitution of the Prairie Band Potawatomi Nation, Art. III, available at www.pbpindiantribe.com/our-constitution.aspx.
- 11 Ordinance, Article V.
- 12 *Butner v. U.S.*, 440 U.S. 48, 55, 99 S.Ct. 914, 59 L.Ed.2d 136 (1979).
- 13 See *Parks v. Dittmar* (*In re Dittmar*), 618 F.3d 1199, 1205 (10th Cir.2010); *In re Allen Bros. Truck Lines, Inc.*, 329 F.2d 735, 737 (10th Cir.1964).
- 14 *Dittmar*, 618 F.3d at 1207.
- 15 *Williamson v. Jones* (*In re Montgomery*), 224 F.3d 1193, 1194 (10th Cir.2000), quoting *Barowsky v. Serelson*, 946 F.2d 1516, 1518-19 (10th Cir.1991) (emphasis added).
- 16 *Dittmar*, 618 F.3d at 1207, quoting *In re Yonikus*, 996 F.2d 866, 869 (7th Cir.1993).
- 17 *In re Neto*, 215 B.R. 939 (Bankr.D.N.J.1997).
- 18 *In re Wicheff*, 215 B.R. 839 (6th Cir.BAP 1998).
- 19 *Montgomery*, 224 F.3d at 1193.

- 20 *In re Hutchinson*, 354 B.R. 523 (Bankr.D.Kan.2006).
21 *In re McDonald*, 353 B.R. 287 (Bankr.D.Kan.2006).
22 *Johnson v. Cottonport Bank*, 259 B.R. 125 (Bankr.W.D.La.2000).
23 *In re Kedrowski*, 284 B.R. 439 (Bankr.W.D.Wis.2002).
24 *McDonald*, 353 B.R. at 291.
25 *Hutchinson*, 354 B.R. at 527–28.
26 *Johnson*, 259 B.R. at 125.
27 *Id.* at 130.
28 *Id.*
29 *Kedrowski*, 284 B.R. at 439.
30 The *Kedrowski* court also considered the specific provisions of the Ho–Chunk Nation Code in conjunction with its rejection of the debtor's position that if the right to payment was property of the estate, it was excluded from the estate by § 541(c)(2). *Id.*, 284 B.R. at 449–451.
31 *Id.* at 451–52.
32 *In re Fess*, 408 B.R. 793 (Bankr.W.D.Wis.2009).
33 *Id.* at 797, quoting Ho–Chunk Nation Code § 8, 4.
34 *Id.* at 799.

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293 B.R. 34

United States Bankruptcy Court,
D. Arizona.

In re Darrell Duane RUSSELL, Debtor.

Darrell Duane Russell, Plaintiff,

v.

Fort McDowell Yavapai Nation, Defendant.

Bankruptcy No. 02-06628-PHX-RJH. |

Adversary No. 02-01215. | May 15, 2003.

Chapter 7 debtor, a member of an Indian tribe who had obtained a business loan from the tribe, filed adversary complaint against tribe, seeking to preclude it from collecting his debt by withholding his monthly "per capita distributions" from gaming revenues. Tribe moved to dismiss on the basis of tribal sovereign immunity. The Bankruptcy Court, Randolph J. Haines, J., held that Indian tribes are "domestic governments" as to which sovereign immunity is abrogated under the Bankruptcy Code.

Motion to dismiss denied.

West Headnotes (11)

1 Bankruptcy

⇔ Governmental Claims; Immunity Waiver

Indian tribe did not waive its tribal sovereign immunity from suit brought by Chapter 7 debtor-tribal member; although tribe appeared at first meeting of creditors, tribe merely appeared to state that it intended to continue collecting debtor's debt to it by setoffs against his monthly per capita distributions from gaming revenues, tribe did not seek or obtain any affirmative relief or other benefit from that appearance, and tribe's appearance in debtor's subsequent adversary proceeding against it was limited to a special appearance to contest jurisdiction.

2 Indians

⇔ Sovereign Immunity

Indian tribes enjoy sovereign immunity from private suit absent waiver or abrogation by Congress.

1 Cases that cite this headnote

3 Indians

⇔ Sovereign Immunity

Any congressional abrogation of tribal sovereign immunity cannot be implied, but must be unequivocally expressed.

3 Cases that cite this headnote

4 Federal Courts

⇔ Eleventh Amendment in General; Immunity

Indians

⇔ Sovereign Immunity

Rule that abrogation of sovereign immunity must be unequivocal and not by implication applies generally to sovereign immunity, not just to tribal sovereign immunity.

1 Cases that cite this headnote

5 Bankruptcy

⇔ Construction and Operation

Bankruptcy Code is to be interpreted according to its "plain meaning."

6 Indians

⇔ Status of Indian Nations or Tribes

Indian tribes are domestic dependent nations that exercise inherent sovereign authority over their members and territories.

7 Indians

⇔ Government of Indian Country, Reservations, and Tribes in General

Indian tribes are distinct, independent political communities, retaining their original natural rights in matters of local self-government.

8 Indians

⇔ Status of Indian Nations or Tribes

Indian tribes are separate sovereigns pre-existing the Constitution.

9 Bankruptcy

↔ Governmental Claims; Immunity Waiver

Indian tribes are "domestic governments" as to which tribal sovereign immunity is abrogated under the Bankruptcy Code. Bankr.Code, 11 U.S.C.A. §§ 101(27), 106(a).

3 Cases that cite this headnote

10 Bankruptcy

↔ Effect as to Securities and Liens

Chapter 7 discharge does not invalidate a lien.

11 Bankruptcy

↔ Effect of Discharge

Bankruptcy

↔ Effect as to Securities and Liens

In cases where a creditor holds a secured interest in property subject to a scheduled debt, a discharge extinguishes only the personal liability of the debtor, so the lien rides through unaffected.

Attorneys and Law Firms

*35 Ronald Rosier, Fountain Hills, AZ, for Fort McDowell Yavapai Nation.

Gary L. Thomas, Phoenix, AZ, for Darrell Duane Russell.

Opinion

**OPINION DENYING NATION'S
MOTION TO DISMISS**

RANDOLPH J. HAINES, Bankruptcy Judge.

Debtor Darrell Russell received his chapter 7 discharge and then filed an adversary proceeding against Defendant Fort McDowell Yavapai Nation (the "Nation") to enforce the discharge. His complaint seeks to preclude the Nation from collecting his debt to the Nation by withholding his monthly entitlement to gaming revenues. The Nation moved to dismiss on the ground of tribal sovereign immunity, and that motion has been briefed, argued and taken under advisement. For the

reasons set forth below, the Court denies the Nation's motion to dismiss.

Facts

Russell is a tribal member of the Nation. In 1998, he obtained a \$200,000 business loan from the Nation's Commercial Development Fund to finance his own collection business, which his application described as the "purchase of chattel paper." He committed to repayment of the loan by 60 equal monthly payments of \$3,960 each from 1999 through 2004. The loan application, signed by Russell, stated that as "additional security for the loan, [Russell] shall assign any Per-Capita payments due to [Russell] at that time that the loan is officially in default, on a pro-rata basis, for such time as is necessary to repay the loan." The promissory note also referenced this provision as security for the note.

Russell's business apparently failed. He filed chapter 7 in May 2002 and obtained his discharge in September, 2002. He listed the business loan from the Nation as an unsecured [sic] debt in his Schedule F and included the Nation as a creditor on the master mailing list. The Nation in fact received notice of the bankruptcy filing and attended the first meeting of creditors, but did not file a proof of claim, object to the debtor's discharge, or object to the scheduling of its debt as unsecured. The Nation also received notice of the Debtor's discharge.

As a tribal member, Russell is entitled to a per capita distribution from the Nation's gaming revenues, which is currently approximately \$2100 per month.¹ Each *36 month, before and after the discharge, the Nation has been deducting from these per capita payments approximately \$1200 per month on account of the business loan.² Russell's adversary complaint seeks to have these deductions terminated on account of the discharge.³

The Issue

The Nation seeks dismissal of the adversary complaint on the ground the court lacks jurisdiction due to tribal sovereign immunity. The Debtor responds the sovereign immunity of "governmental units" is abrogated by 11 U.S.C. § 106(a) as to various sections of the Bankruptcy Code, including § 524(a)(2),⁴ which provides that the discharge "operates as an injunction against" "an act, to collect, recover or offset any such [discharged] debt as a personal liability of the debtor." The Nation replies that it, and Indian tribes generally, are not specifically identified as among the governmental units

to which that abrogation applies, because the definition of "governmental unit" in Bankruptcy Code § 101(27) does not mention Indian tribes:

"[G]overnmental unit" means United States; State; Commonwealth; District; Territory; municipality; foreign state; department, agency, or instrumentality of the United States (but not a United States Trustee while serving as a trustee in a case under this title), a State, a Commonwealth, a District, a Territory, a municipality, or a foreign state; or other foreign or domestic government.

The Nation supports this argument by adding that any Congressional abrogation of tribal immunity "cannot be implied but must be unequivocally expressed." *Santa Clara Pueblo v. Martinez*, 436 U.S. 49, 58–59, 98 S.Ct. 1670, 56 L.Ed.2d 106 (1978) (citations omitted).

1 Thus the issue is whether "domestic government" is an unequivocal expression that includes Indian tribes, or merely implies that.⁵

*37 Analysis

2 It is beyond debate that tribes enjoy sovereign immunity from private suit absent waiver or abrogation by Congress. That doctrine was announced in 1940,⁶ withstood challenge in 1991,⁷ and was recently reaffirmed and applied even off the reservation.⁸ It is also beyond debate that Congress can abrogate tribal sovereign immunity. *Martinez*, 436 U.S. at 58, 98 S.Ct. 1670 ("This aspect of tribal sovereignty, like all others, is subject to the superior and plenary control of Congress."); *Kiowa Tribe*, 523 U.S. at 759, 118 S.Ct. 1700 ("Congress 'has occasionally authorized limited classes of suits against Indian tribes' and 'has always been at liberty to dispense with such tribal immunity or to limit it'"), quoting *Potawatomi*, 498 U.S. at 510, 111 S.Ct. 905.

3 4 Any Congressional abrogation, however, "cannot be implied but must be unequivocally expressed." *Martinez*, 436 U.S. at 58–59, 98 S.Ct. 1670. Case law provides examples of purported waivers that have been found to be either by implication only or by equivocal expression.⁹

Martinez is an example of an attempt to imply an abrogation of sovereign immunity. It dealt with the Indian Civil Rights Act of 1968. The plaintiff sued the Santa Clara Pueblo for violation of its equal protection clause by denying tribal membership to children of female members who marry outside the tribe, but not to children of male members who do so. Because nothing in the Indian Civil Rights Act

"purports to subject tribes to the jurisdiction of the federal courts in civil actions for injunctive or declaratory relief," the Court concluded that Congress had not abrogated tribes' sovereign immunity from such suits. 436 U.S. at 59, 98 S.Ct. 1670. It was not that a purported abrogation was equivocal, as there was not even an arguably equivocal attempt at abrogation. Rather, the argument for abrogation was solely based on implication, that Congress would not have imposed legal obligations on tribes to recognize their members' civil rights without also authorizing private suits to enforce those rights. In fact, the plaintiff's argument really rested on two inferences, because the Court also found that the Act implied no private right of action at all, not even against a tribal officer who was "not protected by the tribe's immunity from suit." *Id.* at 59, 98 S.Ct. 1670.¹⁰

*38 The best example of an "equivocal" abrogation of immunity is *United States v. Nordic Village, Inc.*, 503 U.S. 30, 112 S.Ct. 1011, 117 L.Ed.2d 181 (1992). In that case Justice Scalia explained why Bankruptcy Code § 106(c), the direct ancestor of the current § 106(a) prior to its amendment in 1994, failed to satisfy the "unequivocal expression" requirement—because "It is susceptible of at least two interpretations that do *not* authorize monetary relief." *Id.* at 34, 112 S.Ct. 1011 (emphasis in original). So according to the "plain meaning" of "unequivocal," to be equivocal the statute purporting to abrogate sovereign immunity must be susceptible of an alternative interpretation that does not do so.

5 6 7 8 9 Here there is no purported abrogation of the first type, by implication. The Bankruptcy Code does not merely define the right—the right to a discharge like the right to equal protection in the Indian Civil Rights Act—but also the available remedies to enforce and protect that right, here § 524's express injunctive relief. So the availability of private judicial relief is not implied, but express. The next step is to determine whether the ability to assert it against a sovereign is also express or only implied. That is answered by the current § 106(a), which expressly abrogates sovereign immunity as to any governmental unit, with respect to the private judicial remedies that the Code provides.

"Governmental unit" is expressly defined to include the United States, a State, a foreign state, or "other foreign or domestic government." § 101(27). The Nation argues that because "there is no mention of Indian tribes" in that definition or elsewhere in the Code, it would only be by implication that they could be included, and sovereign immunity cannot be abrogated by implication.

Resolution of the Nation's argument hinges on the meaning of "implied" in the Supreme Court's admonition that abrogation of tribal immunity cannot be implied. As noted by the premier lexicographer of modern legal usage, there are three possible meanings of "imply,"¹¹ but only the third, incorrect usage gives us any pause.

The first possible meaning is "to impute or impose on equitable or legal grounds."¹² This usage is unique to legal writing, and very common in legal writing, and is therefore is the most likely usage the Court intended. This is the usage when courts imply a contract, a trust, or a promise that was never actually made or even suggested. Perhaps the usage closest to the present context is when courts imply a private right of action in a statute. When they do so, they are not using the term in its ordinary English usage, because the *39 court's holding is express rather than implied, and usually the court is not suggesting that the Congress or legislature consciously intended there to be a private right of action but only indicated it by implication. Instead, the court is imposing it because it is equitable to do so, just as a promise or a contract may be implied when a party acts to its detriment in reliance on another's statement or conduct. That is a particularly apt meaning in this context, because it means the Court is saying that abrogation of sovereign immunity cannot be implied in the same way a right of action might be implied even when the statutory language is silent on the subject. Under that meaning, however, there can be no argument that application of § 106(a) to tribes would be to imply an abrogation of sovereign immunity, because the language of § 106 is quite express. To apply § 106 to tribes would not be "to impute or impose" a legal right or obligation on which the statute is silent but is merely to apply the express words of the statute.

The second possible meaning is "to read into (a document)."¹³ This means to infer a meaning that the author probably intended but is not found in the express words of the document.¹⁴ Perhaps, for example, the authors of the Constitution implied a right of privacy even though no words make that intention express. Again, however, it is clear that under this meaning the abrogation of sovereign immunity was not merely implied by Congress, because it is express in § 106. Concluding that §§ 101(27) and 106(a) include Indian tribes is not to conclude the authors implied something without making it express, but merely to apply what is expressly said. So under this meaning as well there is

no violation of the Court's proscription against abrogation by implication in concluding that § 106 includes Indian tribes.

The third meaning, according to Mr. Garner, is simply erroneous, and that is "to infer."¹⁵ Simply because it is erroneous may be sufficient reason to reject it, because the Supreme Court has made clear that the Bankruptcy Code is to be interpreted according to its "plain meaning,"¹⁶ which would obviously preclude a conclusion that the words of the statute were used erroneously. Presumably the Court's rules for interpreting the Code are similarly to be interpreted according to the "plain meaning" of the words used by the Court. It is erroneous to use "imply" *40 when "infer" is meant, so there is no reason to read *Martinez* as saying anything other than abrogation may not be implied, according to one of the two correct usages of that term already discussed, but not to prohibit a deduction from express statutory language.

But even if "implied" were meant to mean "inferred," a further analysis shows that the process of determining whether tribes are included within § 106's abrogation is not by inference, but by an altogether different process, deduction.

The Court has repeatedly held, as the Nation admits, that Indian tribes are domestic governments. "Indian tribes are 'domestic dependent nations' that exercise inherent sovereign authority over their members and territories." *Potawatomi*, 498 U.S. at 509, 111 S.Ct. 905, quoting *Cherokee Nation v. Georgia*, 30 U.S. (5 Pet.) 1, 17, 8 L.Ed. 25 (1831). "Indian tribes are 'distinct, independent political communities, retaining their original natural rights' in matters of local self-government." *Martinez*, 436 U.S. at 55, 98 S.Ct. 1670, quoting *Worcester v. Georgia*, 31 U.S. (6 Pet.) 515, 559, 8 L.Ed. 483 (1832). They are "separate sovereigns pre-existing the Constitution." *Martinez*, 436 U.S. at 56, 98 S.Ct. 1670. Indeed, if they were not sovereign governments they would not enjoy sovereign immunity at all.

So the abrogation of tribal sovereign immunity by §§ 101(27) and 106(a) can be stated as a simple syllogism: Sovereign immunity is abrogated as to all domestic governments. Indian tribes are domestic governments. Hence sovereign immunity is abrogated as to Indian tribes.

The syllogism, of the classic form—All men are mortal; Socrates is a man; hence Socrates is mortal—is one of the two forms of reasoning. The other is induction, drawing implications or inferences from examples. According to

Aristotle, these are the *only* two methods of reasoning, or persuasion by proof:

With regard to the persuasion achieved by proof or apparent proof: just as in dialectic [logic] there is induction on the one hand and syllogism or apparent syllogism on the other, so it is in rhetoric. The example is an induction, the enthymeme is a syllogism, and the apparent enthymeme is an apparent syllogism.... Every one who effects persuasion through proof does in fact use either enthymemes or examples: there is no other way.... When we base the proof of a proposition on a number of similar cases, this is induction in dialectic, example in rhetoric; when it is shown that, certain propositions being true, a further and quite distinct proposition must also be true in consequence, whether invariably or usually, this is called syllogism in dialectic, enthymeme in rhetoric.¹⁷

Implication and inference are the rhetorical versions of induction, drawing conclusions from examples. For example, if the last phrase were eliminated from § 106(a), one might draw the inference that because sovereign immunity is expressly abrogated as to the United States, the States, the Commonwealths, the Districts, and foreign governments, Congress must have intended to abrogate it as to all governments. That would be reasoning by implication or inference. While that might be equally as sound, and in fact how all new knowledge is achieved, it nevertheless *41 retains the possibility for error.¹⁸ The Court may well have intended to proscribe this method of concluding that there has been an abrogation of sovereign immunity, but the Court has not similarly proscribed that conclusion when reached by deduction.

But because the statute expressly abrogates sovereign immunity as to all domestic governments, the statute applies to Indian tribes by deduction rather than by implication, so the conclusion is not proscribed by the Court's limitations. In other words, the proscription against abrogation by implication does not require the listing or naming of each government as to which it applies so long as they are unequivocally identified by the statute. Indeed, if the Nation's argument here were to be adopted, then Arizona could similarly argue that § 106(a) does not apply to it because it is not mentioned. But § 106(a) does apply to Arizona by the exactly the same logical process that it applies to the Fort McDowell Yavapai Nation: Sovereign immunity is abrogated as to States, Arizona is a state, therefore sovereign immunity is abrogated as to Arizona.

That leaves the other possibility, that the abrogation is equivocal, susceptible of more than one meaning, in its application to Indian tribes. But the Nation has not suggested, either in its memoranda or at oral argument, any possible other meaning of "domestic government" that would not include Indian tribes. Indeed, since the meaning of "or other foreign or domestic government" cannot include the United States, or a State, Commonwealth, Territory or District, or a municipality, or a foreign state, or an agency, department or instrumentality of any of them, because they are all expressly mentioned, it is difficult if not impossible to come up with any possible meaning for "other domestic government" *except* Indian tribes. Without another reasonable plausible alternative meaning, the abrogation of sovereign immunity as to all domestic governments is not equivocal. It could hardly be more absolute.¹⁹

It remains to test this analysis by the case law.

The Ninth Circuit has "assume[d], without deciding, that Indian tribes are 'governmental units' for the purposes of § 106." *Richardson v. Mt. Adams Furniture (In re Greene)*, 980 F.2d 590, 597 (9th Cir.1992). That case ultimately concluded, on the basis of *Nordic Village*, that the pre-1994 version of § 106 did not abrogate sovereign immunity against a money judgment. That conclusion is moot after the 1994 amendment to § 106, which made express that the abrogation of sovereign immunity included "an order or judgment awarding a money recovery." § 106(a)(3). *Mitchell v. Franchise Tax Board (In re *42 Mitchell)*, 209 F.3d 1111, 1118 (9th Cir.2000) ("Congress has clearly expressed its intent to abrogate state sovereign immunity in § 106(a)"); *Elias v. United States (In re Elias)*, 218 B.R. 80, 83 (9th Cir. BAP 1998) ("It is clear from the text that § 106(a) 'manifests the requisite intent to abrogate.'"), *aff'd*, 216 F.3d 1082 (9th Cir.2000).

At least three bankruptcy court opinions have concluded, arguably in dictum, that § 106 does abrogate sovereign immunity as to Indian tribes as "domestic governments." *Warfield v. The Navajo Nation (In re Davis Chevrolet, Inc.)*, 282 B.R. 674, 683 (Bankr.D.Ariz.2002); *Turning Stone Casino v. Vianese (In re Vianese)*, 195 B.R. 572, 576 (Bankr.N.D.N.Y.1995); *In re Sandmar Corp.*, 12 B.R. 910 (Bankr.D.N.M.1981).²⁰ The Nation does not address *Warfield*, but argues that the conclusion in *Vianese* was dictum because the tribe there had filed a proof of claim and therefore waived its immunity by virtue of § 106(b), so the analysis of waiver pursuant to § 106(a) was unnecessary to the

result. While it is true that both *Warfield* and *Vianese* rested on § 106(b) rather than on § 106(a) as we must here, it is also the case that waiver pursuant to § 106(b) expressly applies only to governmental units. So the courts' findings of waiver pursuant to that section necessarily hinged on a conclusion that the tribe qualified as a "governmental unit" as defined and used throughout § 106. In fact, *Warfield* made this conclusion explicit, in similarly concluding that tribes are included in § 106 as "other domestic government." 282 B.R. at 683 n. 5.

There are at least two cases to the contrary. An Iowa bankruptcy court concluded that § 106 would apply to Indian tribes only by inference, and therefore run afoul of the Supreme Court's proscription of abrogation by implication:

The Code makes no specific mention of Indian tribes. Unlike States and foreign governments, Indian tribes are not specifically included in the § 101(27) definition of "governmental unit." In order to conclude Congress intended to subject Indian tribes to suit under the Code, the Court would need to infer such intent from language which does not unequivocally and unambiguously apply to Indian tribes. Considering the Supreme Court's pronouncements on tribal sovereign immunity, such an inference is inappropriate.

In re Nat'l Cattle Cong., 247 B.R. 259, 267 (Bankr.N.D.Iowa 2000).

That analysis, however, did not consider the language "or other foreign or domestic government," nor whether Indian tribes would be included in the scope of the statute by deduction from those terms rather than by inference from the prior examples. Because *National Cattle Congress* did not consider the analysis made here, it does not demonstrate any weakness in the present analysis.

A Washington district court employed similar reasoning in concluding that § 106 does not abrogate tribal sovereign immunity:

The Court finds that the Bankruptcy Code does not meet the *Martinez* standard. There is no express mention of Indian tribes anywhere in the Bankruptcy Code, and the Court could only infer that an Indian tribe is a "domestic government" under the definition of governmental unit. For these reasons, the Court concludes that Congress has not *43 unequivocally expressed clear legislative intent to abrogate tribal sovereign immunity pursuant to the Bankruptcy Code.

Confederated Tribe of Colville Reservation Tribal Credit v. White (In re White), 1996 WL 33407856, at *3 (E.D.Wash.1996), *aff'd on other grounds*, 139 F.3d 1268 (9th Cir.1998).

Again, the court failed to note the distinction between implication and deduction, and that the Supreme Court has only proscribed the former as a method of deriving an abrogation of sovereign immunity, not the latter. It similarly failed to demonstrate what is even potentially equivocal about "domestic government," in that it failed to suggest an alternative meaning that would not include Indian tribes. Again, therefore, nothing in this opinion suggests any weakness in the present analysis. On appeal, the Ninth Circuit affirmed on grounds of waiver and "express[ed] no view on whether an Indian Tribe is a 'governmental unit' for purposes of § 106(a) or (b)." 139 F.3d at 1270 n. 1.

Finally, the Nation also argues that because other statutes that abrogate tribal sovereign immunity do so by express mention of Indian tribes, Congress would have similarly made an express mention of Indian tribes in § 106 if it had intended to abrogate their immunity. The Nation notes, for example, that the Eighth Circuit found that Congress abrogated tribal sovereign immunity as to suits under the Resource Conservation and Recovery Act of 1976 (RCRA) because it permitted suits against "any person," and defined "person" to include municipalities, and defined "municipalities" to "include 'an Indian tribe or authorized tribal organization.'" *Blue Legs v. United States Bureau of Indian Affairs*, 867 F.2d 1094, 1097 (8th Cir.1989); *accord*, *Washington, Dep't of Ecology v. United States Envtl. Prot. Agency*, 752 F.2d 1465, 1469 (9th Cir.1985). Similarly, the Eighth and Ninth Circuits found an abrogation of tribal sovereign immunity in the Hazardous Materials Transportation Uniform Safety Act of 1990, because it also expressly mentioned "Indian tribe." *Public Service Co. of Colo. v. Shoshone-Bannock Tribes*, 30 F.3d 1203 (9th Cir.1994); *Northern States Power Co. v. The Prairie Island Mdewakanton Sioux Indian Cmty.*, 991 F.2d 458 (8th Cir.1993). And the Tenth Circuit found an abrogation of tribal sovereign immunity in the Safe Drinking Water Act, because it authorized actions against "persons," which were defined to include "municipalities," which were defined to include "an Indian tribe." *Osage Tribal Council v. United States Dep't of Labor*, 187 F.3d 1174 (10th Cir.1999).

But that is a rather weak inductive argument, that because Congress abrogated tribal sovereign immunity three times by mentioning Indian tribes, that must be the only way that Congress drafts such legislation. And however powerful the

induction might become through a multitude of examples, it fails to demonstrate any fallacy in the deduction made above, or any equivocation in the term "domestic government" as it is found in § 106.

The Eleventh Circuit recently adopted an argument similar to the Nation's in concluding that the Americans With Disabilities Act did not abrogate sovereign immunity as to tribes:

These two statutes—the (now repealed) HMTUSA and the RCRA—are not before us.... We note, however, that the wording of these laws at least implies that Congress comprehends the need to address Indian tribes specifically and individually when it describes the means of enforcing statutorily created rights through judicial action. When we compare Title III of the ADA to the HMTUSA and the RCRA, the absence of any *44 reference to Indian tribes in the former statute stands out as a stark omission of any attempt by Congress to declare tribes subject to private suit for violating the ADA's public accommodation requirements.

The Fla. Paralegic Ass'n, Inc., v. Miccosukee Tribe of Indians of Fla., 166 F.3d 1126, 1132 (11th Cir.1999)(emphasis in original).

The conclusion of *Florida Paralegic* is not applicable here, however, because the ADA does not contain a provision similar to §§ 101(27) and 106 that abrogates sovereign immunity as to all "domestic governments." To the contrary, the ADA expressly only abrogates state sovereign immunity under the Eleventh Amendment, not the common law sovereign immunity of other governmental entities. The Eleventh Circuit also relied on this glaring omission to conclude that the ADA did not abrogate tribal sovereign immunity:

One other provision of the ADA provides further support for our conclusion that Congress did not intend to abrogate sovereign immunity with respect to Indian tribes. Section 12202 states:

A State shall not be immune under the eleventh amendment ... from an action in Federal or State court of competent jurisdiction for a violation of [any portion of the ADA]....

42 U.S.C. § 12202. This provision demonstrates Congress's full understanding of the need to express unambiguously its intent to abrogate sovereign immunity where it wishes its legislation to have that effect....

That it chose not to similarly include an abolition of the immunity of Indian tribes is a telling indication that Congress did not intend to subject tribes to suit under the ADA.

Id. at 1133.

The Eleventh Circuit's latter conclusion appears to be sound. Not only does the ADA fail to contain any words that, by deduction, could be construed to abrogate tribal sovereign immunity, but the doctrine of *expressio unis* would even preclude an inference of that intent, given the express abrogation as to States and the Eleventh Amendment only. Consequently there is no need to resort to its initial conclusion that Congress must "address Indian tribes specifically and individually" in order to abrogate their immunity, which in any event seems to be a significant expansion on the Supreme Court's requirements.

Conclusion

The term "other foreign or domestic government" in § 101(27) unequivocally, and without implication, includes Indian tribes as "governmental units." Section 106(a) unequivocally, and without implication, abrogates sovereign immunity as to governmental units, including Indian tribes, with respect to application of the enumerated sections of the Bankruptcy Code, including § 524's injunctive effect of the discharge. Consequently the Nation's motion to dismiss on grounds of sovereign immunity must be denied.

10 11 This does not, however, mean that Debtor will prevail. As has already been noted, some courts have held that tribal members' rights to receive per capita gaming revenues are property of the estate, rather than earnings from individual services that are excluded from the estate by virtue of § 541(a)(6).²¹ If the postpetition monthly payments are the *45 proceeds of such property interest, in which the Debtor had granted a security interest prepetition, then the Nation's security interest would not be cut off by virtue of § 552(b)(1). *Johnson v. Cottonport Bank*, 259 B.R. 125, 130 (W.D.La.2000). And if the Nation's lien therefore survived the petition, it also survived the discharge, because a chapter 7 discharge does not invalidate a lien. "[I]n cases where the creditor holds a secured interest in property subject to a scheduled debt, a discharge extinguishes only the personal liability of the debtor," so the lien rides through unaffected. *Garske v. Arcadia Fin., Ltd. (In re Garske)*, 287 B.R. 537, 542 (9th Cir. BAP 2002), quoting *Johnson v. Home State Bank*, 501 U.S. 78, 80, 111 S.Ct. 2150, 115 L.Ed.2d 66

(1991)(“Notwithstanding the discharge, the secured creditor’s right to proceed against [the debtor] in rem survived the Chapter 7 liquidation.”). Moreover, since the Nation is owed on the loan and owes Debtor the per capita payments, both on account of prepetition transactions, it may have additional protections under § 553 that also survive the discharge.

Unfortunately although the Nation made these arguments and cited some of these authorities for them, it did so only in its

reply, so Debtor did not have an opportunity to respond to them, and they were not the basis of a Rule 12(b)(6) motion to dismiss. Consequently these issues must await another day and another motion.

Parallel Citations

41 Bankr.Ct.Dec. 88

Footnotes

- 1 The Nation notes now, but apparently did not object at the time, that the Debtor did not list his per capita income from the Nation either as an asset or as income, in his Schedules B and I and Statement of Financial Affairs, even though some bankruptcy courts have held such income to be property of the estate. *In re Kedrowski*, 284 B.R. 439, 451–52 (Bankr.W.D.Wis.2002)(debtor’s per capita distributions from gaming revenues constitute property of the estate); *Johnson v. Cottonport Bank*, 259 B.R. 125 (W.D.La.2000)(same).
- 2 The Nation also deducts federal taxes of approximately \$480 per month, and payments for a house loan of approximately \$400 per month, with the result that the Debtor nets zero pay each month. Russell claims his per capita distributions are his primary source of income, but does not explain how he survives on this income that has netted him nothing for at least the past several months. He also does not explain why he seeks to preclude the Nation from collecting on the business loan by deducting payments from his per capita distribution, but does not similarly object to the deductions for his home loan. Presumably the answer is that the home loan is also secured by the home, which he would lose if the payments were not made via these deductions, but the business loan is not similarly secured, or is no longer secured, by any other collateral.
- 3 The Complaint asserts that despite the Debtor’s discharge, the Nation withholds the Debtor’s per capita payments in violation of the automatic stay of 11 U.S.C. § 362(a). But the trustee reported the estate was fully administered and the case was closed in January, 2003, so the automatic stay as to an act against property of the estate then terminated pursuant to § 362(c). The complaint prays that the Court order the Nation “to cancel the assignment and to cease taking money from the Debtor’s Per Capita payments and to refund all money wrongfully taken by the [Nation] since June, 2002.” The court will therefore treat it as a complaint asserting a violation of the discharge injunction under § 524.
- 4 Except as otherwise noted, all statutory references are to the Bankruptcy Code, 11 U.S.C. §§ 101–1330.
- 5 The Debtor also may be arguing that the Nation waived its immunity by appearing at the § 341 first meeting of creditors. However a transcript of that appearance makes clear that the Nation merely appeared to state that it intended to continue collecting the Debtor’s debt to the Nation by setoffs against his per capita distributions. Because the Nation did not seek or obtain any affirmative relief or other benefit from that appearance, and its appearance in this adversary proceeding has been limited to a special appearance to contest jurisdiction, there is no basis to suggest the Nation has waived its immunity. *Cf. Arizona v. Blumeister (In re Blumeister)*, 296 F.3d 858 (9th Cir.2002).
- 6 *United States v. U.S. Fid. & Guar. Co.*, 309 U.S. 506, 512, 60 S.Ct. 653, 84 L.Ed. 894 (1940)(“These Indian tribes are exempt from suit without Congressional authorization.”).
- 7 *Oklahoma Tax Comm’n v. Citizen Band of Potawatomi Indian Tribe of Okla.*, 498 U.S. 505, 111 S.Ct. 905, 112 L.Ed.2d 1112 (1991).
- 8 *Kiowa Tribe of Okla. v. Mfr. Techs., Inc.*, 523 U.S. 751, 118 S.Ct. 1700, 140 L.Ed.2d 981 (1998).
- 9 Not all of these examples deal with tribal sovereign immunity, but the rule that abrogation of sovereign immunity must be unequivocal and not by implication applies generally to sovereign immunity. For example, when *Martinez* stated this rule as applicable to tribal immunity, it quoted it from a case dealing with the United States’ immunity from suit. *Martinez*, 436 U.S. at 58–59, 98 S.Ct. 1670, quoting *United States v. Testan*, 424 U.S. 392, 399, 96 S.Ct. 948, 47 L.Ed.2d 114 (1976).
- 10 In addressing the suit against an officer of the Pueblo, the Court recognized that a doctrine analogous to *Ex Parte Young* applies to tribal sovereign immunity. It stated that a tribal officer “is not protected by the tribe’s immunity from suit. See *Puyallup Tribe, Inc. v. Washington Dept. of Game*, [433 U.S. 165, 171–72, 97 S.Ct. 2616, 53 L.Ed.2d 667 (1977)]; cf. *Ex parte Young*, 209 U.S. 123[, 28 S.Ct. 441, 52 L.Ed. 714] (1908).” 436 U.S. at 59, 98 S.Ct. 1670. Consequently even if the Nation were immune here, the Debtor presumably could obtain equivalent injunctive relief (but not recovery of past withholdings) by an adversary proceeding against the Tribal officer who is responsible for distributing the per capita payments. See, e.g., *Duke Energy Trading and Mktg., L.L.C. v. Davis*, 267 F.3d 1042, 1051–55 (9th Cir.2001); *Goldberg v. Ellett (In re Ellett)*, 254 F.3d 1135 (9th Cir.2001). See generally Ralph

Brubaker, *Of State Sovereign Immunity and Prospective Remedies: The Bankruptcy Discharge as Statutory Ex Parte Young Relief*, 76 AMER. BANKR.L.J. 461 (Fall 2002). However, the present adversary complaint names only the Nation as a defendant.

11 BRYAN A. GARNER, A DICTIONARY OF MODERN LEGAL USAGE 423–25 (2d ed.1995); accord BLACK'S LAW DICTIONARY 758–59 (7th ed.1999).

12 GARNER, at 423–24.

13 *Id.* at 424.

14 Attempts have been made to argue that the authors of statutes implied an abrogation of sovereign immunity from other language in the statute, and such arguments have also been rejected by the Supreme Court, but under the rubric of requiring unequivocal expression rather than under the rubric of proscribing abrogation by implication. *See, e.g., Atascadero State Hosp. v. Scanlon*, 473 U.S. 234, 242, 105 S.Ct. 3142, 87 L.Ed.2d 171 (1985) (“[R]espondent relies on the pre- and post-enactment legislative history of the [Rehabilitation] Act and *inferences from general statutory language*. To reach respondent’s conclusion, we would have to temper the requirement, well established in our cases, that Congress unequivocally express its intention to abrogate the Eleventh Amendment bar to suits against the States in federal court.”) (emphasis added).

15 GARNER, at 424–25. The distinction between this usage and the second is that in the second the *author* made the implication, whereas in this usage the reader made the implication, which in correct usage would be the reader’s inference, not implication.

16 *See Dewsnap v. Timm*, 502 U.S. 410, 420, 112 S.Ct. 773, 116 L.Ed.2d 903 (1992) (Scalia, J., dissenting); *Union Bank v. Wolas*, 502 U.S. 151, 163, 112 S.Ct. 527, 116 L.Ed.2d 514 (1991) (Scalia, J., concurring); *United States v. Ron Pair Enterprises, Inc.*, 489 U.S. 235, 241–42, 109 S.Ct. 1026, 103 L.Ed.2d 290 (1989).

17 ARISTOTLE, RHETORIC, Book I, chapter 2, at 1356a–1356b (W. Rhys Roberts trans., Random House, Inc. 1984).

18 As Bertrand Russell pointed out, we usually know the truth of the major and minor premises of a deduction only by induction. “We shall all agree that Mr. Smith (say) is mortal, and we may, loosely, say that we know this because we know that all men are mortal. But what we really know is not ‘all men are mortal’; we know rather something like ‘all men born more than one hundred and fifty years ago are mortal, and so are almost all men born more than one hundred years ago.’ This is our reason for thinking that Mr. Smith will die. But this argument is an induction, not a deduction. It has less cogency than a deduction, and yields only a probability, not a certainty; but on the other hand it gives *new* knowledge, which deduction does not.” Bertrand Russell, A HISTORY OF WESTERN PHILOSOPHY 199 (Simon and Schuster 1945).

19 *Cf. Choteau v. Burnet, Comm’r of Internal Revenue*, 283 U.S. 691, 51 S.Ct. 598, 75 L.Ed. 1353 (1931) (the language of the Internal Revenue Act of 1918 that made it applicable to “every individual” was broad and explicit enough to include Indians).

20 Because *Sandmar* was decided prior to *Nordic Village, Kiowa Tribe* and the 1994 amendment to § 106, its precedential value may be questionable so it is not further discussed here.

21 *See* note 1, *supra*. None of the facts presented by either party here suggests that the Nation’s per capita payment program is different in any material respect from that at issue in *Kedrowski*, so the court will assume the same analysis applies here.

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Structure Annuities

MAR 09 2012

NOT FOR PUBLICATION

SUSAN M SPRAY, CLERK
U.S. BKCY. APP. PANEL
OF THE NINTH CIRCUITUNITED STATES BANKRUPTCY APPELLATE PANEL
OF THE NINTH CIRCUIT

In re:)	BAP No. AZ-11-1505-JuPaD
)	
CYNTHIA L. MESSER,)	Bk. No. 11-03007
)	
Debtor.)	
)	
CYNTHIA L. MESSER,)	
)	
Appellant,)	
)	
v.)	M E M O R A N D U M *
)	
EDWARD J. MANEY, Chapter 13)	
Trustee,)	
)	
Appellee.)	

Argued and Submitted on February 24, 2012
at Phoenix, Arizona

Filed - March 9, 2012

Appeal from the United States Bankruptcy Court
for the District of Arizona

Honorable Redfield T. Baum, Sr., Bankruptcy Judge, Presiding

Appearances: David Allegrucci, Esq. of Allegrucci Law Office,
PLLC argued for appellant Cynthia L. Messer;
Stuart Bradley Rodgers, Esq. of Lane & Nach, P.C.
argued for appellee Edward J. Maney, Chapter 13
Trustee.

Before: JURY, PAPPAS, and DUNN, Bankruptcy Judges.

* This disposition is not appropriate for publication.
Although it may be cited for whatever persuasive value it may
have (see Fed. R. App. P. 32.1), it has no precedential value.
See 9th Cir. BAP Rule 8013-1.

Chapter 7¹ debtor, Cynthia L. Messer, claimed as exempt 100% of the fair market value of her vehicle listed at \$12,000. This amount was over the \$5,000 statutory limit for vehicle exemptions under Arizona law. Debtor also claimed that her \$2,000 monthly benefit from a structured settlement annuity was not property of her estate. The bankruptcy court sustained the chapter 7 trustee's objection to debtor's claimed exemption in her vehicle and found that her annuity payments were property of her estate. This timely appeal followed. We AFFIRM.

I. FACTS

On February 7, 2011, debtor filed her chapter 7 petition. Jill H. Ford was appointed the chapter 7 trustee.

In Schedule C, debtor claimed 100% of the fair market value ("FMV") of her 2007 Honda Accord, listed at \$12,000,² as exempt under Ariz. Rev. Stat. ("ARS") §33-1125(8). That statute allows a debtor to exempt "[o]ne motor vehicle not in excess of a fair market value of five thousand dollars."

Debtor also claimed as exempt her \$2,000 monthly benefit from a 1985 annuity under ARS §33-1126(B).³ The record shows that the annuity arose from a settlement for the wrongful death

¹ As explained below, debtor converted her case to one under chapter 13 before this appeal was taken. Unless otherwise indicated, all chapter and section references are to the Bankruptcy Code, 11 U.S.C. §§ 101-1532, and rule references are to the Federal Rules of Bankruptcy Procedure.

² Debtor's Schedule D showed that the vehicle was encumbered by a lien in an amount over \$15,000.

³ ARS §33-1126(B) was inapplicable to the annuity because that section concerns the exemption of certain retirement plans.

1 of debtor's husband. The insurer, United States Fidelity and
2 Guaranty Company ("USF&G"), owned the annuity and it was not
3 assignable.

4 Debtor amended Schedule C to show that her basis for
5 claiming 100% of the FMV of her vehicle exempt was the holding
6 in Schwab v. Reilly, __ U.S. __, 130 S.Ct. 2652, 2668 (2010).
7 Debtor also changed the statutory basis for her exemption in the
8 annuity to ARS §33-1126(A)(7) which authorizes as exempt "an
9 annuity contract where for a continuous unexpired period of two
10 years that contract has been owned by a debtor and has named as
11 beneficiary the debtor"

12 The chapter 7 trustee objected to debtor's exemptions,
13 asserting that the claimed exemption in her vehicle was over the
14 \$5,000 statutory limit set forth in ARS §33-1125(8) and her
15 exemption in the annuity under ARS §33-1125(A)(7) should be
16 denied because that statute applied only to annuities owned by a
17 debtor. In response, debtor asserted that the annuity was not
18 property of her estate because (1) it contained an anti-
19 alienation provision; (2) she did not own the annuity; and
20 (3) the annuity qualified as a spendthrift trust under Arizona
21 law.

22 On July 28, 2011, the bankruptcy court heard the matters.
23 At the hearing, the court found that the Supreme Court's
24 decision in Schwab did not authorize debtor to claim an
25 exemption in her vehicle greater than the \$5,000 limit under ARS
26 §33-1125(8). The bankruptcy court took the matter of debtor's
27 exemption in the annuity under advisement.

28 On August 25, 2011, the bankruptcy court issued its ruling

1 on the annuity exemption. Siding with the trustee, the court
2 found that because the annuity was never owned by debtor, debtor
3 could not claim it exempt under ARS §33-1126(A)(7). The
4 bankruptcy court also found that there was nothing in the record
5 that established the annuity qualified as a spendthrift trust
6 under Arizona law. The court reasoned that the facts, analysis,
7 and holding in In re Kent, 396 B.R. 46 (Bankr. D. Az. 2008),
8 were very similar to this case and compelled the conclusion that
9 the annuity was not exempt and was property of the estate.

10 On September 7, 2011, the bankruptcy court entered the
11 order sustaining the trustee's objection to debtor's claimed
12 exemption in the annuity and finding that it was property of her
13 estate. As a result of the court's ruling, debtor converted her
14 case to chapter 13 on September 14, 2011. On October 11, 2011,
15 the court entered the order denying debtor's claim of exemption
16 in her vehicle above the statutory limit of \$5,000 allowed under
17 Arizona law. Debtor timely appealed the orders.

18 **II. JURISDICTION**

19 The bankruptcy court had jurisdiction over this proceeding
20 under 28 U.S.C. §§ 1334 and 157(b)(2)(A) and (B). We have
21 jurisdiction under 28 U.S.C. § 158.

22 **III. ISSUES**

23 A. Whether the bankruptcy court erred in sustaining the
24 chapter 7 trustee's objection to debtor's claimed exemption for
25 100% of the FMV of her vehicle; and

26 B. Whether the bankruptcy court erred by finding that the
27 annuity was property of debtor's estate.

ISSUES ON CONVERSION FROM CHAPTER 13 TO CHAPTER 7

By Gary Stickell

The Debtor may convert a Chapter 13 case to Chapter 7 as of right. 11 U.S.C. §1307(a). *In re DeFrantz*, 454 B.R. 108 (9th Cir. BAP 2011). [That a Creditor filed a Motion to Dismiss, did not pre-exempt Debtor's right to convert.]

Debtor must file a Statement of Intention within thirty days of conversion and file amended Schedules reflecting unpaid debts incurred after filing of the Petition. Rule 1019(1)(B) and 1019(5)(B), Federal Rules of Bankruptcy Procedure. A deadline for filing Motions under 11 U.S.C. §707 and for objections to exemptions is set unless the case was previously under Chapter 7 and the deadlines for those objections had expired. Rule 1019(2), Federal Rules of Bankruptcy Procedure. Conversion of the case does not re-establish the automatic stay where stay relief has already been granted.

Post-Petition, Pre-Conversion Debts.

Unpaid debts incurred after filing of the Petition and prior to Conversion to Chapter 7 are treated as if they arose prior to the initial petition. 11 U.S.C. §348(d). These debts become subject to the automatic stay and to discharge.

Property of the Estate.

The property of the Chapter 7 Estate consists of the property of the Chapter 13 Estate at the time of filing the petition that remains in the possession or control of the Debtor. 11 U.S.C. §348(f)(1)(A). Any non-exempt property is subject to liquidation by the Chapter 7 Trustee even though unsecured creditors have received monies through the Chapter 13 case.

If the Court finds that the conversion was in “bad faith,” the property of the estate also includes property of the Debtor upon the date of conversion. 11 U.S.C. §348(f)(2).

In a recent BAP decision, the Chapter 7's Motion for Turnover was denied where the Debtors had spent their non-exempt tax refunds prior to conversion. *In re Salazar*, – B.R. – , 2012 WL 898784 (9th Cir BAP 2012).

Vehicle Debts. Valuation Issues.

Any valuation of property and of secured claims made in a Chapter 13 are not binding in a converted case to Chapter 7. 11 U.S.C. §348(f)(1)(B). The Debtor does not get the benefit of a cramdown or a reduce *Til* interest rate.

One of the most practical considerations in whether to convert to Chapter 7 or not is what to do with Debtors' vehicle. During the pendency of the case, Debtors will frequently be delinquent on their vehicle payments, even with adequate protection. There is no payment on the vehicle if the Debtor has not been making plan payments.

The Debtor should immediately contact the vehicle lender on confirmation to determine the availability and the advisability of a reaffirmation agreement. If the Debtor receives a large refund from the Chapter 13 payments, Debtor may consider filing a Motion for Redemption. The issue on redemption is on what date is the vehicle valued: the date of filing or the date of the redemption hearing.

Means Test

Another issue is whether the Debtor needs to file a Means Test under Chapter 7 and if so, for what timeframe. If from the inception of the Chapter 13 case,

Practice Pointer. It is my experience that United States Trustee's office will want updated Schedules I and J (Income and Expense). Within Schedules I and J is the

opportunity to explain the change of circumstance that justifies the conversion to
Chapter 7.



DIVISION ONE
 FILED: 03/20/2012
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 BY: DLL

**IN THE COURT OF APPEALS
 STATE OF ARIZONA
 DIVISION ONE**

HELVETICA SERVICING, INC., a)	1 CA-CV 10-0418
California corporation fna CRM)	
VENTURE LAW, INC. dba THE)	
HELVETICA GROUP,)	DEPARTMENT C
)	
Plaintiff/Appellee,)	
)	O P I N I O N
v.)	
)	
MICHAEL S. PASQUAN, an individual,)	
)	
Defendant/Appellant.)	
)	

Appeal from the Superior Court in Maricopa County

Cause Nos. CV2008-050966 and CV2009-029276 (consolidated)

The Honorable Eddward Ballinger, Jr., Judge
 The Honorable Stephen Kupiszewski, Judge *Pro Tem*

VACATED AND REMANDED

Buchalter Nemer, P.C.	Scottsdale
by Donnelly A. Dybus	
Christopher F. McCarthy	
Jason E. Goldstein, <i>Pro Hac Vice</i>	Irvine, CA
Attorney for Plaintiff/Appellee	
 Berens Kozub Kloberdanz & Blonstein, P.L.C.	 Scottsdale
by Daniel L. Kloberdanz	
William A. Kozub	
Attorneys for Defendant/Appellant	

D O W N I E, Judge

¶1 This case requires us to examine the scope of statutory anti-deficiency protection available to borrowers in the judicial foreclosure context. We hold that refinancing a purchase money loan does not destroy purchase money status and forfeit anti-deficiency protection to the extent proceeds from the refinancing transaction are disbursed in satisfaction of the underlying purchase money obligation. We further hold that loan proceeds used to construct a qualifying residence merit anti-deficiency protection under certain circumstances. However, sums disbursed in a loan transaction for non-purchase money purposes may be traced, segregated, and recovered in a deficiency action. Because the superior court did not apply these legal standards to the various loan transactions at issue in this case, we vacate the deficiency judgment entered against appellant Michael Pasquan and remand for further proceedings.

FACTS AND PROCEDURAL BACKGROUND

¶2 Michael and Kelly Pasquan purchased a 4000-square-foot home in Paradise Valley (the "Property") in May 2003. To satisfy the \$935,000 purchase price, the Pasquans made a \$335,000 cash payment and obtained a \$600,000 loan from Hamilton Mortgage Company ("Hamilton Loan"). The Hamilton Loan was secured by a deed of trust recorded against the Property.

¶3 In December 2004, the Pasquans obtained a \$1.6 million loan from Desert Hills Bank ("Desert Hills"). The Desert Hills

loan proceeds paid off the Hamilton Loan and also funded the demolition of most of the existing residence and the construction of an 11,500-square-foot home in its place. The Desert Hills loan was secured by a new deed of trust recorded against the Property.

¶4 The Pasquans later borrowed an additional \$100,000 from Desert Hills. No new deed of trust was recorded; the additional amount was secured by the existing deed of trust on the Property. Subsequently, the Pasquans obtained an additional \$400,000 loan from Desert Hills that was secured by a second recorded deed of trust. According to a declaration submitted by Michael Pasquan in the superior court, all of the Desert Hills loan proceeds were used for construction expenses.

¶5 In September 2006, the Pasquans obtained a \$3.4 million loan serviced by appellee Helvetica Servicing, Inc. ("Helvetica Loan").¹ The Helvetica Loan was secured by a new deed of trust recorded against the Property. According to Michael Pasquan's declaration, the Helvetica Loan proceeds were disbursed as follows:

Desert Hills Payoff	\$2,154,038
Stephen Pasquan Loan ²	\$225,000
Closing Costs	\$9,674

¹ There are numerous beneficiaries under the Helvetica deed of trust. We refer to them collectively as "Helvetica."

² The Pasquans reportedly borrowed \$225,000 from Stephen Pasquan, Michael's father, for construction expenses.

Points/Interest	\$274,894
Interest/Reserves	\$206,033
Construction Credit Cards	\$172,575
Net Proceeds to the Pasquans	\$357,786.15

Pasquan avowed that roughly \$228,000 of the funds he and his wife received at closing went toward interest payments on the Helvetica Loan, with the remainder being used for "improvements, landscaping, maintenance, taxes, utilities and marketing fees for the house."

¶6 The Pasquans defaulted on their loan payments, and Helvetica filed a judicial foreclosure action. The superior court granted partial summary judgment to Helvetica regarding its right to foreclose and the principal sum owed by the Pasquans -- \$3,657,793.30. The court reserved the question of whether Helvetica could obtain a deficiency judgment.

¶7 Helvetica purchased the Property with a \$400,000 credit bid at a sheriff's sale. Thereafter, the parties briefed the applicability of Arizona's anti-deficiency statutes. The superior court ruled in favor of Helvetica and entered a deficiency judgment against the Pasquans in the sum of \$1,936,825.53, plus pre-judgment and post-judgment interest. Michael Pasquan timely appealed.³

³ The Pasquans divorced in 2009. Kelly Pasquan is not a party to this appeal. References to "Pasquan" are to Michael Pasquan individually.

DISCUSSION

¶8 The overarching issue in this case is whether the Helvetica Loan is a purchase money obligation. If it is, Helvetica may not obtain a deficiency judgment against Pasquan. See *Baker v. Gardner*, 160 Ariz. 98, 107, 770 P.2d 766, 775 (1989) (supplemental opinion) ("By choosing judicial foreclosure, the creditor can obtain a deficiency judgment in all cases except those dealing with purchase money collateral on the residential property described in § 33-729(A)."). A deficiency judgment "is nothing more than the difference between the security and the debt."⁴ *Valley Nat'l Bank of Ariz. v. Kohlhase*, 182 Ariz. 436, 440, 897 P.2d 738, 742 (App. 1995) (quoting *Baker*, 160 Ariz. at 104 n.7, 770 P.2d at 772 n.7).

¶9 The Arizona legislature enacted statutes in 1971 to protect certain borrowers against deficiency judgments arising from purchase money mortgages and purchase money deeds of trust foreclosed judicially. *Baker*, 160 Ariz. at 101, 770 P.2d at 769. This legislation was intended to "protect[] consumers from

⁴ The parties agree that a deficiency exists, though they disputed the amount in the superior court. After an evidentiary hearing, the court set the fair market value of the Property at \$2,266,666.67. See Ariz. Rev. Stat. ("A.R.S.") § 33-814(A) (a deficiency judgment "shall be for an amount equal to the sum of the total amount owed the beneficiary as of the date of the sale, as determined by the court less the fair market value of the trust property on the date of the sale as determined by the court or the sale price at the trustee's sale, whichever is higher").

financial ruin" and "eliminat[e] . . . hardships resulting to consumers who, when purchasing a home, fail to realize the extent to which they are subjecting assets besides the home to legal process." *Id.* (quoting Boyd & Balentine, *Arizona's Consumer Legislation: Winning The Battle but . . .*, 14 Ariz. L. Rev. 627, 654 (1972)). Anti-deficiency protection reflects a legislative policy decision to place the risk of inadequate security on lenders rather than borrowers. *Id.* at 103, 770 P.2d at 771. It is intended to discourage purchase money lenders from over-valuing real property by requiring them to look solely to the collateral for recovery in the event of foreclosure.

¶10 The statute at issue in this case, Arizona Revised Statute ("A.R.S.") section 33-729(A), reads:

[I]f a mortgage is given to secure the payment of the balance of the purchase price, or to secure a loan to pay all or part of the purchase price, of a parcel of real property of two and one-half acres or less which is limited to and utilized for either a single one-family or single two-family dwelling, the lien of judgment in an action to foreclose such mortgage shall not extend to any other property of the judgment debtor, nor may general execution be issued against the judgment debtor to enforce such judgment, and if the proceeds of the mortgaged real property sold under special execution are insufficient to satisfy the judgment, the judgment may not otherwise be satisfied out of other property of the judgment debtor, notwithstanding any agreement to the contrary.

¶11 We review the interpretation and application of statutes *de novo*. *Schwarz v. City of Glendale*, 190 Ariz. 508, 510, 950 P.2d 167, 169 (App. 1997) (citation omitted). Our goal in interpreting a statute is to determine and give effect to legislative intent. *Mail Boxes, Etc., U.S.A. v. Indus. Comm'n*, 181 Ariz. 119, 121, 888 P.2d 777, 779 (1995) (citation omitted). We begin with the statute's language. *Canon Sch. Dist. No. 50 v. W.E.S. Constr. Co.*, 177 Ariz. 526, 529, 869 P.2d 500, 503 (1994) (citations omitted). If the language is unambiguous, we do not employ other tools of statutory construction. *Janson v. Christensen*, 167 Ariz. 470, 471, 808 P.2d 1222, 1223 (1991) (citations omitted).

¶12 The parties agree that the Hamilton Loan, which was obtained to acquire the Property, was a purchase money obligation. Helvetica contends, though, that by refinancing a purchase money loan, a borrower destroys purchase money status, forfeiting anti-deficiency protection. Pasquan, on the other hand, argues: (1) the Desert Hills loans were construction loans that are purchase money in nature; and (2) the Helvetica Loan refinanced an existing purchase money loan and is therefore a purchase money obligation.⁵

⁵ Pasquan raises other issues in his opening brief that Helvetica has not addressed, characterizing them as "irrelevant to this appeal." For purposes of our decision, we assume the

I. The Effect of Refinancing

¶13 Both parties rely on this Court's decision in *Bank One, Arizona v. Beauvais*, 188 Ariz. 245, 934 P.2d 809 (App. 1997), to support their respective positions. In *Bank One*, the borrowers obtained a loan from Bank One to exercise stock options, pledging the stock as collateral. *Id.* at 246, 934 P.2d at 810. They later sought another loan from Bank One to purchase a home. *Id.* The new loan consolidated the first loan with the home purchase loan into a single note. *Id.* The consolidated loan proceeds paid off the first loan and funded the home's purchase. *Id.* The consolidated loan was secured by the stock and a deed of trust. *Id.*

¶14 When the borrowers were unable to pay, they executed a "workout note" that satisfied the consolidated loan. *Id.* The workout note was secured by the stock and the existing deed of trust. *Id.* The borrowers defaulted, and Bank One sued them. *Id.* at 246-47, 934 P.2d at 810-11. The bank argued the workout note was not a purchase money obligation, but a new and independent loan used to pay existing obligations. *Id.* at 247, 934 P.2d at 811. Alternatively, Bank One argued it could recover the pro rata portion of the workout note that was not purchase money in nature. *Id.*

Property is of a size and use meriting protection under A.R.S. § 33-729(A).

¶15 The superior court ruled that the workout note was a purchase money obligation and found no basis for apportioning between purchase money and non-purchase money funds. *Id.* Bank One appealed. *Id.* This Court held that, regardless of whether the workout note was "an extension, renewal, or new obligation," it was a purchase money obligation. *Id.* at 248-51, 934 P.2d at 812-15. Citing *Baker*, we observed that anti-deficiency protection is intended "to protect certain homeowners from the financial disaster of losing their homes to foreclosure plus all their other nonexempt property on execution of a judgment for the balance of the purchase price." *Id.* at 249, 934 P.2d at 813. We concluded:

[T]he legislature did not intend that a loan would lose its character as a purchase-money obligation when, as here, it is extended, renewed, or the remaining portion of the original loan is refinanced and the deed of trust on the property that was bought with the original loan continues or is renewed. Given the realities of the marketplace, to believe otherwise would put many homeowners, unable to make mortgage payments, at the peril of facing personal liability as well as the loss of their homes—a result the legislature intended to avoid through the Anti-Deficiency Statutes.

Id. at 250, 934 P.2d at 814. *Bank One* did not address the propriety of segregating non-purchase money portions of a loan, noting the bank had abandoned its argument that such funds

should be traced and included in a deficiency judgment. *Id.* at 248 n.2, 934 P.2d at 812 n.2.

¶16 Helvetica ascribes significance to two factual differences between this case and *Bank One*: (1) the original deed of trust the Pasquans executed when purchasing the Property was replaced by deeds of trust in favor of the subsequent lenders; and (2) different lenders are involved. We agree that these factual distinctions exist, but we do not read *Bank One* as requiring that the original deed of trust remain in place or that the lender remain the same in order to preserve purchase money status. *Bank One* addressed the facts before it and did not attempt to define the outer limits of anti-deficiency protection.

¶17 The court in *Bank One* held that the character of a purchase money obligation is not changed when it is refinanced and the “deed of trust on the property that was bought with the original loan continues *or is renewed*.” *Id.* at 250, 934 P.2d at 814 (emphasis added). “Renew” can mean “to replace” or “to begin again.” Black’s Law Dictionary 1296 (6th ed. 1990). Section 33-729(A) does not mandate that the lender remain the same or that the deed of trust of record at the time of foreclosure be the same one recorded when the property was purchased. The statute instead accords protection if a mortgage is “given to secure the payment of the balance of the purchase

price, or to secure a loan to pay all or part of the purchase price."

¶18 In the case at bar, a portion of the first Desert Hills loan proceeds satisfied the balance due on the Hamilton Loan. That disbursement paid "the balance of the purchase price." A.R.S. § 33-729(A). A deed of trust on the same property secured the Hamilton and Desert Hills loans.

¶19 A change in the lender's identity does not, standing alone, alter the nature of the underlying purchase money debt. To hold that refinancing a purchase money obligation with a new lender and executing a new deed of trust on the same property destroys anti-deficiency protection would contravene the legislative intent to "abolish the personal liability of persons who give trust deeds encumbering properties that fit within the statutory definition." *Bank One*, 188 Ariz. at 249, 934 P.2d at 813 (citing *Baker*, 160 Ariz. at 104, 770 P.2d at 772). Moreover, it would be anomalous to conclude that an original lender who refinances an acquisition loan at a lower interest rate cannot pursue a deficiency judgment, as *Bank One* instructs, but a new lender who pays off that original loan in a refinancing transaction may do so.

¶20 A determination that refinancing does not destroy purchase money status is also consistent with the policy of discouraging the over-valuation of real property. The risk of

over-valuation is arguably even more substantial in the refinancing context, where property values are not based on actual sales of the collateral. The second rationale for anti-deficiency legislation -- preventing financial ruin of homeowners who have already lost their homes and the attendant drain on the economy -- is also furthered by protecting refinancing transactions, which frequently occur in distressed economic climates.

¶21 Helvetica's reliance on *Union Bank v. Wendland*, 126 Cal. Rptr. 549 (Cal. Ct. App. 1976), is unpersuasive. In *Union Bank*, the homeowner financed the purchase of residential property by borrowing from a savings and loan. *Id.* at 554. He later obtained three additional loans from a bank. *Id.* at 552. The first bank loan was secured by a deed of trust; some of the proceeds were used to satisfy the original purchase money loan, and the remainder went into the homeowner's account. *Id.* at 554. The second loan was used to remodel the residence; the third loan paid off the second loan and made payments due under the first note. *Id.* at 552. The California Court of Appeal held that refinancing is not a purchase money transaction because the loan proceeds are not used to purchase a residence. *Id.* at 554. Accordingly, by refinancing the property, the homeowner destroyed purchase money status and was subject to a deficiency judgment. *Id.*

¶22 The decision in *Union Bank* has been criticized. See, e.g., Carol Burns, Comment, *Will Refinancing Your Home Mortgage Risk Your Life Savings?: Refinancing and California Code of Civil Procedure Section 580B*, 43 UCLA L. Rev. 2077, 2095 (1996) (“As an appellate level decision, *Union Bank*’s value as a precedent is limited. Further, the court’s flawed reasoning weakens its value even as persuasive authority.”); Charles B. Sheppard, *California Code of Civil Procedure Section 580B, Anti-Deficiency Protection Regarding Purchase Money Debts: Arguments for the Inclusion of Refinanced Purchase Money Obligations Within the Anti-Deficiency Protection of Section 580B*, 6 S. Cal. Interdisc. L.J. 245, 269 (1997) (labeling *Union Bank*’s holding that refinancing destroys purchase money status “dicta” and “misguided”). *Union Bank* is also inconsistent with our own Arizona precedent -- specifically, *Bank One*, which holds that refinancing does not necessarily convert a purchase money obligation into a recourse loan.

¶23 We hold that the first Desert Hills loan transaction did not destroy the purchase money status of Pasquan’s obligation, at least to the extent of loan proceeds used to satisfy the Hamilton Loan. We next consider whether proceeds from the Desert Hills loans that were disbursed for other purposes, including construction of the residence, merit different treatment.

II. Construction Loans as Purchase Money Obligations

¶24 No Arizona appellate decision has addressed whether so-called “construction loans” used to build a residence are purchase money obligations entitled to anti-deficiency protection. In *Southwest Savings and Loan Association v. Ludi*, 122 Ariz. 226, 227, 594 P.2d 92, 93 (1979), the homeowners assumed a note secured by a purchase money mortgage and a note for a “property improvement loan” secured by a second mortgage. They defaulted on both. *Id.* The Ludis argued that because they assumed the two mortgages when purchasing the property, both were purchase money obligations, precluding a deficiency judgment. *Id.* at 228, 594 P.2d at 94. Addressing only the property improvement loan, our supreme court disagreed, stating:

In order to determine whether the Ludis may claim any benefit from [the anti-deficiency] statute as a result of their assumption, we must look to the rights given them by their grantor. . . . [The grantor] gave Southwest a second mortgage and note, not for purchase money, but for a property improvement loan. That mortgage is clearly not covered by the statute.

Id.

¶25 *Ludi* did not discuss the nature of the property improvement loan or how its proceeds were used.⁶ There was no

⁶ Considering the policies behind Arizona’s anti-deficiency legislation, we perceive significant differences between construction loans used to build residences and loans obtained to improve existing homes. *Cf. Allstate Sav. & Loan Ass’n v.*

contention that, as to the original borrower, the second mortgage was a purchase money obligation. And because the Ludis stepped into the original borrower's shoes, they could not elevate the loan's status to a purchase money obligation.

¶26 Notwithstanding the decision in *Ludi*, we deem it an open question in Arizona whether a loan that funds construction of a statutorily qualifying residence is a purchase money obligation. And although we reject the holding in *Union Bank* as incompatible with Arizona law, we find guidance in a different California appellate decision relevant to construction loans. See *Baker*, 160 Ariz. at 102-03, 770 P.2d at 770-71 (because California has similar anti-deficiency laws, its appellate decisions are instructive in interpreting Arizona statutes).

¶27 In *Prunty v. Bank of America*, 112 Cal. Rptr. 370 (Cal. Ct. App. 1974), the court considered whether a lender could

Murphy, 159 Cal. Rptr. 663, 664 (Cal. Ct. App. 1979) (construing an analogous California statute and holding that "construction loans for improvements or repairs of the type involved in this case [construction of a swimming pool and block wall] are not within the description of loans protected by the purchase-money deficiency prohibition"). The second scenario, though, is not before us. In some cases, it will be a question of fact whether a particular transaction is a construction loan or some different type of obligation -- e.g., a home improvement loan. Although the record before us suggests that a substantial portion of the Desert Hills financing is properly characterized as a construction loan, the superior court will be required to make this determination on remand. Because the parties have not raised or briefed the issue on appeal, we do not now undertake to define the characteristics of a protected construction loan.

obtain a deficiency judgment based on a loan it made to fund construction of a residence on land the borrower already owned. The bank argued the construction loan financed improvements to the property, not its purchase, so a deficiency judgment was proper. *Id.* at 373. The court, though, ruled that the public policies behind anti-deficiency legislation warranted protection for "residential construction borrowers who fall within its terms." *Id.* at 377. The court found certain undisputed facts significant in that case, including the following:

7. It was intended both by plaintiffs and defendants that the repayment of said loan would be secured by said deed of trust which would cover not only the land but also a dwelling to be constructed thereon. 8. At the time of the application for said loan and at the time of the execution and recording of said deed of trust, plaintiffs intended to use the proceeds of said loan to construct a single family residential dwelling on the property, which they themselves would occupy, and defendant Bank of America was aware and intended that the proceeds of said loan would be so used.

9. All the proceeds of said loan were used by plaintiffs to pay the purchase price of labor and materials which were used in constructing a single family residence on the property. 10. Defendant Bank of America would not have made said loan had not the entire proceeds of said loan been used to pay the purchase price of labor and materials used to construct the residence on said land. 11. Defendant Bank of America looked primarily to the land and to the building thereon as security for its loan.

Id. at 372.

¶28 Prunty looked to the legislative history behind California's statutes, noting that courts "have exhibited a very hospitable attitude toward the legislative policy underlying the antideficiency legislation and have given it a broad and liberal construction that often goes beyond the narrow bounds of the statutory language." 112 Cal. Rptr. at 374 (citing Stefan A. Riesenfeld, *California Legislation Curbing Deficiency Judgments*, 48 Calif. L. Rev. 705, 709 (1960)). The court held that common definitions of the words "purchase" and "purchaser" are broad enough to encompass construction loans, stating:

[T]he owner of real property who finances and builds a "dwelling" on it "acquires" or "obtains" the dwelling for a "price," in no less a sense than the "purchaser" of real property "acquires" or "obtains" the land itself. . . . Thus, the terms actually used by the Legislature . . . ("purchase price" and "purchaser") may reasonably be assigned the suggested alternative definitions "according to the usual, ordinary import" of the statutory language. The reach of that language is therefore to be assessed according to a liberal construction thereof in light of the legislative purpose underlying the amended statute and the "entire statutory system" of anti-deficiency legislation which includes it.

Id. at 376-77 (citations omitted). The court concluded:

The critical fact here is not . . . that the character of the property purchased under a construction Contract is to be determined at the time of execution thereof; it is whether the parties to the construction Loan intended that the deed of trust, securing the loan's payment, cover Real property.

Id. at 379 (internal citations omitted).

¶129 We agree with *Prunty* and find its analysis and conclusion equally applicable to and consistent with Arizona's legislative scheme. See, e.g., *Cely v. DeConcini, McDonald, Brammer, Yetwin & Lacy, P.C.*, 166 Ariz. 500, 504, 803 P.2d 911, 915 (App. 1990) ("The purposes served by Arizona's mortgage anti-deficiency statute are identical to those served by California's statute"); see also A.R.S. § 1-213 ("Words and phrases shall be construed according to the common and approved use of the language."); *W. Corr. Grp., Inc. v. Tierney*, 208 Ariz. 583, 587, ¶ 17, 96 P.3d 1070, 1074 (App. 2004) (citing *State v. Wise*, 137 Ariz. 468, 470 n.3, 671 P.2d 909, 911 n.3 (1983)) (in determining the plain meaning of a term in a statute, courts refer to established and widely used dictionaries).

¶130 Like California, see *Prunty*, 112 Cal. Rptr. at 375, our anti-deficiency statutes allocate the risk of inadequate security to purchase money lenders, thereby discouraging overvaluation of the collateral. Additionally, as in California, "[i]f inadequacy of the security results, not from overvaluing, but from a decline in property values during a general or local depression, [the anti-deficiency statute] prevents the aggravation of the downturn that would result if

defaulting purchasers were burdened with large personal liability.” *Id.*

¶31 Construing anti-deficiency protection to apply to construction loans furthers these legislative policies. See *State v. Clary*, 196 Ariz. 610, 612, ¶ 9, 2 P.3d 1255, 1257 (App. 2000) (citing *Carrow Co. v. Lusby*, 167 Ariz. 18, 21, 804 P.2d 747, 750 (1990)) (courts consider the policy behind the law and the evil it was intended to remedy when interpreting statutes). Such protection will “tend[] to discourage construction borrowing which is ‘unsound’ because the financed construction is overvalued.” *Prunty*, 112 Cal. Rptr. at 377. It also avoids further aggravation of a depressed economy. *Cf.* Burns, Comment, 43 UCLA L. Rev. at 2089 (“Rampant personal judgments against debtors would greatly exacerbate the economic downturn and hinder recovery. To prevent such a catastrophe, the legislature mandated that the losses be distributed: The debtor loses the property, and the lender forfeits the amount by which the debt exceeds the property’s fair value.”).

¶32 We hold that a construction loan qualifies as a purchase money obligation if: (1) the deed of trust securing the loan covers the land *and* the dwelling constructed thereon; and (2) the loan proceeds were in fact used to construct a residence that meets the size and use requirements set forth in

A.R.S. § 33-729(A). In the case at bar, these are questions of fact that must be resolved by the superior court on remand.

III. Treatment of Non-Purchase Money Funds

¶33 Finally, this case presents a question left unanswered in *Bank One*: whether non-purchase money loan funds included in a purchase money transaction may be traced and segregated, according anti-deficiency protection only to the purchase money amounts.

¶34 Pasquan's declaration makes clear that not all of the Helvetica Loan proceeds were disbursed to pay either the remaining purchase price of the Property or construction costs. His declaration identifies payments that clearly are not purchase money in nature, including sums for maintenance, utilities, marketing fees, and penalties.⁷

¶35 There are three possible outcomes when a judicially foreclosed mortgage secures both purchase money and non-purchase money sums: (1) the entire loan is a recourse obligation; (2) the entire amount receives anti-deficiency protection; or (3) non-purchase money sums may be traced, segregated, and included in a deficiency judgment. Arizona's statutes offer little guidance regarding this issue. Relevant

⁷ The Helvetica Loan likely includes additional non-purchase money sums, including interest payments to Helvetica of \$32,555 per month. However, the record on appeal is not sufficiently developed for us to opine further regarding this issue.

legislative history, though, persuades us that the third option is the most rational way of harmonizing the competing interests of borrowers and lenders and of giving effect to legislative intent.⁸ See A.R.S. § 1-211(B) ("Statutes shall be liberally construed to effect their objects and to promote justice."); *Hayes v. Cont'l Ins. Co.*, 178 Ariz. 264, 270, 872 P.2d 668, 674 (1994) (citing *State Farm Mut. Auto Ins. Co. v. Wilson*, 162 Ariz. 251, 254, 782 P.2d 727, 730 (1989)) (when a court cannot ascertain the legislature's intent on a specific issue, it attempts to interpret the statutes in a manner that furthers the perceived goals of the relevant body of legislation).

¶136 Although there is a dearth of case law authority addressing mortgages that commingle purchase money and non-purchase money sums, several legal commentators have explored the issue. In analyzing California's statutory scheme, one such commentator concluded:

[R]efinanced purchase money obligations regarding owner-occupied residential property ought to be recognized as actually being within the purview of the purchase money, anti-deficiency protection of section 580b to the extent that proceeds from the refinance loan were used to pay-off the refinanced purchase money obligation. Any proceeds from the refinance loan that were used for purposes other than a pay-off of

⁸ Pasquan himself acknowledges he is "not urging this Court to adopt a rule which protects a borrower who refinances a purchase money loan and takes out additional cash above and beyond paying off the existing purchase money obligations."

the refinanced purchase money obligation would not be funds which were used, in fact, to pay all or part of the purchase price of the property in question. To that extent, a borrower would be exposed to personal liability for a deficiency in an amount not to exceed the amount of the refinance loan that was used for purposes other than to pay-off the refinanced purchase money obligation.

Sheppard, 6 S. Cal. Interdisc. L.J. at 248.

¶137 We reach a similar conclusion. It appears unnecessarily punitive and contrary to the consumer-protection goals of Arizona's legislation to convert an entire obligation into a recourse loan simply because it happens to include non-purchase money sums. On the other hand, it seems similarly inappropriate to shield borrowers from deficiencies for loan disbursements unrelated to the acquisition or construction of a qualifying residence. Extending anti-deficiency protection in such a manner could encourage irresponsible borrowing and abdication of personal responsibility for repaying legitimate debt. It would also appear to stretch our anti-deficiency laws beyond the scope intended by the legislature. We therefore hold that, to the extent a judicially foreclosed mortgage includes both purchase money and non-purchase money sums, a lender may pursue a deficiency judgment for the latter amounts. If the legislature disagrees with our resolution of this

admittedly murky issue, we presume it will amend the existing statutory scheme to make clear its intentions.

CONCLUSION

¶38 We vacate the deficiency judgment entered against Pasquan and remand to the superior court for further appropriate proceedings. On remand, the court must resolve various issues, including:

1. The amount of the Hamilton Loan payoff, which is entitled to anti-deficiency protection.
2. Whether the deeds of trust at issue cover the newly constructed residence.
3. Whether and to what extent loan proceeds, beginning with the first Desert Hills loan, were disbursed for construction of the residence and/or payment of the remaining purchase price of the Property.
4. The purposes for which the Helvetica Loan proceeds were disbursed.
5. The amount of a revised default judgment against Pasquan that includes only non-purchase money sums.

¶39 We do not foreclose consideration of other matters on remand. Given the procedural context of this case in the superior court, only limited issues have been litigated to date. For example, there is some suggestion that Helvetica disputes whether the Property's size and use merit protection under A.R.S. § 33-729(A). Additionally, it is unclear whether the factual assertions contained in Pasquan's declaration are disputed. Because Helvetica prevailed below on its claim that

refinancing destroys purchase money status, such issues have not been litigated. Nothing in this opinion prevents their litigation on remand.

/s/

MARGARET H. DOWNIE, Judge

CONCURRING:

/s/

DANIEL A. BARKER, Presiding Judge*

/s/

MICHAEL J. BROWN, Judge

* Judge Daniel A. Barker was a member of this court when the matter was assigned to this panel. He retired effective December 31, 2011. In accordance with the authority granted by Article 6, Section 3, of the Arizona Constitution, and pursuant to A.R.S. § 12-145, the Chief Justice of the Arizona Supreme Court has designated Judge Barker as a judge *pro tempore* for the purpose of participating in the resolution of cases assigned during his term in office.

Rule 2019. Disclosure Regarding Creditors and Equity Security Holders in Chapter 9 and Chapter 11 Cases

(a) DEFINITIONS. In this rule the following terms have the meanings indicated:

(1) “Disclosable economic interest” means any claim, interest, pledge, lien, option, participation, derivative instrument, or any other right or derivative right granting the holder an economic interest that is affected by the value, acquisition, or disposition of a claim or interest.

(2) “Represent” or “represents” means to take a position before the court or to solicit votes regarding the confirmation of a plan on behalf of another.

(b) DISCLOSURE BY GROUPS, COMMITTEES, AND ENTITIES.

(1) In a chapter 9 or 11 case, a verified statement setting forth the information specified in