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Using Section 707(b): Tale in Futility or Proper Means to Dismiss Cases Converted to Chapter 7?


Clay Roberts


Annabelle Torgman

By Clay Roberts and Annabelle Torgman

Section 707 of the Bankruptcy Code outlines the "circumstances under which a court may dismiss a Chapter 7 case or, with the debtor's consent, convert it to a Chapter 11 or a Chapter 13 case."[1] Subsection (b)(1) provides bankruptcy courts with the power to "dismiss a case filed by an individual debtor under this chapter whose debts are primarily consumer debts . . . if it finds that granting of relief would be an abuse of the provisions of this chapter."[2] Chapter 7 Trustees utilize section 707(b)(1) to dismiss cases when the Trustee believes that a debtor is abusing the bankruptcy process.

Section 707(b)(1) is not facially ambiguous. However, there is a split of opinion amongst bankruptcy courts as to whether section 707(b)(1) applies to cases that are converted to a chapter 7 from another chapter of the Bankruptcy Code. Furthermore, some courts cite the plain reading of section 707(b) as a guiding principle, yet still arrive at different results.

ABOUT THE AUTHOR
Clay Roberts and **Annabelle Torgman** are law clerks in the Miami Division of the United States Bankruptcy Court for the Southern District of Florida. They can be reached at Clay_Roberts@flsb.uscourts.gov and Annabelle_Torgman@flsb.uscourts.gov.

Approaches to Interpreting Section 707(b)

Courts have developed a number of approaches in interpreting section 707(b).[3] The first has been referred to as the "common sense approach." One of Congress's objectives with the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA") was to prevent chapter 7 discharges in cases where debtors possessed disposable income that could be paid to creditors.[4] Congress created the Means Test as a general prerequisite to receiving a chapter 7 discharge. Therefore, it is "common sense" that allowing debtors to avoid the Means Test by filing chapter 13 petitions and them converting to chapter 7 would run counter to Congress' intent.[5]

> "Judge Isicoff of the United States Bankruptcy Court for the Southern District of Florida recently held that a case converted to chapter 7 from another chapter may be dismissed for abuse under section 707(b)(1)."

Under the "plain language" view, courts simply look to the language of section 707(b) for answers. The Bankruptcy Code provision states:

> After notice and a hearing, the court . . . may dismiss a case filed by an *individual debtor under this chapter* whose debts are primarily consumer debts, or, with the debtor's consent, convert such a case to a case under chapter 11 or 13 of this title, if it finds that the granting of relief would be an abuse of the provisions of this chapter.[6]

This view strictly observes that the words "filed

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Substantive Consolidation of the Non-Debtor in Florida Southern v. Middle District

By G. Steven Fender

Substantive consolidation is a remedy available in bankruptcy court where the assets and liabilities of two or more entities are administered as one. Substantive consolidation comes into play in both chapter 7 and chapter 11. It accomplishes goals of trustees, debtors-in-possession, or any other parties-in-interest in various instances. No provision in the Bankruptcy Code specifically authorizes such relief; it is permitted under the bankruptcy courts' "general equitable powers" under 11 U.S.C. § 105.[1]

Eleventh Circuit Standard

The Eleventh Circuit has stated that substantive consolidation "involves the pooling of assets and liabilities of two or more entities; the liabilities of the entities involved are then satisfied from the common pool of assets created by consolidation."[2] "[T]he proponent of substantive consolidation must show that (1) there is a substantial identity between the entities to be consolidated; and (2) consolidation is necessary to avoid some harm or to realize some benefit."[3] "In making [the] prima facie case for consolidation, the proponent . . . may want to frame [the] argument using the seven

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ABOUT THE AUTHOR
G. Steven Fender is Of Counsel at Greenspoon Marder, P.A.'s West Palm Beach office, where he handles commercial and bankruptcy litigation matters.
He can be reached at Steven.fender@gmlaw.com.

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THE BANKRUPTCY BAR ASSOCIATION
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MESSAGE FROM THE PRESIDENT

By Scott N. Brown

Dear Readers,

On behalf of the Board of Directors of the Bankruptcy Bar Association of the Southern District of Florida, I am pleased to present you with this year's *BBA Journal*. Thank you to everyone involved in producing this wonderful Journal, especially its Editor in Chief, Ashley Dillman Bruce.

The BBA has had an exciting year so far, and the best is yet to come at our 31st Annual Retreat, which will take place Mother's Day Weekend at the Hyatt Regency Coconut Point in Bonita Springs. For those who have never attended a Retreat, I encourage you to join us this year. Eight Bankruptcy Judges from across the United States will serve as group leaders to discuss a broad array of both business and consumer hypotheticals designed to generate thoughtful discussion of relevant and timely issues in chapters 7, 11 and 13. The Sunday morning panel will feature William A. Brandt and Elliot Ganz debating the new ABI Chapter 11 Commission Report, and will be moderated by Judge Michael G. Williamson.

Thanks to record membership levels and generous sponsorships, the BBA has expanded its programming throughout the year in all three counties, to include pro bono clinics, Brown Bag CLE lunch programs, happy hours, dinner meetings, and various other educational and social events jointly sponsored with other local bar associations. We also continue to host other premier events throughout the year, including View From the Bench and the View From the Bench Judge's Dinner, Table of 8 dinners which give our younger members an opportunity to dine with and learn from many of the Bar's most well-known and learned members, courthouse appreciation lunches that allow our members to personally thank the staff from the Court, the Clerk's Office, the United States Trustee's Office and the Judiciary for all of their hard work, and our annual Holiday Party. The BBA is only as good and strong as its members, so I encourage each of you to take advantage of the programming we offer and provide feedback on how we can improve.

Finally, I would like to thank our outstanding Bench led by Chief Judge Paul G. Hyman. While we may not always realize it, as practitioners, we are extremely fortunate to have seven judges that care so much about our community, the bankruptcy system and the BBA. In closing, I want to thank everyone who has contributed to the BBA's success over the past year, especially the BBA's Board, Officers and Committee Chairs, for their tireless work to continue to make the BBA a world-class association. It has been my honor to serve as your President and I thank you for the opportunity.

Sincerely,
Scott N. Brown, President

The *BBA Journal* is designed to educate the BBA community and enhance its members' professional lives by providing accurate and authoritative information in regard to the subject matter covered. The views expressed herein are those of the authors, and are not necessarily those of the editorial staff, or any director, officer, or member of the Bankruptcy Bar Association of the Southern District of Florida, Inc. The *BBA Journal* is distributed with the understanding that the publisher is not engaged in rendering legal, accounting, or other professional services. If legal advice or other expert assistance is required, the service of a competent person should be sought.

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Fax (954) 726-3492
www.bbasdfl.org.

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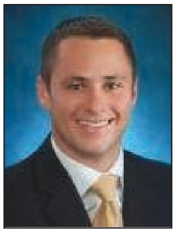
Momentive Sets No-Nonsense Tone to Cramdown Interest Rates



By Christopher M. Broussard

In the recent case *In re MPM Silicones, LLC* ("*Momentive*"),[1] Judge Robert Drain of the United States Bankruptcy Court for the Southern District of New York held that secured creditors could be crammed down through replacement notes paying substantially below market rates of interest. This article reviews Judge Drain's bench ruling in *Momentive* and compares it to Florida cases to analyze its potential impact.

Case Background

Momentive Performance Materials, Inc. and related debtors ("MPM") proposed a plan (the "MPM Plan") that, if accepted, provided for complete payment of allowed claim amounts to holders of $1.1 billion of 8.875% First Priority Notes due 2020 (the "First Lien Notes") and $250 million of 10% Senior Secured Notes due 2020 (the "1.5 Lien Notes") (together, the "Prior Notes").[2] The MPM Plan, however, required that the holders of the Prior Notes (the "Noteholders") forfeit the ability to litigate their potential entitlement to any prepayment penalty, "make-whole" premium, or any other, similar claim (the "Make-Whole Claims").[3] MPM intended to pay the Prior Notes through proceeds from exit and bridge financing commitments (the "Exit Financing").[4]

> "While Florida courts interpreting *Till* and calculating cramdown interest rates use the *Till* formula, they do so only after examining market evidence and testimony for the presence of an efficient market."

The MPM Plan also included a "death-trap" provision, which stated that if the Noteholders rejected the plan, they would, instead, receive replacement First and 1.5 Lien Notes (the "Replacement Notes") paying annual interest equal to the Treasury rate plus 1.50% on the First Lien Notes and 2.00% on the 1.5 Lien Notes (together, the "Cramdown Rates") over a period of 7 and 7.5 years, respectively. In the event of rejection, the Noteholders would, however, retain the right to pursue any and all Make-Whole Claims.

The MPM Plan was overwhelmingly rejected. Indenture trustees for both the First and 1.5 Lien Notes (the "Trustees") then filed formal objections to the MPM Plan.[5] In their objections, the Trustees campaigned for application of a market-based approach to calculating interest rates for the Replacement Notes and argued that MPM's use of the Treasury rate was inappropriate, MPM's risk premium was grossly inadequate and unsubstantiated, and the Exit Financing should serve as a reference, advising a more appropriate rate of interest.

MPM, in turn, argued that nothing mandates a market-based approach and the short term prime rate is inappropriate when applied to long term maturities such as the Replacement Notes.[6] According to MPM, the Treasury rate more accurately tracks the duration of the Replacement Notes and is thus more appropriate under the circumstances. MPM further argued the Replacement Notes' risk premium is supported by rigorous process and analysis, provides substantial equity cushion, is backed by significant collateral and post-emergence liquidity, and is further hedged by the legitimate possibility for new debt acquisition, if necessary, to service the Replacement Notes.

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ABOUT THE AUTHOR

Christopher M. Broussard is a bankruptcy and litigation attorney representing business debtors, creditors, and trustees in complex chapter 7 and 11 bankruptcy cases and a variety of clients across a diverse range of state and federal court litigation. He can be reached at cbrouss@suzytate.com.

VIEW FROM THE CHIEF JUDGE

By The Honorable Paul G. Hyman

The Eleventh Circuit Court of Appeals Approves the Expanded Use of Non-Debtor Releases in Reorganization Plans

ABOUT THE AUTHOR

The Honorable Paul G. Hyman is Chief Judge of the United States Bankruptcy Court for the Southern District of Florida.

It is not uncommon for a debtor in bankruptcy to propose a plan of reorganization that would result in the release of non-debtors. When faced with such a plan, the question for the bankruptcy court is: can the court grant such a release, and if so, what standard should the court use to determine whether the release is appropriate? Recently, the Eleventh Circuit Court of Appeals issued an opinion clarifying these issues and approving the expanded use of non-debtor releases in chapter 11 plans of reorganization: *In re Seaside Engineering & Surveying, Inc.*, No. 14-11590, 2015 WL 1061718 (11th Cir. Mar. 12, 2015).

The Debtor in *Seaside* was a closely held engineering and surveying company. Its principal shareholders—Gustin, Mainor, Binkley, Barton, and Spears—were also its officers and directors. Vision held an equity interest in the Debtor that it acquired by purchasing Gustin's stock from the chapter 7 trustee in Gustin's individual bankruptcy. Following the sale of Gustin's stock to Vision, the Debtor filed for chapter 11 bankruptcy protection.

In its chapter 11 plan, the Debtor proposed to reorganize and continue operations as an entity (the "Reorganized Debtor") managed by Gustin, Mainor, Binkley, and Bowden. The Reorganized Debtor would be owned by the irrevocable family trust of each manager. The prepetition equity holders in the Debtor, one of which was Vision, were to receive promissory notes with interest accruing at a rate of 4.25% in exchange for their shareholder interest in the Debtor. The bankruptcy court confirmed the plan of reorganization over the objection of Vision. Vision appealed, and the district court affirmed the bankruptcy court's approval of the plan. Vision then appealed to the Eleventh Circuit.

One of the provisions of the Debtor's confirmed plan of reorganization was a release of all claims—in connection with, relating to, or arising out of the chapter 11 case—held by any creditor or equity holder of the Debtor against the Reorganized Debtor or any individual officer, director, or member of the Debtor or the Reorganized Debtor. In confirming the plan with this non-debtor release, the bankruptcy court concluded that: (1) without the non-debtor release, the Reorganized Debtor would deplete its assets continuing to defend against potentially voluminous litigation; and (2) without the release, the key employees and managers of the Reorganized Debtor, many of whom were previously officers, directors, and members of the Debtor, would expend their time in defense of litigation as opposed to focusing on their professional duties for the Reorganized Debtor. The propriety of the non-debtor release was the main issue raised by Vision on appeal.

The Eleventh Circuit in *Seaside* noted that it had spoken once before on the validity of non-debtor releases in bankruptcy restructuring plans. In *In re Munford*, 97 F.3d 449 (11th Cir. 1996), the Eleventh Circuit approved the use of non-debtor releases in restructuring plans when a settlement was to fund the bankruptcy estate and the settling defendant would not have entered into the settlement without the release. The facts of *Seaside*, however, differ significantly from those considered in the *Munford* case. Instead of issuing a release in the settlement context, the *Seaside* non-debtor release barred claims that would undermine the operations of the Reorganized Debtor and its chances for success by depleting the assets of the Reorganized Debtor and diverting the time and attention of key skilled employees and managers.

As noted by the Eleventh Circuit, there is a split among the circuits as to whether bankruptcy courts have the authority to issue non-debtor releases under circumstances similar to those presented in *Seaside*. The minority view, followed by the Fifth, Ninth, and Tenth Circuits, prohibits such releases and bar orders. The majority of the circuits, including the Second, Third, Fourth, Sixth, and Seventh, permit such releases and bar orders.

After considering both the minority and majority views, the Eleventh Circuit determined that it agreed with the majority view. It thus upheld the authority of the bankruptcy courts to approve non-debtor releases when the absence of such a release would undermine the operations of the reorganized entity. The Eleventh Circuit warned, however, that such releases ought not to be issued lightly and should be reserved for those unusual cases in which such an order is necessary for a successful reorganization and is fair and equitable.

Moreover, the Eleventh Circuit instructed that in considering whether to approve a non-debtor release under the circumstances presented in *Seaside*, bankruptcy courts should apply the seven-factor test set forth by the Sixth Circuit in *In re Dow Corning Corp.*, 280 F.3d 648, 657-58 (6th Cir. 2002). In *Dow Corning*, the Sixth Circuit held that the bankruptcy court may approve a non-debtor release when the following seven factors are present:

(1) There is an identity of interests between the debtor and the third party, usually an indemnity relationship, such that a suit against the non-debtor is, in essence, a suit against the debtor or will deplete the assets of the estate;

(2) The non-debtor has contributed substantial assets to the reorganization;

(3) The injunction is essential to reorganization, namely, the reorganization hinges on the debtor being free from indirect suits against parties who would have indemnity or contribution claims against the debtor;

(4) The impacted class, or classes, has overwhelmingly voted to accept the plan;

(5) The plan provides a mechanism to pay for all, or substantially all, of the class or classes affected by the injunction;

(6) The plan provides an opportunity for those claimants who choose not to settle to recover in full and;

(7) The bankruptcy court made a record of specific factual findings that support its conclusions.

However, instead of following the Sixth Circuit's insistence that all seven factors be present, the Eleventh Circuit in *Seaside* stressed that the list of factors should be considered nonexclusive and that bankruptcy courts should retain discretion to determine which of the *Dow Corning* factors is relevant in each case.

In sum, the *Seaside* case is significant in that the Eleventh Circuit unequivocally approved the expanded use of non-debtor releases and bar orders in reorganization plans when such releases bar claims against non-debtors that would undermine the operations of the reorganized entity. The Eleventh Circuit also clarified the test that bankruptcy courts should follow when determining whether such a non-debtor release is appropriate. ■

The Impact of the Absolute Priority Rule on Individual Chapter 11 Bankruptcy Cases

Ashley Dillman Bruce

Leslie Gern Cloyd

By Ashley Dillman Bruce and Leslie Gern Cloyd

ABOUT THE AUTHOR

Ashley Dillman Bruce practices on Berger Singerman's business litigation and reorganization teams, is a Palm Beach director of the BBA, and is the Editor in Chief of the BBA Journal. Ashley can be reached at ADBruce@bergersingerman.com.

Leslie Gern Cloyd is a partner on Berger Singerman's business reorganization team and is the Broward County coordinator for pro bono services for the BBA. Leslie can be reached at LCloyd@bergersingerman.com.

Individuals who own businesses or have personally guaranteed the obligations of their company, often consider filing for bankruptcy when their business fails. Individuals who consider filing chapter 7 will have to deal with a straight liquidation — where they may not keep any property without paying for its value. Many business owners forgo filing chapter 13 because they are ineligible due to debt limitations where an individual debtor cannot have over a certain amount of debt to qualify.[1] Although more expensive, chapter 11 is often the best choice for business owners who have assets, yet wish to reorganize their business affairs. But as many bankruptcy practitioners know, individual chapter 11 debtors face a demanding path down the road of plan confirmation.

A Typical Chapter 11 Scenario

An individual debtor owns an operating business, say a chain of convenience stores for which a creditor is the primary supplier of gasoline and gas station products. Several years ago, the debtor's gas station began operating at a loss due to the rising price of petroleum and a diminishing customer base which caused the debtor to owe the gasoline supplier millions of dollars. To continue the flow of gasoline and products, the debtor executed second mortgages on various tracts of real estate, including his house and farmlands, in favor of the gasoline supplier. Unfortunately, the business continued to lose money and the debtor could no longer pay the supplier. Faced with no other option, the debtor filed for chapter 11 protection and proposed a plan of reorganization. Pursuant to the plan, the gasoline supplier would be paid only 2% of the millions of dollars owed yet the debtor would retain possession and control of his house and farmlands. Not surprisingly, the gasoline supplier objected to the proposed plan on the ground that it did not treat the creditor fairly and equitably, a violation of the absolute priority rule.

Absolute Priority Rule: If I can't have it, neither can you!

A chapter 11 debtor cannot successfully emerge from bankruptcy without proposing a plan of reorganization which must specify how each class of claims will be treated. A plan cannot be confirmed over a creditor's objection without committing all of the debtor's disposable income over five years unless the plan pays the claim in full, with interest, over a shorter period of time.

> "Although more expensive, chapter 11 is often the best choice for business owners who have assets, yet wish to reorganize their business affairs."

Section 1129(a) allows for plan confirmation where each class of creditors consents to the proposed treatment. Since the supplier in our scenario did not consent to the proposed plan, the debtor must travel under an alternative section of the Bankruptcy Code.

Section 1129(b) provides a cram-down mechanism whereby a plan may be confirmed without the consent of each creditor class. When a debtor seeks confirmation of a plan over the objection of an impaired class of creditors, the court must assess whether the plan "discriminates unfairly" and is "fair and equitable." Section 1129(b) outlines the "fair and equitable" criteria, one of which includes what courts call the "absolute priority rule."

Under section 1129(b)(2)(B), a "fair and equitable" plan must fully satisfy the claims of senior classes of unsecured creditors before junior classes can receive or retain any property "on account of" their prior ownership interests. The absolute priority rule prohibits a cram down of a plan without payment of the unsecured claims in full if the debtor seeks to retain any interest in his property. In our scenario, because the debtor proposed to retain his farmlands and house, it could be argued that the plan violates the absolute priority rule.

An Unsettled Issue: Does the Absolute Priority Rule Even Apply?

The Bankruptcy Abuse Prevention and Consumer Protection Act ("BAPCPA"), added language in sections 1129(b)(2)(B) and 1115 that permits a debtor to retain certain property. Section 1115 was amended to provide that property of the estate includes everything the debtor owned on the date of the petition plus anything earned by the debtor post-petition. Section 1129 now provides that a "debtor may retain property included in the estate under § 1115." The question is: What property is included under section 1115?

One bankruptcy appellate panel and a handful bankruptcy courts[2] have adopted a "broad view," holding that the BAPCPA amendments eliminate the absolute priority rule. The broad view interprets the relevant language to absorb and then supersede section

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Nonprofits in Bankruptcy: Is Chapter 11 a Fresh Start or a Finale?

By Carol Fox

ABOUT THE AUTHOR

Carol Fox, CPA, CFE, CIRA is a Senior Managing Director in the Miami office of GlassRatner Advisory & Capital Group, LLC, where she focuses her practice in the areas of bankruptcy and restructuring, forensic accounting, and litigation support. She can be reached at cfox@glassratner.com.

Here Today, Gone Tomorrow

With state and federal budgets shrinking, private donations dwindling, and expenses on the rise, many charitable and nonprofit organizations are filing for bankruptcy protection. Is emergence from chapter 11 realistic? Without our help, the ultimate fate of these organizations, some of which have operated and served their communities for decades, may be closed doors and liquidation.

Non-Profit's Long and Winding Road to Chapter 11 Plan Confirmation

Even in the for-profit sector, it is not unusual for a plan and disclosure statement to be amended, sometimes more than once. For charitable and nonprofit organizations, plan confirmation is a little trickier. This has to do with the unique business models of the many nonprofits that rely on public and private support for cash flow. The Bankruptcy Code requires chapter 11 debtors to prove that their plan has a reasonable probability of success:

> "The court shall confirm a plan only if all of the following requirements are met: . . . (11) Confirmation of the plan is not likely to be followed by liquidation, or the need for further financial reorganization, of the debtor or any successor to the debtor under the plan, unless such liquidation or reorganization is proposed in the plan."[1]

Unfortunately for nonprofits, prior court rulings have denied confirmation of plans that are based solely on post-petition fundraising campaigns. For example, the Court of Appeals for the Fifth Circuit affirmed the denial of plan confirmation of the non-profit *Save Our Springs (S.O.S.) Alliance, Inc.*, reasoning as follows:

> S.O.S.'s argument fails, because there was no evidence showing even a reasonable assurance of success. S.O.S. points to its past financial statements showing successful fundraising campaigns. But raising funds during bankruptcy is more difficult than at other times. That is particularly true here, given that S.O.S.'s donors are hesitant to give for the purpose of paying off judgment creditors. The bankruptcy court's conclusion that past donations are not evidence of future fundraising ability is thus appropriate.[2]

Cases such as *S.O.S.* thus illustrate the necessity of identifying a supplemental means of funding the nonprofit's plan of reorganization. Given the hobbling effect a bankruptcy can have on the organization not only operationally but also from a public relations standpoint, one wonders how many non-profits will be able to grow or even maintain the ancillary sources of revenue (e.g., ticket sales, facility rentals, tuition) necessary to augment their fundraising efforts.

> "Unfortunately for nonprofits, prior court rulings have denied confirmation of plans that are based solely on post-petition fundraising campaigns."

Musical Chairs

It comes as no surprise that a decline in discretionary spending is the direct and inevitable result of tough and challenging economic times. Doubly hit are performing arts groups who not only suffer from decreased ticket sales and attendance at events but the diversion of public and private donations from the arts to organizations that address other worthy causes, such as food, clothing, and shelter. The *Philadelphia Orchestra Association* is a case in point.

Citing "a series of challenges stemming from factors including declining ticket revenues, eroding endowment income, decreased donations, increased operational costs, increasing pension obligations and burdensome contractual agreements[,]"[3] and coupled with the projection that "they would run out of cash in May 2011 barring any change in circumstances[,]"[4] the 111-year-old orchestra filed for relief under chapter 11 of the Bankruptcy Code in April 2011.[5] Backed by the support of their largest donor, the Annenberg Foundation (whose pre-petition grant of $50 million remained intact as of the petition date), the debtor's plan of reorganization was confirmed approximately fifteen months later. The case of the Philadelphia Orchestra, shows that even the oldest and most established institutions can find themselves without a chair when the musical funding stops.

The Trend Travels South

Over ten years ago South Florida bid farewell to The Florida Philharmonic Orchestra, Inc. (the "Florida Philharmonic"), which was established in 1985 and filed a chapter 11 petition in May 2003 as a result of failed labor negotiations and difficulty making royalty payments in respect of its music library. In December 2005, the Florida Philharmonic filed its plan of liquidation with the Court after selling substantially all of its assets, including its real property and music library.[6]

A review of recent bankruptcy filings indicates that the number of nonprofit filings in the Southern District of Florida is on the rise. Detailed below are some recent nonprofit filings between 2012 and 2015.

(*See Chart on page 12*)

To File or Not to File

As is the case with all businesses, a nonprofit organization's financial and operational strengths and weaknesses should be evaluated before

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Safe Harbor Provisions of Bankruptcy Code Section 546(e) Simplified: Limitations on a Trustee's Avoidance Powers

Siddharth P. Sisodia

ABOUT THE AUTHOR

Siddharth P. Sisodia received his J.D. in 2013 and LL.M. in Bankruptcy in 2014, both from St. John's University School of Law. While pursuing his law degree, he interned for the Honorable Sean H. Lane, U.S. Bankruptcy Court Judge for the Southern District of New York and for the Office of the U.S. Trustee for the Southern District of Florida. He can be reached at siddharth.p.sisodia@gmail.com.

Avoidance of Claims Under Section 546(e) of the Bankruptcy Code

As often is the case, creditors and victims of a Ponzi scheme will justifiably try to recoup their "investments" upon its discovery. In order to compensate the victims, an appointed trustee to administer a Ponzi scheme case in bankruptcy will seek to avoid payments from the recipients who may have received more than their share of their initial investment. A trustee, however, may not be able to avoid a payment made to a transferee if the safe harbor provisions of section 546(e) of the Bankruptcy Code apply. This article highlights the decisions of the circuit courts and bankruptcy courts in interpreting the section.

The Bankruptcy Code permits a trustee to pursue avoidance actions to unwind transactions that are fraudulent in nature. There are, however, limits to the trustee's avoidance power. Under section 546(e) of the Bankruptcy Code, " . . . the trustee may not avoid a transfer that is . . . a settlement payment . . . or that is a transfer made to a financial institution [or] financial participant . . . in connection with a securities contract, . . . except under section 548(a)(1)(A)."[1] Even though these requirements may seem straightforward, there are, however, varying degrees of interpretations as to the application of section 546(e). Each of the requirements of section 546(e) and how various courts have interpreted them are discussed in detail below.

Settlement Payment

Under section 741(8), a settlement payment means "a preliminary settlement payment, a partial settlement payment, an interim settlement payment on account, a final settlement payment, or any other similar payment *commonly used in the securities trade*."[2] Because the definition of a settlement payment is circular the statutory definition is not very useful. As a result, courts have used the phrase "commonly used in the securities trade" in the statute to define the term settlement payment.[3]

There is a circuit split as to what types of transactions are commonly involved in the securities trade. The Seventh Circuit has held that settlement payment means what it ordinarily means in the securities business: the financial settling-up after a trade.[4] The Second Circuit on the other hand defines settlement payment as "a transfer of cash made to complete a securities transaction."[5] The Third Circuit has held that a securities transaction is not limited to sale or purchase of securities and that any transaction involving privately or publicly held securities constitutes a securities transaction.[6] Several other circuit courts have also held that the definition of settlement payment is "extremely broad."[7] Conversely, the Ninth Circuit has held that common usage in the securities trade does not include non-public trades of unregistered securities in an illegal transaction.[8] The dissenting opinion in *Enron Creditors Recovery Corp.* case held that securities transaction means only those payments that relate to the purchase or sale of securities.[9]

> "In order to compensate the victims, an appointed trustee to administer a Ponzi scheme case in bankruptcy will seek to avoid payments from the recipients who may have received more than their share of their initial investment."

There is also a difference of opinion in the interpretation of legislative history of section 546(e) to define settlement payment. The Ninth Circuit has held that the section 546(e) was designed to protect the public markets and its integrity. Therefore, securities not publicly traded and in transactions where public markets are not utilized, such transactions should not be covered within the definition of the settlement payment.[10] The Ninth Circuit has also held that in a stock-fraud scheme, the payments are so steeped in fraud that they can hardly be deemed to be so "ordinary" as used in the "ordinary securities trade."[11] Conversely, the Second, Third, Sixth, Seventh, Eighth, and Tenth Circuits have held the purpose of section 546(e) was to clarify, and in some instances, broaden the commodities market protections and expressly extend similar protections to the securities market.[12] Based on this, these courts have interpreted the legislative history of section 546(e) to be very broad to protect any standard business transaction.

Financial Participant

There is a split of authority regarding what role a financial institution must play in the transaction for it to qualify for the safe harbor of section 546(e). Four circuits have held that the plain language of section 546(e) includes any transfer to a financial institution, even if it is only serving as a conduit or an intermediary.[13] Only the Eleventh Circuit has held that the financial institution must acquire a beneficial interest in the transferred funds or securities for the safe harbor provision of the Bankruptcy Code to apply.[14]

Securities Contract

Under section 741(7) a securities contract is "a contract for the purchase, sale, or loan of a security . . . including . . . any repurchase or reverse repurchase transaction on any such security . . . ."[15] The definition of a securities

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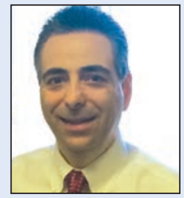
MESSAGE FROM THE CLERK

By Joseph Falzone

ABOUT THE AUTHOR

Joseph Falzone is Clerk of Court for the United States Bankruptcy Court for the Southern District of Florida. Email: Joe_Falzone@FLSB.uscourts.gov.



Bankruptcy Case Filing Statistics

Bankruptcy case filings in the Southern District of Florida for calendar year 2014, continued their downward trend to 28,218, an 8.23% decrease below 2013 bankruptcy case filing levels of 30,748. As bankruptcy filings in the federal courts fell nearly 13% according to data published by the Administrative Office of the U.S. Courts, the Southern District of Florida continues to rank 5th in the nation based on total filings. For more information on national bankruptcy filing statistics, visit the Administrative Office of the U.S. Courts statistics web page.

Miami Division Move to the C. Clyde Atkins U.S. Courthouse

After nearly 40 years in the Claude Pepper Federal Building at 51 S.W. First Avenue, the Miami division of the Bankruptcy Court relocated to the C. Clyde Atkins U.S. Courthouse at 301 North Miami Avenue on October 9, 2014. The Miami bankruptcy court now occupies substantial space on the first, second, and third floors of the Atkins Courthouse. The three Miami judges have each moved into an entire spacious floor with courtrooms more than twice the size of their previous courtrooms. The court is occupying chambers and courtrooms on the 4th floor (Honorable Robert A. Mark), the 7th floor (Honorable A. Jay Cristol) and the 8th floor (Honorable Laurel M. Isicoff). This move is expected to save the judiciary approximately $818,000 annually in rent and security costs.

Status of Judiciary Budget for Fiscal Year 2015

On December 16, 2014, the President signed, H.R. 83, the "Consolidated and Further Continuing Appropriations Act of 2015," which provides final fiscal year 2015 funding for the federal government, including the Judiciary. Overall, the Judiciary fared better than expected given this austere budget climate. The final FY 2015 plan increases the amount of funding by 2.8% over fiscal year 2014. While funding levels for the Judiciary in fiscal years 2014 and 2015 will allow the courts to recover from the harmful effects of sequestration, we must remain cognizant that the federal government will continue to operate in a constrained budget environment for the foreseeable future.

Amendments to Federal Bankruptcy Rules, Forms, and Fees

On April 25, 2014, the Supreme Court approved amendments to the Federal Rules of Bankruptcy Procedure which took effect on December 1, 2014. The following Public Notices and Administrative Order referencing these amendments have been posted on the court web page:

- Clerk's Notice of Amendments to Bankruptcy Rules and Forms
- Bankruptcy Court Miscellaneous Fee Schedule Increases
- Administrative Order 14-06

As bankruptcy filings in the federal courts fell nearly 13% according to data published by the Administrative Office of the U.S. Courts, the Southern District of Florida continues to rank 5th in the nation based on total filings.

NEW Court Website

We are pleased to announce that we launched our new court website on December 22, 2014. Please take a moment to visit and familiarize yourself with the new site, as we are confident it will provide a greatly improved user experience. If you have any comments, suggestions and/or questions about the new website, please contact us at: Webmaster_FLSB@flsb.uscourts.gov.

CM/ECF Training Moves Online

In concert with launching our new court website, we have also developed and implemented a CM/ECF Online Training course to replace the in-person classroom training that has been conducted by the clerk's office since 2004. The online training program is comprised of a series of electronic learning modules (ELMs) that have been customized for this court. ELMs are available to practitioners and limited filers seeking to register for privileges to electronically file documents in the court's automated case management system (CM/ECF). The training program can also be used as a resource for support staff who routinely file documents in CM/ECF. Each tutorial provides the option for closed captioning and includes a PDF of slide notes. In the brief period of time that this new training program has been LIVE, we have registered over 243 users, 203 of which have already successfully completed the program.

Digital Audio Recording Coming to Miami Division

As you may recall, on October 1, 2013, the court transitioned to Digital Audio Recording (DAR) in the divisional courtrooms located in Ft. Lauderdale and West Palm Beach. As a result, all court proceedings conducted in these divisions are exclusively digitally recorded and digital recording constitutes the official record of the court. Over the next 3-5 months, the Miami division will transition to DAR. More information will be posted on the court's web page as it becomes available.

Court Calendar Kiosks

In the next few months, the court will deploy touch screen kiosks outside each of the courtrooms in all three divisions. Kiosks will display the judge's court calendar for the day and will eliminate the need for the courtroom deputy to hang a pre-printed copy of the calendar on a bulletin board outside the courtroom.

Next Generation of CM/ECF

Case Management/Electronic Case Files (CM/ECF) is a judiciary-developed case management program offering Internet access to official case records in the federal courts. This program enables participating attorneys and litigants to file pleadings and allows courts to file,

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MESSAGE FROM THE CLERK

maintain, and retrieve case file information using electronic format.

In 1995, the first CM/ECF prototype was placed in LIVE operation to specifically support the thousands of asbestos case related documents being filed in the U.S. District Court for the Northern District of Ohio. As a result of its overwhelming success, the project was expanded to support other types of court filings, including bankruptcy cases. As part of a pilot program in 1997 CM/ECF was implemented in five bankruptcy courts. Today, CM/ECF is LIVE in every federal court in the country.

In 2008, it became apparent that the current version of CM/ECF needed to be upgraded and rewritten in order to support new functionality and technological enhancements. As a result, CM/ECF NextGen was born. The goals of the NextGen project included greater integration among the district, bankruptcy and appellate versions of CM/ECF, shared data with other Judiciary systems, more streamlined processes, greater consistency for external users, enhanced case management functionality, and greater efficiency through use of new tools and technology.

In an effort to build the most functional system possible, input was elicited from the bar, academia, government agencies and others. A review of the judiciary's information technology infrastructure was also done. In 2012, the requirements gathering phase was completed and the development of CM/ECF NextGen commenced with the first release being made available to a few select appellate courts in October 2014, with full implementation to occur over the next two years.

The first release of CM/ECF NextGen will include central sign-on functionality, which will allow users of CM/ECF and PACER to maintain one account across ALL CM/ECF NextGen courts. Users will sign in one time to access multiple courts. Additionally, this release will also include Electronic Self-Representation [eSR]. The eSR module will allow a pro se debtor to prepare and submit (NOT FILE) to the court either a partial, or fully complete, chapter 7 or chapter 13 individual petition. Debtors will be able to work on their petition packages over time by using their self-selected login and password.

The clerk's office will keep you posted as more CM/ECF NextGen information becomes available.

Clerk's Retirement and Successor Appointed

On December 31, 2014, Katherine (Kathy) Gould Feldman retired as the clerk of the Bankruptcy Court, and was replaced by her former chief deputy, Joe Falzone. Prior to Kathy's appointment as clerk, she served as the chief deputy clerk of court for 20 years and had nearly 37 years of federal court service. During her career in the federal judiciary, Kathy has served on various national working groups and educational committees. Before joining the bankruptcy court in 1987, Kathy was employed by the U.S. District Court for the Southern District of Florida, where she held various positions, including operations manager, court reporter supervisor and judicial assistant to two U.S. district judges.

Joe Falzone was appointed clerk of court effective January 1, 2015. Prior to his appointment as clerk, Joe served as the court's chief deputy clerk for 8 years, Operations Manager for 10 years, and has over 23 years of bankruptcy court service and experience.

In Closing

We are extremely proud of what we have accomplished in 2014, and we remain extremely grateful for your continued support throughout the years. As always, we welcome your comments and suggestions on how we can better serve you. ■

Substantive Consolidation of the Non-Debtor in Florida Southern v. Middle District

Continued from page 1

factors outlined in *In re Vecco Construction Indus.*"[4] The *Vecco* factors include: **(1)** the presence or absence of consolidated financial statements; **(2)** the unity of interests and ownership between various corporate entities; **(3)** the existence of parent and intercorporate guarantees on loans; **(4)** the degree of difficulty in segregating and ascertaining individual assets and liabilities; **(5)** the existence of transfers of assets without formal observance of corporate formalities; **(6)** the commingling of assets and business functions; and **(7)** the profitability of consolidation at a single physical location. The *Eastgroup Properties* opinion notes that the following additional factors could also be relevant in deciding whether to substantively consolidate entities: **(1)** the parent owning the majority of the subsidiary's stock; **(2)** the entities having common officers or directors; **(3)** the subsidiary being grossly undercapitalized; **(4)** the subsidiary transacting business solely with the parent; and **(5)** both entities disregarding the legal requirements of the subsidiary as a separate organization.[5]

On their face, these factors do not turn on the target entity being a debtor in bankruptcy court. The Eleventh Circuit has not addressed whether a bankruptcy court may order substantive consolidation of a non-debtor, i.e. an entity not in bankruptcy. However, courts in both the Southern District and the Middle District have squarely addressed the issue, with entirely opposite holdings. The analysis appears to turn on the deciding court's consideration of the Bankruptcy Code's involuntary bankruptcy protections under 11 U.S.C. § 303, and the interplay with the court's powers to order substantive consolidation under § 105.

> "The Eleventh Circuit has stated that substantive consolidation 'involves the pooling of assets and liabilities of two or more entities; the liabilities of the entities involved are then satisfied from the common pool of assets created by consolidation.'"

Alter Ego?

The issue first arose in *In re Alico Mining*, before Judge Paskay in 2002 where a creditor sought to substantively consolidate a non-debtor entity with the debtor in a pending chapter 11.[6] The court commented that this remedy is "unorthodox" because it "would be tantamount to force an entity to become an

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Using Section 707(b): Tale in Futility or Proper Means to Dismiss Cases Converted to Chapter 7?

Continued from page 1

by an individual debtor under this chapter" mean only under chapter 7.[7] Because a converted chapter 11 or 13 case was not filed under chapter 7, section 707(b)(1) is not the vehicle to dismiss cases for abuse. These plain language courts explain that bankruptcy courts do not need section 707(b) to dismiss cases because section 105(a) provides courts with "broad authority" to "prevent an abuse of process."[8] Judge Williamson of the United States Bankruptcy Court for the Middle District of Florida followed this rationale in *In re Layton*.[9]

In re Layton involved a debtor who filed a chapter 13 petition, but later converted to chapter 7 when the she lost her job and could no longer afford to make chapter 13 plan payments.[10] After the case was converted, the debtor found a job prior to receiving her chapter 7 discharge.[11] It was undisputed that the debtor failed the means test because her monthly income exceeded $1,200.[12] The court, however, accepted the plain language approach by pointing out the weaknesses of the "common sense" approach—primarily that every court has the inherent power to handle abuse through the application of section 105, thus the application of section 707(b)(1) is unnecessary.[13]

In the United States Bankruptcy Court for the Southern District of Georgia, Chief Judge Barrett also used a plain reading approach, yet came to the opposite conclusion of Judge Williamson.[14] In *In re Davis*, the court held that section 707(b) applies to any chapter 7 case involving an individual debtor, not simply one originally filed under chapter 7.[15] In support of her holding, Chief Judge Barrett cited 11 U.S.C. § 348(a), which provides that the "'[c]onversion of a case from a case under one chapter of this title to a case under another chapter of this title constitutes an *order for relief* under the chapter to which the case is converted.'"[16] The court went on to explain that under 11 U.S.C. § 301, the commencement of a bankruptcy case is an "order for relief."[17] Reading the two sections together, converting a case from another chapter to chapter 7 is an order for relief, thereby making it the same as a case originally filed under chapter 7. Thus, for purposes of section 707(b), a case converted to chapter 7 is a case "*filed under this chapter*."[18]

In further support of her holding, Chief Judge Barrett also highlighted that dismissing cases for abuse was part and parcel of Congress' intention to limit the chapter 7 remedy to "those debtors who are honest and who need the remedy to preserve a decent standard of living for themselves and their dependents."[19] Finally, as additional support, Bankruptcy Rule 1019(2) specifically provides for a new time period for which to file a motion to dismiss under section 707(b) when a case has been converted to chapter 7.[20] In Judge Barrett's view, this is evidence of Congress' awareness that courts were using section 707(b) to dismiss converted cases and accordingly, its tacit approval of the practice.[21]

Judge Isicoff of the United States Bankruptcy Court for the Southern District of Florida recently held that a case converted to chapter 7 from another chapter may be dismissed for abuse under section 707(b)(1).[22] In *In re Pollitzer*, Judge Isicoff directly adopted Chief Judge Barrett's view from *In re Davis*.[23]

A final viewpoint has been referred to as the "hybrid approach," because it follows the plain language application but arrives at the "common sense" conclusion.[24] The hybrid view applies the grammatical rule of last antecedent, which states that a limiting clause or phrase modifies only the noun or phrase immediately following it.[25] Thus, under section 707(b)(1), the word "filed" would apply to directly to a debtor, regardless of the chapter so long as the debtor is an individual.[26]

Conclusion

Despite the apparent split of authority on the issue of whether 11 U.S.C. § 707(b) applies to a case that has been converted to a chapter 7 case, an increasing amount of case law tilts the scales toward the "common sense" view, albeit through a "plain meaning" approach. The issue will continue to be debated unless and until Congress decides to create a clearer avenue for handling converted cases. ■

NOTES

[1] *Witcher v. Early (In re Witcher)*, 702 F.3d 619, 621 (11th Cir. 2012).
[2] 11 U.S.C. § 707(b)(1).
[3] *In re Layton*, 480 B.R. 392 (M.D. Fla. 2012) (collecting cases).
[4] *Id.* at 396 (*citing* H.R. Rep. No. 109–31, pt. 1, at 2 (2005), 2005 U.S.C.C.A.N. 88, 89).
[5] *Id.* at 396.
[6] 11 U.S.C. § 707(b)(1) (emphasis added).
[7] *See In re Layton*, 480 B.R. at 397; *In re Fox*, 370 B.R. 639 (Bankr. D. N.J. 2007).
[8] *In re Layton*, 480 B.R. at 398 (*quoting Marrama v. Citizen's Bank of Mass.*, 549 U.S. 365, 375 (2007)).
[9] *Id.*
[10] *Id.* at 394.
[11] *Id.*
[12] *Id.*
[13] *Id.* at 397-98.
[14] *In re Davis*, 489 B.R. 478 (S.D. Ga. 2013).
[15] *Id.* at 481.
[16] *Id.* at n. 4 (*citing* 11 U.S.C. § 348(a) (emphasis added)).
[17] *Id.* at 481.
[18] *See* 11 U.S.C. §§ 301, 348, 707(b).
[19] *In re Davis*, 489 B.R. at 484 (*citing In re Goddard*, 323 B.R. 231, 233 (Bankr. S.D. Ohio 2005)); S.Rep. No. 65, 98th Cong., 1st Sess. 53, 54 (1983).
[20] *Id.*; Fed. R. Bankr. P. 1019(2) ("[W]hen a chapter 11, chapter 12, or chapter 13 case has been converted or reconverted to a chapter 7 case . . . a new time period for filing a motion under § 707(b) or (c), a claim, a complaint objecting to discharge, or a complaint to obtain a determination of dischargeability of any debt shall commence . . . .").
[21] *Id.* at 483-84.
[22] *In re Pollitzer*, No. 11-16703, 2014 WL 6612932, at *1 (Bankr. S.D. Fla. Nov. 13, 2014).
[23] *See id.* at *2 ("I find that the reasoning of the bankruptcy court in *In re Davis*, 489 B.R. 478, reflects precisely my analysis of, and position with respect to, all of the issues raised by the U.S. Trustee and by the Debtor, and therefore, I adopt the reasoning and holding of Judge Barrett.").
[24] *In re Layton*, 480 B.R. at 395 (*citing Justice v. Adv. Control Solutions, Inc.*, No. 07-5231, 2008 WL 4368668, at *4 (W.D. Ark. 2008)).
[25] *Justice*, 2008 WL 4368668, at *4.
[26] *Id.*

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Momentive Sets No-Nonsense Tone to Cramdown Interest Rates

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Cutting Out The Market

A core controversy in *Momentive* centered on whether the Cramdown Rates were sufficiently calibrated to provide a stream of cash flow approximating an appropriate present value.[7] To reconcile the controversy, *Momentive* adopted the formula approach advanced in both *Till v. SCS Credit Corp.*[8] and *In re Valenti*[9] as the appropriate method for calculating cramdown interest rates in chapter 11 cases.[10] The formula approach adds a risk premium to a base rate to calculate the applicable cramdown interest rate.

Momentive then rejected market-based alternatives to the formula approach. Through heavy doses of both *Till* and *Valenti*, the court explained: "Each of these approaches is complicated, imposes significant evidentiary costs, and aims to make each individual creditor whole rather than to ensure the debtor's payments have the required present value."[11] The goal is "to put the creditor in the same economic position it would have been in had it received the value of its allowed claim immediately . . . not to put the creditor in the same position that it would have been in had it arranged a 'new' loan."[12] Market rates overcompensate through transaction costs and profits.[13] A secured creditor's allowed claim does not include any degree of profit.[14] There is no reason cramdown rates should be any different.[15]

Momentive next analyzed footnote 14 in *Till* to diffuse the effects of "inapt and unstated inference."[16] Footnote 14 links to a sentence in *Till* which commented on the impossibility of creditor indifference between cramdown and foreclosure.[17] Creditors will always prefer foreclosure and reinvestment at market rates because cramdown generates no profit.[18] Accordingly, *Till* concluded the market for cramdown loans in chapter 13 is merely illusory.[19] Applying that logic, *Momentive* concluded the relevant market for involuntary loans may be just as illusory in chapter 11 and there is no meaningful difference between the two chapters compelling migration to a market approach.[20]

Momentive also rejected as misinterpretation, arguments advancing a two-step formula analysis, which looks first at market-based information and testimony to see if there is, in fact, an efficient market.[21] Because "capturing profit, fees and costs is the marketplace lender's reason for being," an efficient market and by extension, market rate, excluding profits, fees, and costs in compliance with *Till*, *Valenti*, and section 1129(b)(2)(A)(i)(II), is highly unlikely.[22] As per *Momentive*, the concepts are simply incompatible, which is why courts engaging a two-step process almost invariably conclude the absence of an efficient market.[23] *Momentive* then dismissed Trustees' arguments regarding use of the Exit Financing as a proxy for the *Till* formula, concluding no private lender would lend without a built-in profit element.[24]

There is, however, one concession regarding market information in *Momentive*. The court states: "[M]arket-based evidence should not be considered, except, arguably and, if so secondarily, when setting a proper risk premium in the formula approach taken by *Till* and *Valenti*."[25] The court did specifically hedge that concession though, explaining that "risk adjustment is not a back door to applying a market rate."[26]

Finally, *Momentive* endorsed MPM's use of the Treasury rate, citing "the circumstances of the debtors' estate, the nature of the security (both the underlying collateral and the terms of the new notes), and the duration and feasibility of the reorganization plan."[27] The court did, however, push back, explaining that "there should be an additional amount added to the risk premium in light of the fact that the debtors used Treasury rates as the base rate."[28] That additional amount is 0.50% for the First Lien Replacement Notes and 0.75% for the 1.5 Lien Replacement Notes, bringing the Cramdown Rates up to 4.10% and 4.85%, respectively.[29] The court did not provide an explanation as to how these additional amounts were calculated or whether and to what extent they capture the spread between Treasury and prime.

Conclusion

Core concepts are neatly packaged in *Momentive* through several "first principles," which advise: (1) use an interest rate that takes the profit out, takes the fees out, and compensates the creditor under a formula starting with a base rate that is essentially riskless; (2) add to that formula a risk premium of 1.00% to 3.00% to compensate for a debtor's unique risks in completing plan payments; (3) market-based evidence and testimony is relevant only when constructing an appropriate risk premium; and (4) the risk premium is not a back door to obtaining a market rate. [30]

These *Momentive* conclusions do, however, conflict with Florida cases. While Florida courts interpreting *Till* and calculating cramdown interest rates use the *Till* formula, they do so only after examining market evidence and testimony for the presence of an efficient market.[31] Moreover, instead of a riskless base rate, Florida courts utilize the prime rate, which, unlike the Treasury rate, is increased to compensate for probability of default. The significance of that spread is evidenced by the fact that even with an added bump, *Momentive* still generated a 4.10% interest rate. In contrast, Florida cases generally yield rates greater than or equal to at least 5.00%.[32]

Momentive is thus primed to ignite a push in Florida for a one-step, direct-to-formula calculation, utilizing a Treasury base to trim cramdown interest rates. If it catches, *Momentive* is likely to increase debtor-side leverage in plan negotiations, but may spike market rates as lenders compensate for enhanced risk in bankruptcy. ■

NOTES

[1] *In re MPM Silicones*, No. 14-22503-RDD, 2014 WL 4436335, at *1 (Bankr. S.D.N.Y. Sept. 9, 2014).
[2] No. 14-22503-RDD, [ECF Nos. 814, 857, and 867].
[3] *Id.*
[4] *Id.* at [ECF Nos. 13, 253, 606, and 702].
[5] *Id.* at [ECF Nos. 813 and 820].
[6] *Id.* at [ECF No. 867].
[7] *See In re MPM Silicones, LLC*, 2014 WL 4436335, at *24.
[8] *Till v. SCS Credit Corp.*, 541 U.S. 465 (2004).
[9] *In re Valenti*, 105 F.3d 55 (2d Cir. 1997).
[10] *See In re MPM Silicones, LLC*, 2014 WL 4436335, at *24.
[11] *Id.* at *25.
[12] *Id.*
[13] *See id.*
[14] *Id.*
[15] *Id.*
[16] *Id.* at *27.
[17] *Id.* at *26.
[18] *See id.* at *26.
[19] *See id.* at *26.
[20] *See id.* at *27.
[21] *Id.* at *28.
[22] *Id.*
[23] *Id.* at *28.
[24] *Id.* at *29.
[25] *Id.* at *26.
[26] *Id.*
[27] *Id.* at *30.
[28] *Id.* at *32.
[29] *Id.*
[30] *Id.* at *28.
[31] *See, e.g., In re J.C. Householder Land Trust #1*, 501 B.R. 441, 453-54 (Bankr. M.D. Fla. 2013); *SPCP Group, LLC v. Cypress Creek Assisted Living Residence Inc.*, 434 B.R. 650, 660 (M.D. Fla. 2010).
[32] *See, e.g., In re J.C. Householder*, 501 B.R. at 456; *SPCP Group*, 434 B.R. at 660.

Nonprofits in Bankruptcy: Is Chapter 11 a Fresh Start or a Finale?

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Nonprofit Bankruptcy Filings • Southern District of Florida
December 2012 Through March 2015

Case Name	Case Number	Filing Type	Filing Date	Case Status As of March 2015
Palm Beach Community Church, Inc.	13-35141	Chapter 11	10/20/13	Plan of Reorganization confirmed 12/04/14
Millennium Educational & Research Charitable Foundation	13-25913	Chapter 15	07/03/13	Pending
Hollywood Community Synagogue Inc.	12-39875	Chapter 11	12/14/12	Case dismissed 03/22/13
L'Alliance Francaise De Miami Inc.	12-37564	Chapter 11	11/15/12	Case converted to Chapter 7 - 01/25/13; final decree - 01/24/14
Grace Baptist Church of Cutler Ridge, Florida Inc.	12-32462	Chapter 11	09/20/12	Plan of Reorganization confirmed 01/30/14
Temple Messianique Inc.	12-26713	Chapter 11	07/11/12	Case dismissed 02/26/13
Apostolic Alliance Church of the Lord Jesus Christ Inc.	12-19619	Chapter 11	04/20/12	Case dismissed 11/21/12
Solid Rock Missionary Baptist Church Inc.	12-11456	Chapter 11	01/19/12	Case dismissed 04/11/13

deciding whether to file for bankruptcy or seek an out-of-court workout. The procedures summarized briefly below should be implemented in all financially distressed situations (if not before problems start) and are critical to nonprofits who are not held accountable in the same way as their for-profit counterparts.

- **Cash flow budgeting:** The cash flow budget is the lifeline of every distressed situation. Starting with actual cash on hand, add the weekly cash inflows from operations and subtract the weekly cash outflows. This will result in the anticipated cash flow at the end of the week. If ending cash is dangerously low or negative, expenses need to be cut. The cash flow budget should be updated weekly for the upcoming 13-week cycle.

- **Monitoring key operating metrics:** This is commonly referred to as a dashboard and includes financial drivers such as cash balance, accounts receivable and accounts payable aged for delinquencies, balance on line of credit and operating statistics (e.g., ticket sales, admissions, and public and private support). Optimally, the dashboard should be updated daily and compared on a monthly and annual basis.

- **Benchmarking:** This is simply a comparison to operating metrics and business practices to other entities operating in the same space.

- **Budgeting:** Unnecessary extravagances are obviously the first to go. But what did the results of the benchmarking indicate? Are general and administrative expenses too high? What about salaries and fundraising expenses? Is the current office space unaffordable? This is the time to put aside useless rationalizations such as "We always did it this way," and to make some tough decisions.

> "As is the case with for-profits, liquidation of nonprofits should be considered as a last resort as the organization will cease to exist, thereby jeopardizing public interests and needs."

- **Evaluating organizational leadership:** The prospect for successful reorganization is severely undermined by the retention of inexperienced leadership, or even worse, leadership that is exacerbating the organization's financial distress through self-dealing or other forms mismanagement.

While these processes alone will not guarantee financial survival, if implemented early and effectively they will preserve the value of the organization, minimize creditor losses, and provide some much needed breathing room, thus giving the organization time to consider whether an out-of-court workout is preferable to a chapter 11 filing.

As is the case with for-profits, liquidation of nonprofits should be considered as a last resort as the organization will cease to exist, thereby jeopardizing public interests and needs. Additionally, the value of the organization's assets is generally less in liquidation as compared to their value in a going concern.

Together We Make a Difference

All too often, as professionals we are consumed by tight schedules, case deadlines, and client demands. Putting this aside for a moment, consider the following: each of us has a toolbox bursting with knowledge, case experience, and connections that can be shared on a pro bono basis. And by providing this assistance to nonprofits teetering on the brink of financial distress, we can make a meaningful difference at a time when they need it most. Carve out some time and pay it forward with a nonprofit today. ■

NOTES

[1] 11 U.S.C. §1129(a)(11)

[2] *In re Save Our Springs (S.O.S.) Alliance, Inc.*, 632 F.3d 168, 172 (5th Cir. 2011) (citing 7 COLLIER ON BANKRUPTCY ¶ 1129.02[11] (16th ed. rev. 2010) (stating that the court "has significant leeway on the types of evidence it may consider, including preferring results during the pendency of the case over prior results")).

[3] *In re The Philadelphia Orchestra Association*, Case No. 11-13098, ECF No. 1115 (Bankr. E.D. Pa. June 11, 2012).

[4] *Id.*

[5] *Id.*

[6] There was, though, a silver lining to the case of the Florida Philharmonic. Funds totaling $300,000 were returned to the Sylvester Foundation and, similarly, funds earmarked to support the Florida Philharmonic held by the Community Foundation of Broward were channeled to other performing arts groups in South Florida.

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Substantive Consolidation of the Non-Debtor in Florida Southern v. Middle District

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involuntary chapter 11 debtor without obtaining an entry for order for relief in an involuntary case commenced by creditors of the non-debtor entity pursuant to 11 U.S.C. § 303."[7] However, that court ruled it is appropriate to do so if the moving party is "able to present competent and persuasive evidence to warrant a granting of [its] Motion [for substantive consolidation] on an alter ego theory."[8] Thus, *Alico Mining* holds a bankruptcy court may substantively consolidate a non-debtor, but the movant must make a showing of alter ego.

That court does not address the issue, but a showing of alter ego is different than substantive consolidation and itself can permit a bankruptcy court to administer the target's assets because that finding requires that the two entities are one and the same.[9] To pierce the corporate veil under Florida law, the claimant must establish by a preponderance of the evidence that: "**(1)** the shareholder dominated and controlled the corporation to such an extent that the corporation['s] independent existence, was in fact non-existent and the shareholder shareholders were in fact alter egos of the corporation; **(2)** the corporate form must have been used fraudulently or for an improper purpose; and **(3)** the fraudulent or improper use of the corporate form caused injury to the claimant."[10] To the extent substantive consolidation factors rely on commonality, proof of such may overlap with proof of the first alter ego factor. However, while evidence of an improper scheme or purpose can be considered in a substantive consolidation analysis, it is not required.[11] Thus, the proof of alter ego as appears required by *Alico Mining* to obtain substantive consolidation is materially higher than what is usually required for substantive consolidation under the Eleventh Circuit standards.

Alico Mining appears to permit the substantive consolidation remedy, but only if the alternative proof of alter ego is made, a showing of which itself would permit the liquidation of a non-debtor entity with the debtor. For any attorney who has tried these issues, that difference can determine the outcome of a case. The case does not address the effect of the materially different standards and was decided at the motion to dismiss stage, with the direct holding simply being that a bankruptcy court has the authority to substantive consolidate a non-debtor.[12]

The Southern District

In 2011, Judge Isicoff of the Southern District directly decided the issue in *In re S & G Financial Services*.[13] There, a chapter 7 trustee sought substantive consolidation of a non-debtor entity so the latter would be liquidated with the debtor's estate.[14] That court carefully analyzed the Eleventh Circuit case of *Eastgroup Properties* as well as other law from other federal appeals courts and concluded that a bankruptcy court has the authority to substantively consolidate a non-bankrupt entity into a pending bankruptcy case, stating that the Eleventh Circuit and other courts have held that a bankruptcy court's jurisdiction over non-debtors can be "quite broad."[15] As to the requirement of whether an alter ego showing was required, the court commented that "this Court holds that this Court has jurisdiction over non-debtor entities to determine the propriety of an action for substantive consolidation insofar as the outcome of such proceedings could have an impact on the bankruptcy case.[16] Piercing of the corporate veil or alter ego need not be proven to substantively consolidate, rather the same factors set forth in *Eastgroup Properties* apply."[17] While the court relied on *Alico Mining* for the proposition it had jurisdiction to order such, it departed from *Alico Mining* by ruling no proof of alter ego was necessary.

> "The Eleventh Circuit has not addressed whether a bankruptcy court may order substantive consolidation of a non-debtor, i.e. an entity not in bankruptcy."

The Middle District

The following year in 2012, Chief Judge Jennemann of the Middle District was presented the same issue in *In re Pearlman*.[18] There, several recipients of alleged fraudulent conveyances of the debtors sought to have the companies for whose benefit they received the conveyances substantively consolidated with the debtors, as a defense to the avoidance actions.[19] While not addressing *Alico Mining*, the court squarely rejected the reasoning of *S & G Financial Services* and the case law relied upon therein, and, after considering the national split of authorities, held that a bankruptcy court may not substantively consolidate a non-debtor entity with a debtor entity; piercing the corporate veil is the only way to make a non-debtor part of a bankruptcy proceeding, recognizing that alter ego is a separate remedy.[20] That court ruled that substantive consolidation is a bankruptcy remedy only, and may not be imposed on non-debtors because "[b]ankruptcy courts cannot and should not simply drag unwilling entities that never chose to file bankruptcy into a bankruptcy forum simply because it is expedient and will help one party or another."[21] To rule otherwise would permit a party to evade the "stringent procedures and protections" of an involuntary bankruptcy under § 303 that are not present in substantive consolidation.[22] State law remedies on alter ego and piercing the corporate veil are instead the appropriate remedies in bankruptcy court in this circumstance.[23] The *Pearlman* ruling has been followed twice in the Middle District, and in situations other than a defensive posture presented in *Pearlman*.[24]

Judge Isicoff addressed the evasion of § 303 argument found to be dispositive by Judge Jennemman. Relying on *Munford*, Judge Isicoff oppositely held that "substantive consolidation and the right to file an involuntary petition [under § 303] are two different remedies[,]" because "imposing the insolvency requirement of [§ 303] would 'subvert the entire process of substantive consolidation in this case, which is to recover assets form a financially sound affiliated entity.'"[25] The courts' considerations of § 303 appear to have determined their holdings.

Conclusion

The vanquished faded into the night in *S &G Financial* and *Pearlman*. Those holdings never made it to any review before the Eleventh Circuit. Both have been followed within their respective districts. Until the Eleventh Circuit rules on the issue, any party seeking to have the assets and liabilities of a non-debtor administered with the debtor, or any other relief available from

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The Impact of the Absolute Priority Rule on Individual Chapter 11 Bankruptcy Cases

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541, meaning that the reference to section 1115 in section 1129(b)(2)(B)(ii) encompasses all property of the estate. Thus, property "included by" section 1115 means all property, combining both pre and post-petition property. Accordingly, this minority of courts finds the rule does not apply to individual debtors because all of the property is excluded. If the absolute priority rule does not apply in our scenario then the debtor gets to keep his farmlands and house while paying the supplier pennies on the dollar.

Several circuits and a majority of courts[3] adopt the exact opposite conclusion. This "narrow view" holds that section 1115 adds to rather than supersedes section 541's definition of property of the estate. After application, only post-petition property that is added by section 1115's two subsections is exempt from the absolute priority rule. Thus, the absolute priority rule continues to apply to section 541's pre-petition property. Proponents of the narrow view urge that Congress did not intend to abolish the rule otherwise it would have done so in far less convoluted language.

Few Florida bankruptcy courts have officially weighed in other than Judges Michael G. Williamson and Karen S. Jennemann. Judge Williamson in *In re Martin*[4] and Jennemann in *In re Gelin*[5] have both adopted the narrow view that the absolute priority rule still applies to individual chapter 11 debtors. Taking the opposite view is Judge Laurel M. Isicoff in *In re Barrera*.[6] During a confirmation hearing,[7] Judge Isicoff expressed her view on the record that the absolute priority rule does not apply. She began her comments by expressing that she has considered this issue long and hard, and ultimately the courts that find the rule still applies arrive at that conclusion by a "strained reading" of sections 1115 and 1129(b)(2)(B)(ii).

The Impact on Individual Bankruptcy Cases

If a court applies the absolute priority rule in our scenario, the debtor must buy back his property with outside funds (i.e., loans or gifts from family members), pay the gasoline supplier's claim in full, or somehow get the supplier's agreement. All three of these options are often unmanageable for debtors whose failing business is their only real "asset." Unlike shareholders of a corporation, individual debtors whose assets are already part of their bankruptcy estate do not usually have other sources of capital to contribute. Unfortunately, the practical application of the absolute priority rule to individual debtors often results in dismissal of the case or conversion of the case to a chapter 7 liquidation where they will lose nearly all of their encumbered property.[8]

Conclusion

While some courts insist that the introductory language of section 1115 is not ambiguous, the better view seems to be that it is, especially given the varying interpretations. The broad-view courts make reasonable arguments, which if accepted, would certainly increase the number of successful chapter 11 outcomes for individual debtors.[9] Nevertheless, courts will continue to disagree about the applicability of the absolute priority rule to individual chapter 11 debtors until the Supreme Court resolves this great divide. ■

NOTES

[1] 11 U.S.C. § 109(e).

[2] *See Friedman v. P+P, LLC (In re Friedman)*, 466 B.R. 471 (9th Cir. BAP 2012); *SPCP Grp., LLC v. Biggins (In re Biggins)*, 465 B.R. 316 (M.D. Fla. 2011).

[3] *See Ice House Am., LLC v. Cardin*, 751 F.3d 734 (6th Cir. 2014); *In re Lively*, 717 F.3d 406 (5th Cir. 2013); *Dill Oil Co., LLC v. Stephens (In re Stephens)*, 704 F.3d 1279 (10th Cir. 2013); *In re Maharaj*, 681 F.3d 558 (4th Cir. 2012)).

[4] *In re Martin*, 497 B.R. 349 (Bankr. M.D. Fla. 2013).

[5] *In re Gelin*, 437 B.R. 435 (Bankr. M.D. Fla. 2010). Judge Williamson recognized in *Martin* that although District Court Judge Susan C. Bucklew in *Biggins* expressly declined to follow *Gelin*, *see In re Biggins*, 465 B.R. at 321-22, that determination by Judge Bucklew was only dicta because the dissenting class was paid in full and therefore a consideration of the rule was unnecessary. *Martin*, 497 B.R. at 355.

[6] *In re Barrera*, No. 10-18929-BKC-LMI (Bankr. S.D. Fla. Dec. 27, 2012).

[7] Ultimately, the creditor did not object to confirmation and did not take a position on the absolute priority rule issue.

[8] Debtors have tried to side-step the rule by retaining exempt assets, such as their homestead. Although some courts have held that the retention of exempt property violates the absolute priority rule, *see In re Gosman*, 282 B.R. 45 (Bankr. S.D. Fla. 2002), others conclude that the total liquidation of an individual chapter 11 debtor's assets is not required in order to satisfy the absolute priority rule. *See In re Henderson*, 321 B.R. 550 (Bankr. M.D. Fla. 2005).

[9] For a contra view, *see* Spector & Bruce, *Tenth Circuit Retains Absolute Priority Rule for Individuals: Is it Right?*, 4 Norton Bankr. L. Adv. 1 (Apr. 2013).

Substantive Consolidation of the Non-Debtor in Florida Southern v. Middle District

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substantive consolidation, that party will have to prove Florida's alter ego elements if the case is in the Middle District. While alter ego is available in the Southern District, substantive consolidation and its factors are available as well. The factors differ significantly. ■

NOTES

[1] *Eastgroup Properties v. Southern Motel Ass'n, Ltd.*, 935 F.2d 245, 248 (11th Cir. 1991).

[2] *Id.*

[3] *Id.* (adopting the test of the District of Columbia Circuit set forth in *Drabkin v. Midland-Ross Corp. (In re Auto-Train Corp.)*, 810 F.2d 270, 276 (D.C. Cir. 1987)).

[4] *Id.* at 249 (citing *In re Vecco*, 4 B.R. 407, 409 Bankr. E.D. Va. 1980).

[5] *Id.* (*citing Pension Benefit Guar. Corp. v. Ouimet Corp.*, 711 F.2d 1085, 1093 (1st Cir. 1983)).

[6] *In re Alico Mining, Inc.*, 278 B.R. 586 (Bankr. M.D. Fla. 2002).

[7] *Id.* at 588.

[8] *Id.*

[9] *In re Hillsborough Holdings Corp.*, 166 B.R. 461, 468-69 (Bankr. M.D. Fla.), *aff'd*, 176 B.R. 223 (M.D. Fla. 1994).

[10] *Id.*

[11] *Munford, Inc. v. TOC Retail, Inc. (In re Munford, Inc.)*, 115 B.R. 390, 397 (Bankr. N.D. Ga. 1990).

[12] 278 B.R. at 588.

[13] *Kapila v. S & G Fin. Servs., LLC (In re S & G Fin. Servs. of S. Fla., Inc.)*, 451 B.R. 573 (Bankr. S.D. Fla. 2011).

[14] *Id* at 576.

[15] *Id.* at 581-82.

[16] *Id.* at 582.

[17] *Id.* at 583-84.

[18] *In re Pearlman*, 462 B.R. 849 (Bankr. M.D. Fla. 2012).

[19] *Id.* at 851.

[20] *Id.*

[21] *Id.* at 854.

[22] *Id.*

[23] *Id.* at 855.

[24] *First Federal Bank v. Footman (In re Big Foot Properties, Inc.)*, No. 12-06868-JAF, 2012 WL 6892645, at *3-4 (Bankr. M.D. Fla. May 25, 2012); *see also In re Cordia Communications Corp.*, No. 11-06495-KSJ, 2012 WL 379776, at *4 (Bankr. M.D. Fla. Feb. 2, 2012 ; *compare Estate of Juanita Amelia Jackson v. Gen. Electric Capital Corp. (In re Fundamental Long Term Care, Inc.)*, No. 13-00893-MGW, at ECF No. 1046 (Bankr. M.D. Fla. Feb. 2, 2015) (granting substantive consolidation of non-debtor and debtor in an adversary proceeding).

[25] *In re S&I Fin. Servs. of Fla., Inc.*, 451 B.R. at 582.

Safe Harbor Provisions of Bankruptcy Code Section 546(e) Simplified: Limitations on a Trustee's Avoidance Powers

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contract is quite broad and even an involvement in fraud will not render a contract or a transaction to be outside the definition of the securities contract.[16]

"Actual intent to hinder, delay, or defraud" under Section 548(a)(1)(A) of the Bankruptcy Code

Safe harbor provisions of section 546(e) will not protect a transaction undertaken with an actual intent to hinder, delay, or defraud the creditors. The relevant authorities discussing the interplay of the safe harbor and actual fraud are limited, however many courts have interpreted the interplay of the two sections in the context of a Ponzi scheme. For example, in *In re Derivium Capital LLC*, the court stated that the existence of a Ponzi scheme gives rise to a presumption of the actual fraud that may trigger the exception of section 546(e).[17] Similarly, in *Peterson*, the court stated that the actual intent to defraud seems an apt description of a Ponzi scheme's payouts.[18] *Peterson*, however, did not decide the issue because the trustee in that case did not argue actual fraud.[19] In *In re Lancelot Investors Fund L.P.*, the bankruptcy court held that by excluding transfers representing actual fraud, Congress has refused to extend safe harbor protection of section 546(e) to massive Ponzi schemes.[20] A bankruptcy court in the Second Circuit has also stated that the operation of a Ponzi scheme gives a presumption of debtor's actual intent to defraud its creditors under section 548(a)(1)(A).[21]

Finally, it is the intent of the transferor alone, and not the intent of the transferee that is relevant in establishing the actual intent to defraud.[22] This, however, may not be the case where the transferee had knowledge of the fraudulent scheme.[23] For example, the bankruptcy court in *In re Arbco Capital Management, LLP*, held that a transferee who had the actual knowledge of the fraud is not entitled to seek safe harbor protections of section 546(e) of the Bankruptcy Code.[24]

The Eleventh Circuit

In *Munford*, the Eleventh Circuit has held that the financial institution must acquire a beneficial interest in the transferred funds or securities for the safe harbor provision of the Bankruptcy Code to apply.[25] There, the court held that even though a financial institution was presumptively involved, the institution was nothing more than an intermediary or a conduit in the transaction.[26] The court found the support for its proposition from *In re Chase & Sanborn Corp.*[27], another Eleventh Circuit case, that held that "[w]hen banks receive money for the sole purpose of depositing it into a customer's account . . . the bank never has actual control of the funds and is not a [section] 550 transferee."[28]

Since *Munford*, only one court in the Eleventh Circuit has addressed the avoidance of a transfer under section 546(e). In *In re Bankest Capital Corp.*, Judge A. Jay Cristol held that there is a limit to the definition of "settlement payment" despite its broad meaning.[29] The court held that when a transaction does not involve ". . . the utilization of public markets or publicly traded securities", it is not a "settlement payment" and thus not protected under section 546(e).[30]

Therefore, the Eleventh Circuit is much like the Ninth in that the 546(e) defense is not a viable defense when a financial institution does not take a beneficial interest in the transferred funds or when a transaction does not involve public markets or publicly traded securities.

Conclusion

In conclusion, the requirements for section 546(e) may seem simple from the language of the statute; however, as the above discussion indicates, interpretation on the safe harbor provisions of the statute vary from circuit to circuit. ■

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Notes

[1] 11 U.S.C. § 546(e).
[2] 11 U.S.C. § 741(8) (*emphasis added*).
[3] *Peterson v. Somers Dublin Ltd.*, 729 F.3d 741, 748-49 (7th Cir. 2013); *Official Comm. of Unsecured Creditors v. American United Life Ins. Co. (In re Quebecor World (USA) Inc.)*, 719 F.3d 94, 98 (2d Cir. 2013).
[4] *Peterson*, 729 F.3d at 748-49.
[5] *In re Quebecor World (USA) Inc.*, 719 F.3d at 98.
[6] *Brandt v. B.A. Capital Co. L.P. (In re Plassein Int'l Corp.)*, 590 F.3d 252, 258 (3d Cir. 2009).
[7] *QSI Holdings, Inc. v. Alford (In re QSI Holdings, Inc.)*, 571 F.3d 545, 549 (6th Cir. 2009); *Contemporary Indus. Corp. v. Frost*, 564 F.3d 981, 985 (8th Cir. 2009); *Lowenschuss v. Resorts Int'l, Inc. (In re Resorts Int'l, Inc.)*, 181 F.3d 505, 515 (3d Cir. 1999); *Kaiser Steel Corp. v. Pearl Brewing Co. (In re Kaiser Steel Corp.)*, 952 F.2d 1230, 1237 (10th Cir. 1991).
[8] *Kipperman v. Circle Trust F.B.O. (In re Grafton Partners, L.P.)*, 321 B.R. 527, 538-41 (9th Cir. B.A.P. 2005).
[9] *Enron Creditors Recovery Corp. v. Alfa, S.A.B. de C.V. (In re Enron Creditors Recovery Corp.)*, 651 F.3d 329, 341 (2d Cir. 2011) (Koeltl, J., dissenting).
[10] *In re Grafton Partners L.P.*, 321 B.R. at 535-38.
[11] *Id.* at 540.
[12] *Peterson*, 729 F.3d at 748; *Grayson Consulting, Inc. v. Wachovia Securities, LLC (In re Derivium Capital LLC)*, 716 F.3d 355, 364 (4th Cir. 2013); *In re Enron Creditors Recovery Corp.*, 651 F.3d at 343; *In re QSI Holdings, Inc.*, 571 F.3d at 550; *Contemporary Indus. Corp.*, 564 F.3d at 986; *Kaiser Steel Corp. v. Charles Schwab & Co., Inc.*, 913 F.2d 846 (10th Cir. 1990).
[13] *In re Quebecor World (USA) Inc.*, 719 F.3d at 94; *In re Enron Creditors Recovery Corp.*, 651 F.3d at 338; *In re Plassein Int'l Corp.*, 590 F.3d at 258; *In re QSI Holdings, Inc.*, 571 F.3d at 550; *Contemporary Indus. Corp.*, 564 F.3d at 987.
[14] *Munford v. Valuation Research Corp. (In re Munford, Inc.)*, 98 F.3d 604, 610 (11th Cir. 1996).
[15] 11 U.S.C. § 741(7).
[16] *Peterson*, 729 F.3d at 750.
[17] *In re Derivium Capital LLC*, 716 F.3d at 366.
[18] *Peterson*, 729 F.3d at 748.
[19] *Id.*
[20] *Peterson v. Enhanced Inv. Corp. (In re Lancelot Investors Fund, L.P.)*, 467 B.R. 643, 656 (Bankr. N.D. Ill. 2012) (collecting cases).
[21] *O'Connell v. Penson Fin. Serv., Inc. (In re Arbco Capital Mgmt.., LLP)*, 498 B.R. 32, 41 (Bankr. S.D.N.Y. 2013) (collecting cases).
[22] *Id.* at 43.
[23] *Id.*
[24] *Id.*
[25] *In re Munford, Inc.*, 98 F.3d at 610.
[26] *Id.*
[27] *In re Chase & Sanborn Corp.*, 848 F.2d 1196, 1200 (11th Cir. 1988).
[28] *In re Munford, Inc.*, 98 F.3d at 610.
[29] *In re Bankest Capital Corp.*, 374 B.R. 333, 345 (Bankr. S.D. Fla. 2007).
[30] *Id.* at 346.

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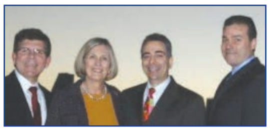


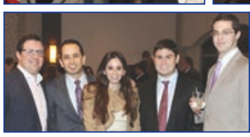

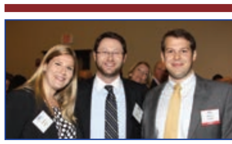

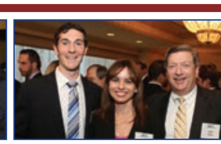


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