



U.S. Supreme Court Decides That Debtor's Right to Convert Is Not Absolute

by Howard S. Beltzer and Annie C. Wells

Introduction

Does a debtor have an absolute right under Section 706 of the Bankruptcy Code to convert a Chapter 7 case to one under Chapter 11 or 13? Until recently, the circuits were split on the issue. Some courts held that the plain language of Section 706, as well as the legislative history, provided an absolute one-time right to convert.¹ Other courts decided that the right to convert was subject to a bankruptcy court's discretion and could be denied under limited circumstances.² In *Marrama v. Citizens Bank of Massachusetts*, 127 S. Ct. 1105, 1109 (2007), the U.S. Supreme Court, in a 5 to 4 decision, sided with the latter view and held that a debtor's right to convert may be denied in limited circumstances. The Court's holding suggests the continued role of equitable principles even in an era of literalist statutory interpretation by the Court.

The *Marrama* Case

In *Marrama*, the debtor Marrama filed a voluntary petition under Chapter 7. He had made numerous false and misleading statements in his verified schedules and at the 341 meeting of creditors regarding his principal asset, a house in Maine.³ After the Chapter 7 trustee indicated that he intended to recover the Maine property as an asset of the estate, Marrama moved to convert the case to one under Chapter 13 pursuant to Section 706(a) of the Bankruptcy Code. Both the Chapter 7 trustee and the largest creditor objected, contending that the conversion request was made in bad faith and was an abuse of the bankruptcy process.

The bankruptcy court found that the facts established bad faith, and denied the motion to convert. The Bankruptcy Appellate Panel for the First Circuit agreed, holding that when read in conjunction with other provisions of

summer 2007

in this issue

- 1 U.S. Supreme Court Decides That Debtor's Right to Convert Is Not Absolute
- 3 Rule 2019
a long neglected rule of disclosure gains increasing prominence in bankruptcy
- 8 Post-Travelers
Fobian may be gone, but unsecured creditors are still in limbo
- 12 Recent Noteworthy Decisions

editors

Menachem O. Zelmanovitz
mzelmanovitz@morganlewis.com

Wendy S. Walker
wwalker@morganlewis.com

This communication is provided as a general informational service to clients and friends of Morgan, Lewis & Bockius LLP. It should not be construed as, and does not constitute, legal advice on any specific matter, nor does this message create an attorney-client relationship. These materials may be considered ATTORNEY ADVERTISING in some states. Please note that the prior results discussed in the material do not guarantee similar outcomes.

© 2007 Morgan, Lewis & Bockius LLP
1701 Market Street • Philadelphia, PA 19103-2921
Tel: 215.963.5000 • Fax: 215.963.5001

U.S. Supreme Court Decides That **Debtor's Right to Convert Is Not Absolute**

continued from page 1

the Bankruptcy Code and Bankruptcy Rules, the right to convert under Section 706(a) is "absolute only in the absence of extreme circumstances,"⁴ such as the bad faith displayed in the case at bar. On appeal, the First Circuit Court of Appeals again affirmed.⁵

The U.S. Supreme Court began its analysis with subsections 706(a) and 706(d), as well as the accompanying legislative history.⁶ The Court noted that the face of the statute makes clear that the right to convert is not absolute, in that it is not available if either the case has previously been converted or the debtor is ineligible for relief under the proposed new chapter. The Court then noted that under Section 1307⁷ of the Bankruptcy Code, a Chapter 13 case may be dismissed or converted to Chapter 7 for "cause," which bankruptcy courts have defined to include bad faith. Such dismissal or conversion based on bad faith is "tantamount to a ruling that [a bad-faith debtor] does not qualify as a debtor under Chapter 13."

In addition, the Court held that, in any case, the broad powers granted to a bankruptcy court under Section 105(a)⁸, and perhaps even the inherent powers of a federal court to sanction abusive litigation, would have provided

construction of Section 706 "strained", and arguing that the right to convert is indeed absolute.

Marrama in the Context of Recent Supreme Court Jurisprudence

The *Marrama* holding is something of a departure from the Supreme Court's recent jurisprudence construing various provisions of the Bankruptcy Code. The Court has generally been construing the face of the statute rather literally. For example, in *United States v. Ron Pair Enterp., Inc.*, 489 U.S. 235, 237 (1989), the Court held, based on the language of Section 506(b) of the Bankruptcy Code (including the placement of a comma therein), that a creditor may recover postpetition interest on a nonconsensual oversecured claim. There, the Court noted that "[t]he plain meaning of legislation should be conclusive, except in the 'rare cases [in which] the literal application of a statute will produce a result demonstrably at odds with the intentions of its drafters.'"

Likewise, in *Lamie v. U.S. Trustee*, 540 U.S. 526, 529 (2004), the Court was faced with a conflict among the circuit courts as to whether an attorney for the debtor who was not retained

Marrama indicates that, notwithstanding this general context of strict construction of the Bankruptcy Code, the traditional role of equitable principles in bankruptcy jurisprudence at least remains alive. We would note that such vitality may be tenuous, given Justice Alito's sharp dissent which was joined by three of his brethren.

Possible Applications of Marrama

There are other provisions of the Bankruptcy Code where the limited equitable considerations set forth in *Marrama* could qualify otherwise clear statutory rights in limited contexts. For example, Section 365(h) provides that when a debtor/lessor rejects an unexpired lease of real property, the lessee may choose to remain in possession (although the lessee's rights under the lease will be limited). One court denied such rights to an insider lessee which appeared to have engaged in improper transactions vis-à-vis the debtor. *In re Harborview Dev. 1986 Ltd. P'ship*, 152 B.R. 897, 900-01 (D.S.C. 1993). Cf. *In re Lee Road Partners, Ltd.*, 169 B.R. 507, 509-512 (E.D.N.Y. 1994), which distinguished *Harborview* on both factual and equitable grounds, but noted:

[T]he *Harborview* court appeared to credit allegations of insider dealing — if not downright fraud. Since the bankruptcy court is at heart a court of equity, the end result in *Harborview* seems unimpeachable. In *Harborview*, the entity seeking § 365(h) protection was an insider of the debtor whose actions were therefore subject to "rigorous scrutiny."

If this issue ever comes up before the U.S. Supreme Court, it will be interesting to see whether the Court would similarly craft a *Marrama*-type of limited equitable exception to an otherwise clear statutory right under the Bankruptcy Code.

Practice Tip

Creditors seeking to keep a debtor in a Chapter 7 liquidation proceeding, rather than a Chapter 11 reorganization, now have a basis for seeking this result in cases of bad faith.

The *Marrama* holding is something of a departure from the Supreme Court's recent jurisprudence construing various provisions of the Bankruptcy Code.

an adequate basis to deny conversion under Section 706, rather than allowing conversion only to then quickly reconvert or dismiss the case. The Court cautioned that its holding was limited to bad-faith conduct by "the atypical litigant who has demonstrated that he is not entitled to the relief available to the typical debtor."

Justice Alito, joined by Chief Justice Roberts and Justices Scalia and Thomas, filed a dissenting opinion calling the majority's

under Section 327 of the Bankruptcy Code was entitled to receive fees for his services under Section 330(a)(1). Although the Court acknowledged that the language of the statute was awkward and ungrammatical, it nonetheless found it to be unambiguous. The Court held that under a plain reading of Section 330(a)(1), an attorney was not entitled to compensation from estate funds unless the attorney was employed by the trustee and such retention was approved by the bankruptcy court.

endnotes

- 1 See *Croston v. Davis (In re Croston)*, 313 B.R. 447, 451-52 (9th Cir. B.A.P. 2004); *Miller v. U.S. Trustee (In re Miller)*, 303 B.R. 471, 476-77 (10th Cir. B.A.P. 2003); *Martin v. Martin (In re Martin)*, 880 F.2d 857, 859 (5th Cir. 1989).
- 2 See *Kuntz v. Shambam (In re Kuntz)*, 233 B.R. 580, 585 (1st Cir. B.A.P. 1999); *Finney v. Smith (In re Finney)*, 992 F.2d 43, 45 (4th Cir. 1993); *In re Krishnaya*, 263 B.R. 63, 69 (Bankr. S.D.N.Y. 2001); *In re Marcakis*, 254 B.R. 77, 83-84 (Bankr. E.D.N.Y. 2000).
- 3 Marrama had transferred the Maine property (which had substantial value) into a newly created trust for no consideration just seven months prior to filing his bankruptcy petition. In his verified schedules, Marrama denied that he had transferred any property other than in the ordinary course of business during the preceding year, and listed the value of the trust as zero. Among his other bad acts, he also failed to disclose a tax refund due to him from the IRS.
- 4 *In re Marrama*, 313 B.R. 525, 531 (1st Cir. B.A.P. 2004).
- 5 *In re Marrama*, 430 F.3d 474, 481 (1st Cir. 2005).
- 6 Section 706(a) states:

The debtor may convert a case under this chapter to a case under chapter 11, 12, or 13 of this title at any time, if the case has not been converted under section 1112, 1208, or 1307 of this title. Any waiver of the right to convert a case under this subsection is unenforceable.

Section 706 (d) provides:

Notwithstanding any other provision of this section, a case may not be converted to a case under another chapter of this title unless the debtor may be a debtor under such chapter.

The Senate Committee Report on Section 706 states:

Subsection (a) of this section gives the debtor one absolute right of conversion of a liquidation case to a reorganization or individual repayment plan case. If the case has already once been converted from chapter 11 or 13 to chapter 7, then the debtor does not have that right. The policy of the provision is that the debtor should always be given the opportunity to repay his debts, and a waiver of the right to convert a case is unenforceable.

S. Rep. No. 95-989, 95th Cong. 2nd Sess., p.94 (1978)
- 7 Section 1307 provides, in relevant part:

(c) Except as provided in subsection (e) of this section, on request of a party in interest or the United States trustee and after notice and a hearing, the court may convert a case under this chapter to a case under chapter 7 of this title, or may dismiss a case under this chapter, whichever is in the best interests of creditors and the estate, for cause...
- 8 Section 105(a) states:

The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title. No provision of this title providing for the raising of an issue by a party in interest shall be construed to preclude the court from, sua sponte, taking any action or making any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process.



Rule 2019

a long neglected rule of disclosure gains increasing prominence in bankruptcy¹

by Menachem O. Zelmanovitz and Matthew W. Olsen

Recent divergent decisions of two bankruptcy courts have catapulted a largely ignored rule of procedure into the forefront of issues concerning hedge fund participation in bankruptcy cases.² First, in February, the court in *Northwest Airlines* ruled that Bankruptcy Rule 2019 required individual members of an unofficial or “ad hoc” committee of creditors or equity holders to publicly disclose, among other things, the amount, date, and cost of acquisition of all of their claims and interests in the debtor.³ Conversely, the bankruptcy court in *Scotia Pacific (ScoPac)* denied the debtor’s motion under Rule 2019 to compel an ad hoc committee of

noteholders to disclose the same information.⁴ These rulings are of serious concern to hedge funds and other investors of distressed securities who often form ad hoc committees to improve their standing, credibility, and leverage in bankruptcy cases, but who are vehemently opposed to publicly revealing such closely held information. Indeed, financial industry groups have appeared in both *Northwest* and *ScoPac*, arguing against the requested disclosures. Such private-interest groups contend that requiring such disclosure will create a significant obstacle to the participation of investors who make valuable contributions and bring liquidity to the Chapter 11 process.⁵

The disclosure requirements under Rule 2019 have existed in bankruptcy reorganizations in substantially similar form for nearly 70 years. Their avowed purpose is to promote the openness of reorganization proceedings and to ensure that such proceedings are free from conflicts of interest.⁶ So what is the controversy all about?

The answer lies in the ever-increasing involvement of hedge funds and similar investors in Chapter 11 reorganizations. With substantial amounts of their cash on the line, such funds, not surprisingly, are demanding a greater say in the restructuring process. At the same time, hedge funds, which are largely

Rule 2019 a long neglected rule of disclosure gains increasing prominence in bankruptcy

continued from page 3

free from regulation and highly averse to the disclosure of internal financial information, have historically participated in bankruptcy cases, often as members of an ad hoc committee, without disclosing such information, despite the existence of Rule 2019. Ultimately, the resolution of the inconsistent rulings in *Northwest* and *ScoPac* may well determine the future scope and nature of hedge fund participation in Chapter 11 cases.

or formation of the committee, . . . *the amounts of claims or interests owned by the entity, [or] the members of the committee, . . . the times when acquired, the amounts paid therefor, and any sales or other disposition thereof.*" (Emphasis added).⁷

Rule 2019 specifically applies to all "committees" other than official committees. Unofficial or "ad hoc" committees clearly appear

to represent the interests of security holders but were often dominated by insiders of the debtor, financial advisors or other entities with serious conflicts of interest. Often such dominant members held either no bona fide interest in the debtor or acquired their interest at "default prices," and sought either to "capitalize on their nuisance position or endeavor to effectuate settlements or plans favorable to those who bought at depressed prices but disadvantageous to those who purchased at pre-default prices."¹² The SEC Report warned that such conflicts "are in fact made the more obnoxious if these groups operate under the guise of independent committees, for security holders are induced more readily to believe that in the hands of these self-styled independents their cause will be honestly and rigorously served."¹³ In order to eliminate these conflicts and perceived abuses, the SEC Report "recommended that persons who represent more than 12 creditors or stockholders (including committees) be required to file with the court a sworn statement containing the information now required by Rule 2019."¹⁴ The SEC Report concluded that such information "will provide a routine method of advising the court and all parties in interest of the actual economic interest of all persons participating in the proceedings."¹⁵ Congress accepted the recommendation of the SEC Report and enacted Sections 210 and 211 of Chapter X of the former Bankruptcy Act.¹⁶ These provisions were later combined into Bankruptcy Rule 10-211, the text of which was largely carried forward into present-day Rule 2019.¹⁷

Prior Case Law

Relatively little case law exists interpreting Rule 2019 or its predecessors. Most of the reported decisions applied Rule 2019 to law firms representing plaintiffs in class action claims against the debtor's estate, where the court's principal concern was whether the attorney representing the class had the requisite authority to act for the class.¹⁸ These cases did not address application of Rule 2019 to unofficial or ad hoc committees and, therefore, did not consider the more controversial aspects

Ultimately, the resolution of the inconsistent rulings in *Northwest* and *ScoPac* may well determine the future scope and nature of hedge fund participation in chapter 11 cases.

Bankruptcy Rule 2019 – Requirements, Purpose and History

Bankruptcy Rule 2019(a) provides, in relevant part, that "[i]n a . . . Chapter 11 reorganization case, except with respect to [official committees], every entity or committee representing more than one creditor or equity security holder . . . shall file a verified statement setting forth

- (1) the name and address of the creditor or equity security holder;
- (2) the nature and amount of the claim or interest and the time of acquisition thereof unless it is alleged to have been acquired more than one year prior to the filing of the petition;
- (3) a recital of the pertinent facts and circumstances in connection with the employment of the entity . . . and, in the case of a committee, the name or names of the entity or entities at whose instance, directly or indirectly, the employment was arranged or the committee was organized or agreed to act; and
- (4) with reference to the time of the employment of the entity, the organization

to be among the rule's intended subjects. Thus, under Rule 2019(b), the bankruptcy court may refuse to permit an unofficial or ad hoc committee that fails to fully comply with part (a) to be heard further or to otherwise participate in the case.

As characterized by one leading commentator, Rule 2019 is part of the Bankruptcy Code's overarching disclosure scheme and is "designed to foster the goal of reorganization plans which deal fairly with creditors and which are arrived at openly."⁸ Official committees are exempt from Rule 2019 because they are subject to direct court oversight in a variety of ways.⁹ Rule 2019's disclosure requirements enable the court and parties in interest to similarly monitor unofficial committees that are not otherwise subject to court scrutiny, and "to assure equality of distribution among creditors, to root out conflicts of interest, and to secure overall fairness of the [Chapter 11 plan]."¹⁰

Rule 2019 can be traced to a 1930's study by the Securities and Exchange Commission, which centered on perceived abuses by unofficial committees in corporate reorganizations and equity receiverships.¹¹ At the time, privately formed committees known as "protective committees" were formed ostensibly

contained in subparagraph (b)(4) of the rule, including disclosure of the timing and price of the committee members' acquisition of their claims and interests.

Nevertheless, there is ample evidence predating *Northwest* to suggest that Rule 2019 is concerned with more than representative authority and is an important tool in ensuring the integrity of the Chapter 11 process. For example, in *In re Oklahoma P.A.C. First Limited Partnership*, the bankruptcy court ordered a law firm representing five creditors, two of which held potentially competing liens on the debtor's real property, to fully comply with Rule 2019.¹⁹ There, the court's principal concern was exposing and remedying the conflict of interest created by the law firm's dual representation of adverse clients.²⁰ More recently, in *Congoleum Corporation*, several law firms, representing various asbestos claimants, were accused of improperly aggregating claims to gain control of the plan process and employing under-the-table fee-sharing arrangements.²¹ The district court upheld the bankruptcy court's order requiring the law firms to disclose any type of consulting or fee-sharing arrangements in connection with the bankruptcy case.²² Such disclosure was ordered under Rule 2019 to "prevent conflicts of interest among Creditors' counsel from undermining the fairness of the Plan, bringing to bear the values of good faith and fairness in the reorganization process that pervade the bankruptcy code."²³

Until the *Northwest* decisions, however, unofficial or ad hoc committees have generally not filed statements fully in accord with Rule 2019. Counsel for such committees typically filed verified statements that disclosed only the names of the committee members and their aggregate holdings of the particular tranche of debt or equity the committee purported to represent, although members often held claims or interests at multiple levels of the debtor's capital structure.

Northwest

The *Northwest* Rule 2019 decisions arose out of a motion by an ad hoc committee of equity

security holders to be appointed as an official committee. In response to discovery requests served by the ad hoc committee in connection with that motion, the debtors filed a motion seeking, among other things, to compel the ad hoc committee to supplement its Rule 2019 statement, which at that point identified only the committee members and the aggregate number and value of their shares of the debtors.²⁴ In response, the ad hoc committee principally argued that Rule 2019 applied only to entities or committees representing more than one creditor or equity holder, that no member of the committee represented any party other than itself, and that only the committee's law firm, which held no claim or interest in the debtors, represented more than one party.²⁵

Bankruptcy Judge Gropper rejected that argument, stating "the Rule cannot be so blithely avoided." First, the Court noted that the plain terms of Rule 2019 required unofficial committees to disclose the amounts, cost and date of purchase of their members' claims or interests,²⁶ and the ad hoc committee was clearly a "committee" subject to that Rule. The ad hoc committee had filed a notice of appearance, moved for the appointment of an official equity committee and actively litigated discovery issues, all in its capacity as a "committee." Counsel was retained by the ad hoc committee and compensated by the committee for work performed on its behalf, rather than on behalf of its individual members. Significantly, counsel did not purport to represent the separate interests of any committee member and took its instructions from the committee as a whole.²⁷ Accordingly, counsel represented one entity for purposes of the rule—the ad hoc committee—which, in turn, was "required to provide the information plainly required by Rule 2019 on behalf of each of its members."²⁸

The court held that the ad hoc committee fell within the purview of Rule 2019 because "[b]y appearing as a 'committee' . . . the members purport to speak for a group and implicitly ask the court . . . to give their positions a degree of credibility appropriate to a unified group with

large holdings."²⁹ The court further reasoned that the committee's intention to seek financial compensation from the estate necessitated complete disclosure under Rule 2019. Creditors and unofficial committees are entitled to seek compensation from the estate only upon a showing that they have made a "substantial contribution" to the case.³⁰ By appearing as a committee purporting to speak for a group, the ad hoc committee stood a better chance of demonstrating it had made such a "substantial contribution."³¹

Confronted with the choice of filing the required financial information or being precluded from further participation in the case, the ad hoc committee moved to file the required

Long-term commitment

The Restructuring Practice represents a diverse clientele ranging from financial institutions to media enterprises to retail companies.

Dedicated client relationship teams

We represent our clients in a wide variety of matters, from Chapter 11 proceedings and out-of-court restructurings to turnarounds and liquidations.

In-depth experience

The Restructuring Practice was recognized by *Chambers and Partners* in their annual compilation *Chambers Global: The World's Leading Lawyers 2005–2006*, a ranking of the leading practices and practitioners in the global market.

Top-tier, effective legal advice

The Restructuring Practice consistently ranks in the top 10 in the *Daily Deal's* review of 61 law firms with practices in the corporate bankruptcy area, based on active bankruptcy cases.

Rule 2019 a long neglected rule of disclosure gains increasing prominence in bankruptcy

continued from page 5

disclosures under seal to be viewed only by the court and the United States Trustee. Again, the Court rejected the committee's arguments that the acquisition price and timing of its members' claims and interests were "confidential commercial information," holding that "any interest committee members may have in keeping such information confidential is overridden by the interests that Rule 2019 seeks to protect."

Rule 2019 is based on the premise that the other shareholders have a right to information.

Rule 2019 is based on the premise that the other shareholders have a right to information as to Committee member purchases and sales so that they [may] make an informed decision whether this Committee will represent their interests. . . . It also gives all parties a better ability to gauge the credibility of an important group that has chosen to appear in a bankruptcy case and play a major role.³²

The court found that the need for full disclosure was underscored by two facts. The ad hoc committee's members held significant amounts of debt as well as equity and such claims and interests may have been acquired at the same time, raising questions of "divided loyalties." In addition, committee members may sell their positions at any time, thereby leaving the remaining shareholders without a representative, a possibility for which other shareholders would be prepared only if the committee's Rule 2019 disclosures were publicly available.³³

On March 8, 2007, the ad hoc committee moved for reconsideration of the first *Northwest* decision. Among other arguments, the ad hoc committee contended that it was not acting as a "committee," did not hold

itself out as representing any nonmembers' interests, and was merely a cost-sharing "consortium" of creditors who combined "to undertake an operation beyond the resources of any member."³⁴ The court denied the reconsideration motion, characterizing it as "frivolous."³⁵ The ad hoc committee has since sought leave from the District Court to appeal both the first and second *Northwest* decisions. However, its request for a stay of the rulings pending appeal was denied. On March 21, 2007, the remaining members of the ad hoc committee filed an amended Rule 2019 statement containing the information required by the Court.

ScoPac

On the heels of the *Northwest* rulings, the Bankruptcy Court for the Southern District of Texas in the *ScoPac* case denied a similar motion to compel an ad hoc committee of noteholders to comply with Rule 2019.³⁶ In *ScoPac*, the debtor, an owner and operator of over 200,000 acres of timber, had issued, prepetition, approximately \$867 million of secured notes. Prior to the bankruptcy filing, certain noteholders formed an ad hoc committee to engage in restructuring negotiations with the debtor. From the outset, the ad hoc committee actively participated in the bankruptcy case, taking positions consistently at odds with the debtor. The ad hoc committee's law firm had filed a Rule 2019 statement setting forth only the names and the approximate aggregate holdings of the committee members. Relying on the *Northwest* rulings, the debtor moved to compel the ad hoc committee to file a statement setting forth all information required of "committees" under Rule 2019.

In opposition, the ad hoc committee asserted three principal arguments.³⁷ First, the ad hoc committee, then referring to itself as the "Noteholder Group," asserted that it was neither a "committee" nor a representative of creditors as contemplated by Rule 2019(a). The ad hoc committee asserted that, contrary to the legal and common definitions of "committee", its members were

not appointed or elected, did not represent or act as agent for any other noteholders, and merely comprised a self-selected group of investors who were free to join or drop out of the group at any time. Second, as reflected in the SEC Report, Rule 2019 was designed to curb the abuses of protective committees, which bound members to the committee's decisions while failing to disclose the serious conflicts of interest of the committee's predominant members. In contrast, members of the ad hoc committee were free to take individual positions inconsistent with that of the group as a whole. Third, *Northwest* was factually distinguishable in that the ad hoc committee there held only 27% of the outstanding equity, as well as debt claims, but sought appointment as an official committee and attempted to negotiate chapter 11 plan treatment on behalf of all equity holders. The *ScoPac* ad hoc committee, on the other hand, held 97% of the notes, held no other claims or interests, and sought only to represent the interests of its members, thus implicating none of the "divided loyalties" that concerned the court in *Northwest*.³⁸

On April 17, 2007, ruling from the bench, Bankruptcy Judge Schmidt held, without explanation—other than stating that he was taking "a practical approach"—that the *ScoPac* ad hoc committee was not a "committee" for purposes of Rule 2019, but merely "a bunch of creditors" represented by a single law firm.³⁹ The Court thereafter denied the debtor's motion for reconsideration, ruling from the bench once again during a hearing held on May 22, 2007.⁴⁰

Conclusion

The *Northwest* and *ScoPac* decisions plainly offer inconsistent interpretations of a "committee" that will be subject to the full disclosure requirements of Rule 2019.⁴¹ Although the ultimate resolution of this important issue is uncertain, the *Northwest* court appears to have provided the more reasoned approach. Importantly,

the *Northwest* court highlighted the concerns that the rule was designed to address.

By designating itself as the ad hoc committee of a certain class of claims or interests, such committee implicitly holds itself out as a representative of the entire class. Creditors and interest holders within the same class understandably may assume that their interests in the case are aligned with the positions espoused by the committee. Rule 2019 was designed to reduce the risk of unfairness to such outsiders resulting from the ad hoc committee members' actual, but undisclosed, interests that may conflict with that of the class generally (e.g., in *Northwest*, where the ad hoc equity committee members also held substantial debt claims).

To some extent *Northwest* and *ScoPac* may be distinguished on the facts of each case. Among other things, the ad hoc committee in *Northwest* sought official committee status

and to negotiate plan treatment on behalf of all shareholders. Thus, the application of Rule 2019 to ad hoc committees going forward may depend on the manner in which they conduct themselves—the more prominent the role a committee seeks to play, the more likely a court is to find that Rule 2019 applies.

Though much is left to be determined, the *Northwest* decisions may indeed affect the level of participation of hedge funds and other investors of distressed securities in bankruptcy reorganizations. Clearly, these institutions are loath to divulge the acquisition cost of their securities to the public. Hedge funds rely heavily on liquidity and often move quickly into and out of positions at multiple levels of a debtor. Many may be concerned that full compliance with Rule 2019 would damage their bargaining position and give counterparties an unfair advantage in their efforts to sell their holdings. Some investors may even fear that

through the combination of the information required by Rule 2019—acquisition cost, timing, and any subsequent sales—competitors may be able to discern a committee member's trading strategies.

However, if the *Northwest* approach is widely adopted, such disclosure requirements may simply be the price that such investors must pay should they choose to participate actively in reorganization cases in order “to foster the goal of reorganization plans which deal fairly with creditors and which are arrived at openly.”^{14,2}

endnotes

¹ Morgan Lewis & Bockius LLP is counsel to Wachovia Bank, N.A. in the Le-Nature's, Inc. bankruptcy case (Chapter 11 case no. 06-25454, Bankr. W.D. Pa.) in which Wachovia has moved to compel two ad hoc committees to fully comply with Rule 2019.

² *In re Northwest Airlines Corp.*, No 05-17930 (ALG), 2007 WL 609214 (Bankr. S.D.N.Y. Feb. 26, 2007) (requiring ad hoc committee of equity security holders to fully comply with Bankruptcy Rule 2019(a)); *In re Northwest Airlines, Corp.*, No. 05-17930 (ALG), 2007 WL 724977 (Bankr. S.D.N.Y. Mar. 9, 2007) (denying the ad hoc committee's motion to file required disclosures under seal); Transcript of Hearing, at 4-5, *In re Scotia Dev., LLC*, No 07-20027 (Bankr. S.D. Tex. April 17, 2007) (denying debtor's motion to compel ad hoc committee of noteholders to comply with Rule 2019).

³ *In re Northwest Airlines Corp.*, 2007 WL 609214, at *2.

⁴ Transcript of Hearing, at 4-5, *In re Scotia Dev., LLC*, No. 07-20027.

⁵ See Joinder of Loan Syndications and Trading Association and Securities Industry and Financial Markets Association as Amici Curiae, etc., dated

March 15, 2007, at 3, *In re Northwest Airlines, Corp.*; Brief of Amici Curiae Securities Industry and Financial Markets Association and Loan Syndications and Trading Association in Support of Noteholder Group's Objection, etc., dated April 9, 2007, at 2, 10-11, *In re Scotia Dev., LLC*.

⁶ *In re Northwest Airlines Corp.*, 2007 WL 724977, at *2 (citing Securities and Exchange Commission, Report on the Study and Investigation of the Work, Activities, Personnel and Functions of Protective and Reorganization Committees (the “SEC Report”), pt. 1, at 880 (1937)).

⁷ Fed. R. Bankr. P. 2019(a).

⁸ 9 Alan N. Resnick & Henry J. Sommer, *Collier on Bankruptcy* 2019.01 (15th ed. rev. 2006).

⁹ Among other things, official committees are appointed by the United States Trustee and must seek bankruptcy court authorization to retain professionals and court approval of their professionals' fees and expenses. 11 U.S.C. §§ 1102, 327, 328, 330.

¹⁰ *Baron & Budd, P.C. v. Unsecured Asbestos Claimants Comm.* (*In re Congoleum Corp.*), 321 B.R. 147, 168; see 9 *Collier on Bankruptcy* 2019.02.

¹¹ See SEC Report, supra, n. 5.

¹² *Id.* at 897.

¹³ *Id.* at 880 (quoted in *In re Northwest Airlines Corp.*, 2007 WL 724977, at *2 n.6).

¹⁴ *In re Northwest Airlines, Corp.*, 2007 WL 724977, at *2.

¹⁵ SEC Report, Part I, at 902.

¹⁶ The Bankruptcy Act of 1898, as amended by the Chandler Act of 1938, was repealed by Congress through the adoption of the Bankruptcy Reform Act of 1978 (commonly referred to as the “Bankruptcy Code”).

¹⁷ *In re Northwest Airlines Corp.*, 2007 WL 609214, at *3; 13A King, et al., *Collier on Bankruptcy*, 10-211.04 (14th ed. 1976).

¹⁸ See, e.g., *Wilson v. Valley Elec. Membership Corp.*, 141 BR 309 (E.D. La. 1992); *In re Ionosphere Clubs, Inc.*, 101 B.R. 844 (Bankr. S.D.N.Y. 1989). In *Wilson*, the court approved a verified statement by an attorney who represented a class of plaintiffs without disclosing all of the members within the class where such disclosure would have been “impractical, if not impossible.” 141 B.R. at 314. In *In re Ionosphere Clubs*, the bankruptcy court suggested that a Rule 2019 statement filed on behalf of a class of claimants must include all 100,000 airline ticketholders in order to comply with the Rule. 101 B.R. at 851-52. See also *In re Vestra Industries, Inc.*, 82 B.R. 21, 22 (Bankr. D.S.C.

Rule 2019 a long neglected rule of disclosure gains increasing prominence in bankruptcy

continued from page 7

1987), where the court disallowed a proof of claim filed by a labor union on behalf of individual union members because the union failed to file a verified statement pursuant to Rule 2019 setting forth the names and addresses of its members, the nature and amount of their claims and the relevant facts and circumstances surrounding the engagement of the union.

- 19 *In re Oklahoma P.A.C. First Ltd. P'Ship*, 122 B.R. 387, 392. (Bankr. D Ariz. 1990)
- 20 *Id.* 392-93 (noting Rule 2019 "is part of the Chapter 11 reorganization process that all matters should be done openly and subject to scrutiny, whether it is the proposal of a plan of reorganization, representation of the debtor, or representation of numerous creditors—secured or unsecured").
- 21 See Transcript of Bankruptcy Court Hearing, at 21, *In re Congoleum Corp.*, 03-51524 (KCF) (Bankr. D.N.J. July, 26, 2004).
- 22 *Baron & Budd*, 321 B.R. at 168.
- 23 *Id.*
- 24 *In re Northwest Airlines Corp.*, 2007 WL 609214, at *1.
- 25 *Id.* at *2.
- 26 *Id.*
- 27 *Id.*
- 28 *Id.* (the court distinguished the situation where a law firm represents several individual clients and, therefore, is the only entity required to file a Rule 2019 statement).
- 29 *Id.* at *3.
- 30 11 U.S.C. § 503(b)(3)(D).
- 31 *In re Northwest Airlines Corp.*, 2007 WL 609214, at *3.
- 32 *Id.*
- 33 *Id.*
- 34 Motion of Certain Equity Holders, Pursuant to 11 U.S.C. § 105(a), Fed. R. Civ. P. 59(e) and 60(b), and L.R. Bankr. P. 9023-1(a) for Reconsideration of Memorandum of Opinion and Order, etc., dated March 8, 2007, at *2, *In re Northwest Airlines Corp.*
- 35 *Transcript of Hearing held March 15, 2007*, at 5, *In re Northwest Airlines Corp.*
- 36 *Transcript of Hearing held April 17, 2007*, at 4-5, *In re Scotia Dev., LLC.*

endnotes

- 37 See generally, Noteholder Group's Objection to Scotia Pacific Company LLC's Motion for an Order Compelling the Ad Hoc Committee to Fully Comply with Bankruptcy Rule 2019(a), etc., dated April 6, 2007, *In re Scotia Dev., LLC.*
- 38 Only one or two noteholders of ScoPac were not already members of the Noteholder Group, but were apparently free to join at any time if they wished. *Id.* at 3.
- 39 Transcript of Hearing held April 17, 2007, at 4-5, *In re Scotia Dev., LLC.*
- 40 *Courtroom Minutes of Hearing held May 22, 2007*, *In re Scotia Dev., LLC.*
- 41 Of course, as a practical consideration, hedge fund participation in bankruptcy may be more prevalent in the Southern District of New York, where the *Northwest* decisions, although still not binding, are likely to be afforded greater deference.
- 42 9 *Collier on Bankruptcy* 2019.01.



Post-Travelers

Fobian may be gone, but unsecured creditors are still in limbo

by Karen Gartenberg

Resolving a circuit court split in *Travelers Casualty & Surety Co. of America v. Pacific Gas & Electric Co.*¹ (*Travelers*), the United States Supreme Court recently abrogated the Ninth Circuit Court of Appeals' bright-line *Fobian* rule, holding that an unsecured creditor's claim for contractual attorneys' fees could be allowed despite the fees having been incurred in litigating issues of bankruptcy law.² *Travelers*, however, appears to have left unanswered a key issue with respect to the allowance of unsecured creditors' attorneys' fees: whether Bankruptcy Code (Code) Section 506(b), by only allowing oversecured creditors to

recover their reasonable attorneys' fees incurred post-petition, precludes unsecured creditors from successfully asserting a claim for such fees.

The *Fobian* Rule

In *Fobian v. W. Farm Credit Bank (In re Fobian)*,³ the debtors appealed a Bankruptcy Appellate Panel decision reversing the bankruptcy court's confirmation of their Chapter 12 plan on the grounds that the plan did not meet the requirements of Code Sections 1225(a)(4), (a)(5), and (b)(1).⁴ The bank, an undersecured creditor, opposed the appeal and sought

affirmance of the Bankruptcy Appellate Panel's decision. Citing provisions in the promissory note and deed of trust, which obligated the Debtors to pay the bank's fees and costs incurred in pursuing collection and enforcement of its rights, the bank also sought an award of all attorneys' fees it incurred in the bankruptcy proceedings.⁵

The Court of Appeals affirmed the Bankruptcy Appellate Panel's decision, but declined to award the bank its attorneys' fees.⁶ The court recognized that "[w]here a contract or statute provides for an award of attorneys' fees, a creditor may be entitled

to such fees in bankruptcy proceedings,”⁷ and that such an award is governed by state law. Nevertheless, the court held that “where the litigated issues involve not basic contract enforcement questions, but issues *peculiar to federal bankruptcy law*, attorney’s fees will not be awarded absent bad faith or harassment by the losing party.”⁸ Finding that the litigation in which the bank incurred such fees involved solely issues of bankruptcy law, namely the proper application of certain Code sections relating to plan confirmation, and not a traditional contract action, the court determined an award of fees to be inappropriate.

Circuit Courts Split Post-*Fobian*

Post-*Fobian*, circuit courts split on whether to allow contract-based claims for attorneys’ fees incurred litigating bankruptcy law issues. In addition to several other Ninth Circuit decisions reaffirming the *Fobian* rule,¹⁰ the Second Circuit¹¹ and the Tenth Circuit¹² each cited *Fobian* with approval, albeit in the different context of debtors (and not creditors) seeking recovery of such fees under state statutes. The Fourth,¹³ Sixth,¹⁴ and Eleventh Circuits,¹⁵ however, did not follow the *Fobian* rule and instead held that contract-based claims for attorneys’ fees incurred while litigating bankruptcy law issues were allowable. In particular, the Fourth Circuit noted that the *Fobian* rule “inappropriately focuses on the presence of issues peculiar to bankruptcy law, rather than on whether the attorney’s actions were reasonably undertaken in furtherance of purposes for which attorneys’ fees are properly recoverable under the terms of the lease and applicable state law.”¹⁶

Travelers: The *Fobian* Rule Is Rejected

Travelers arose against the backdrop of this circuit court split. Travelers Casualty & Surety Company (*Travelers*) had issued, for the benefit of the California Department of Industrial Relations, a \$100 million surety bond guaranteeing Pacific Gas and

Electric Company’s (PG&E) payment of state workers’ compensation benefits to injured employees. A series of indemnity agreements executed in connection with the bond provided that PG&E would be responsible for any loss Travelers might sustain in connection with the bonds, including any attorneys’ fees incurred in pursuing, protecting, or litigating Travelers’ rights in connection with the bonds.¹⁷

Subsequently, in April 2001, PG&E filed a voluntary Chapter 11 bankruptcy petition. Travelers filed an amended proof of claim based on the bonds and indemnity agreements for attorneys’ fees incurred during PG&E’s bankruptcy case. PG&E objected to Travelers’ attorneys’ fees claim, and following the *Fobian* rule, the bankruptcy court, the district court, and the Ninth Circuit Court of Appeals agreed with PG&E and rejected Travelers’ claim. Specifically, the Ninth Circuit noted that Travelers’ claim failed because the fees claimed by Travelers were incurred litigating issues “governed entirely by federal bankruptcy law.”¹⁸ Travelers appealed to the United States Supreme Court, and the Court, in order to resolve the

In concluding that it did not, the Court, not surprisingly, rested on a textual reading of Code § 502.²⁰

The Court noted that once a proof of claim has been filed, Code Section 502(a) deems the claim allowed unless a party in interest objects.²¹ Even where an objection has been made, the claim must be allowed unless one of the nine exceptions set forth in Code Section 502(b) is applicable. The Court found that the only arguable basis for the *Fobian* rule was Code Section 502(b)(1), which disallows any claim that is “unenforceable against the debtor and property of the debtor, under any agreement or applicable law for a reason other than because such claim is contingent or unmatured.”

However, the Court determined that Section 502(b)(1) did not support the *Fobian* rule. The Court interpreted this statutory provision to merely provide that defenses to a claim available outside of the bankruptcy context were also available in bankruptcy. Travelers’ claim, however, had been disallowed not

Travelers appealed to the United States Supreme Court, and the Court, in order to resolve the split among the circuits regarding the validity of the *Fobian* rule, granted certiorari.

split among the circuits regarding the validity of the *Fobian* rule, granted certiorari.¹⁹

The Supreme Court thereafter issued its decision, rejecting the *Fobian* rule. In doing so, however, Justice Alito, writing for a unanimous Court, narrowly framed the issue as whether the Bankruptcy Code required the disallowance of contract-based claims for attorneys’ fees solely because the fees were incurred litigating bankruptcy law issues.

because of any applicable nonbankruptcy law, but rather on the basis of the Ninth Circuit’s self-created *Fobian* rule.²² Moreover, the Court characterized the case law purporting to support that self-created rule—three of the Ninth Circuit’s prior decisions—as inapposite to the facts in *Fobian*, because in each case, the claim for attorneys’ fees failed as a matter of state law.²³ The Court accordingly struck down the rule articulated in *Fobian*.

morgan lewis fast facts

firmwide

One of the largest law firms in the world

More than 1,300 lawyers

#1 firm serving the Fortune 250
(*Corporate Counsel*, September 2006)

business and finance practice

More than 300 lawyers in 18 offices
throughout the world

More than 200 active bankruptcy cases
at any one time

Nearly 40 private equity transactions
completed in the last two years with a
combined market value of more than \$50B

More than 80 capital markets transactions
completed in the last two years

More than 100 venture capital financing
transactions completed in the past two years

Nearly 200 M&A transactions completed in
the last two years, with a combined market
value of more than \$100B

More than 20 significant outsourcing
transactions completed in the last
two years

More than 100 bank financings in 2006,
ranging from \$25M to \$3B

The Unresolved Issue

Travelers makes clear that to the extent an unsecured creditor files a proof of claim that includes attorneys' fees, a court will not distinguish between fees incurred in litigating purely state-law issues and fees incurred in litigating purely bankruptcy-related matters. The Court in *Travelers*, however, "express[ed] no opinion with regard to whether, following the demise of the *Fobian* rule, other principles of bankruptcy law might provide an independent basis for disallowing *Travelers*' claim for attorney's fees."²⁴ The Supreme Court thus left unanswered the broader question whose answer potentially may render *Travelers* academic: whether an unsecured creditor can recover on a contractual claim, postpetition, for attorneys' fees at all.

Code Section 506(b), which allows oversecured creditors to recover their reasonable attorneys' fees, provides:

To the extent that an allowed secured claim is secured by property the value of which, after any recovery under subsection (c) of this section, is greater than the amount of such claim, there shall be allowed to the holder of such claim, interest on such claim, and any reasonable fees, costs, or charges provided for under the agreement or State statute under which such claim arose.²⁵

Thus, on its face, Code Section 506(b) allows attorneys' fees to be claimed by secured creditors, and only to the extent that such creditors' collateral exceeds the debt secured thereby. Courts are divided as to whether Section 506(b) impliedly bars the allowance of unsecured creditors' attorneys' fees claims incurred postpetition.

Some courts have held that since Congress expressly permitted oversecured creditors to recover attorneys' fees and expenses under Code § 506(b) but was silent with respect to unsecured creditors, the latter are precluded

from asserting claims for attorneys' fees incurred postpetition.²⁶ In support of their position, such courts also cite the United States Supreme Court decision in *United Savs. Assoc. of Texas v. Timbers of Inwood Forest Assocs.*,²⁷ which held that under Section 506(b), undersecured creditors were not entitled to post-petition interest on their collateral. These courts analogize the rationale in *Timbers* to apply equally to a claim for attorneys' fees by unsecured creditors on the ground that Code Section 506(b) does not distinguish between interest and attorneys' fees.²⁸ "Since [Code § 506(b)] permits postpetition interest to be paid only out of the 'security cushion,' the undersecured creditor, who has no such cushion, falls within the general rule disallowing postpetition interest."²⁹

Other courts, however, reason that Code Section 506(b) does not address the allowance of unsecured creditors' attorneys' fees incurred postpetition, and that Code Section 502 does not, on its face, preclude such claims. Accordingly, such courts refuse to disallow claims for postpetition attorneys' fees.³⁰

Conclusion

Although *Travelers* clearly signaled the demise of the *Fobian* rule, the larger question, whether Code Section 506(b) precludes the allowance to unsecured creditors of a claim for attorneys' fees incurred postpetition, based on contract or state law, remains unanswered. Accordingly, until the Supreme Court provides a definitive answer to the Section 506(b) issue, unsecured creditors should continue to include in their proofs of claim any contractual or state law claim they may have to attorneys' fees.

endnotes

- 1 – B.R.—, 127 S. Ct. 1199 (2007).
- 2 The *Fobian* rule did not extend to oversecured creditors. See *Kord Enters II v. Cal. Commerce Bank (In re Kord Enters. II)*, 139 F.3d 684, 689 (9th Cir. 1998)
- 3 951 F.2d 1149 (9th Cir. 1991), *abrogated by Travelers Cas. & Sur. Co. of Am. v. Pac. Gas & Elec. Co.*, —B.R.—, 127 S. Ct. 1199 (2007).
- 4 Code § 1225(a)(4) provides that “[e]xcept as provided in subsection (b), the court shall confirm a plan if . . . the value, as of the effective date of the plan, of property to be distributed under the plan on account of each allowed unsecured claim is not less than the amount that would be paid on such claim if the estate of the debtor were liquidated under chapter 7 of this title on such date.” 11 U.S.C. § 1225(a)(4). Code § 1225(a)(5)(C) provides that “[e]xcept as provided in subsection (b), the court shall confirm a plan if . . . with respect to each allowed secured claim provided for by the plan . . . the debtor surrenders the property securing such claim to such holder.” 11 U.S.C. § 1225(a)(5)(C). Code § 1225(b)(1) provides, in relevant part,

If the trustee or the holder of an allowed unsecured claim objects to the confirmation of the plan, then the court may not approve the plan unless, as of the effective date of the plan –

(A) the value of the property to be distributed under the plan on account of such claim is not less than the amount of such claim; [or]

(B) the plan provides that all of the debtor’s projected disposable income to be received in the three-year period, or such longer period as the court may approve under section 1222(c), beginning on the date that the first payment is due under the plan will be applied to make payments under the plan.

11 U.S.C. § 1225(b)(1).

The Chapter 12 plan, which called for the surrender of real property collateral to the undersecured creditor in full satisfaction of the debt, could not be confirmed because the plan failed to provide for the unsecured portion of the Bank’s claim, which, under a chapter 7 liquidation, would have been paid in full, given the debtors’ substantial net worth. *In re Fobian*, 951 F.2d at 1152-53.
- 5 *Fobian*, 951 F.2d at 1150, 1153.
- 6 *Fobian*, 951 F.2d at 1153.
- 7 *Id.* at 1153 (citing cases).
- 8 *Id.* at 1153 (citing *a Collingwood Grain, Inc. v. Coast Trading Co. (In re Cost Trading Co.)*, 744 F.2d 686, 693 (9th Cir. 1984); *Grove v. Fulwiler (In re Fulwiler)*, 624 F.2d 908, 910 (9th Cir. 1980); and *Johnson v. Righetti (In re Johnson)*, 756 F.2d 738, 741-42 (9th Cir. 1985) (emphasis added)).
- 9 *Fobian*, 951 F.2d *Id.* at 1153.
- 10 See, e.g., *DeRoche v. Ariz. Indus. Comm’n (In re DeRoche)*, 434 F.3d 1188 (9th Cir. 2006), *abrogated by Travelers Cas. & Sur. Co. of Am. v. Pac. Gas & Elec. Co.*, —B.R.—, 127 S. Ct. 1199 (2007) (holding that Chapter 7 debtors could not recover attorneys’ fees incurred in establishing the dischargeability of a claim by the Arizona Industrial Commission seeking reimbursement of workers’ compensation benefits, even though state law authorized the recovery of fees when parties prevailed in litigation with the state, because the litigation involved only substantive federal bankruptcy law).
- 11 *BankBoston, N.A. v. Sokolowski (In re Sokolowski)*, 205 F.3d 532, 535 (2d Cir. 2000) (holding that state statute permitting the recovery of attorneys’ fees was inapplicable in case where the enforceability of a default-upon-filing provision in a loan contract turned on Code § 521(2) and the “fresh start” policy behind the Bankruptcy Code).
- 12 *Burns v. Great Lakes Higher Educ. Corp. (In re Burns)*, 3 Fed. Appx. 689, 691 (10th Cir. 2001) (holding that state statute permitting the recovery of attorneys’ fees was inapplicable where the substantive issue litigated involved the dischargeability of a debt, which is a matter of federal law and is decided independently of the terms of the loan documents).
- 13 *Three Sisters Partners, L.L.C. v. Harden (In re Shangra-La, Inc.)*, 167 F.3d 843, 852 (4th Cir. 1999) (holding that the Ninth Circuit bright-line test precluding the award of fees for actions primarily involving issues of bankruptcy law should not have been applied without analyzing the terms of the instrument between the parties and the effect of state law).
- 14 *Official Comm. of Unsecured Creditors v. Dow Corning Corp.*, 456 F.3d 668, 686 (6th Cir. 2006), *cert. denied*, 127 S. Ct. 1874 (2007) (holding that despite the Ninth Circuit’s bright-line rule, an unsecured creditor may recover those costs to which it has a state-law based right against a solvent debtor, regardless of the nature of the federal proceedings).
- 15 *TransSouth Fin. Corp. of Florida v. Johnson*, 931 F.2d 1505, 1507 (11th Cir. 1991) (holding that a creditor successful in a dischargeability proceeding was entitled to its attorney’s fees if a statute or valid contract so provided).
- 16 *In re Shangra-La, Inc.*, 167 F.3d at 848.
- 17 *Travelers Cas. & Sur. Co. of Am.*, —B.R.—, 127 S. Ct. at 1202 & n.1.
- 18 *Id.* at 1203.
- 19 *Id.* at 1203.
- 20 This strict plain-meaning approach is at odds with the approach taken in another recent United States Supreme Court case, *Marrama v. Citizens Bank of Massachusetts*, — U.S. —, 127 S. Ct. 1105, 1109 (Feb. 21, 2007), where the majority opinion held that a Chapter 7 debtor did not have an absolute right to convert its case to a Chapter 13 under § 706(a), even though the statute provides that “[a]ny waiver of the right to convert a case under [§ 706(a)] is unenforceable.” It is, however, consistent with Justice Alito’s dissent in that same case, where he criticized the majority opinion for ignoring the plain meaning of Code § 706(a): “Nothing in § 706(a) or any other provision of the Code suggests that a bankruptcy judge has the discretion to override a debtor’s exercise of the § 706(a) conversion right on a ground not set out in the Code.” 1275 S. Ct. *Id.* at 1113. For an analysis of the case, see “U.S. Supreme Court Decides That Debtor’s Right to Convert Is Not Absolute” by Howard S. Beltzer and Annie C. Wells in this issue of the Morgan Lewis *Restructuring Newsletter*.
- 21 Code § 502(a) provides, in relevant part: “A claim or interest, proof of which is filed under section 501 of this title, is deemed allowed, unless a party in interest . . . objects.” 11 U.S.C. § 502(a).
- 22 *Travelers Cas. & Sur. Co. of Am.*, —B.R.—, 127 S. Ct. at 1205.
- 23 Specifically, the Ninth Circuit held in *In re Johnson* that a debtor could not avail itself of a California statute permitting a borrower to recover attorneys’ fees incurred in an action on a contract, because a request for relief from the automatic stay pursuant to Code § 362(d)(1) could not be considered an action on a contract. 756 F.2d 738, 741-42 (9th Cir. 1985). Similarly, in *In re Coast Trading Co.*, 744 F.2d 686, 693 (9th Cir. 1984) and *In re Fulwiler*, 624 F.2d 908, 909-10 (9th Cir. 1980), the Ninth Circuit held that an Oregon statute similar to the California statute at issue in *Johnson* was inapplicable to claims for attorneys’ fees incurred in a dischargeability action and a creditor’s action under Code § 546, respectively.
- 24 See *Travelers Cas. & Sur. Co. of Am.*, 127 S. Ct. at 1207-08 (refusing to address whether Code § 506(b) precludes an unsecured creditor from recovering attorneys’ fees postpetition because the argument was not raised or addressed in the lower courts or in PG&E’s brief in opposition to certiorari).
- 25 11 U.S.C. § 506(b).
- 26 See *Global Indus. Techs., Inc. v. J.P. Morgan Trust Co., N.A. (In re Global Indus. Techs., Inc.)*, 344 B.R. 382, 386 (Bankr. W.D. Pa. 2006); *In re Woodmere Investors Ltd. P’ship*, 178 B.R. 346, 356 (Bankr. S.D.N.Y. 1995); *In re Saunders*, 130 B.R. 208, 210 (Bankr. W.D. Va. 1991); *In re Sakowitz, Inc.*, 110 B.R. 268 (Bankr. S.D. Tex. 1989).
- 27 484 U.S. 365 (1988).
- 28 See, e.g., *In re Woodmere Investors Ltd. P’ship*, 178 B.R. at 356; *In re Global Indus. Techs., Inc.*, 344 B.R. at 386.
- 29 *United Sav. Assoc. of Texas*, 484 U.S. at 372-73.
- 30 See *In re Dow Corning Corp.*, 456 F.3d 668, 683 (6th Cir. 2006); *Marine Midland Bank, N.A. v. Ladycliff College (In re Ladycliff College)*, 56 B.R. 765, 769 (S.D.N.Y. 1985) (citing *United Merchants and Mfrs., Inc. v. Equitable Life Assurance Soc’y of the United States (In re United Merchants and Mfrs., Inc.)*, 674 F.2d 134 (2d Cir. 1982)); *GATX Terminals Corp. v. A. Tarricone, Inc. (In re A. Tarricone, Inc.)*, 83 B.R. 253, 255 (Bankr. S.D.N.Y. 1988).

- 1** *In re First Alliance Mortg. Co.*, 471 F.3d 977 (9th Cir. 2006). Even though lenders knew of numerous complaints against debtor for alleged fraudulent practices, which practices were assisted by the lenders' financing, lenders' claims would not be equitably subordinated where lenders' activities were arm's-length, in the normal course of business, not in contemplation of debtor's bankruptcy, and did not deplete or adversely impact debtor's assets.
- 2** *Johnson Bank v. George Korbakes & Co., LLP*, 472 F.3d 439 (7th Cir. 2006). Under Illinois law, where auditor did not know that bank relied on its audit report, a bank was not a third-party beneficiary and could not sue its borrower's auditor for breach of its engagement letter, even though the audit was a condition of the borrowing and bank received the audit report.
- 3** *In re Lazarus*, 478 F.3d 12 (1st Cir. 2007). Where new lender perfected within 90 days of the petition date but failed to record the refinanced mortgage within 10 days after paying off the original mortgage debt, the earmarking defense would not be applied to protect the new mortgage from avoidance as preferential.
- 4** *In re Finova Capital Corp.*, 356 B.R. 630 (Bankr. D. Del. 2006). Post-petition secured lender was not barred from "credit bidding" at auction sale where its letter agreement with stalking-horse bidder did not waive such right, despite provision that highest bid would be based on greatest "net cash proceeds" to the lender after payment of any break-up fee.
- 5** *In re Adelpia Communications Corp.*, 359 B.R. 54 (Bankr. S.D.N.Y. 2006). Plan provision for releases and reimbursement of fees to creditors who supported and voted for plan, together with holding or acquisition of claims in different debtor estates to maximize recoveries was not bad faith that would warrant disallowance of votes under Section 1126(e).
- 6** *In re JZ, LLC*, 2006 WL 3782988 (Bankr. D. Idaho 2006). Where debtor failed to assume, reject, or even disclose licensing agreement in its schedules as executory contract, contract "rode through" and interests of both parties were unaffected by the bankruptcy, regardless of whether debtor's failure was inadvertent or intentional.
- 7** *In re Bethlehem Steel Corp.*, 479 F.3d 167 (2d Cir. 2007). Employee terminated during Chapter 11 case did not have administrative expense claim for lump-sum retirement benefit because such benefit represented the accelerated payment of benefits that employee accrued over the course of his employment. Employee eventually would have been entitled to the same benefits even if not terminated, although not in a lump sum.
- 8** *Excelsior Funds, Inc. v. JPMorgan Chase Bank, N.A.*, 470 F.Supp.2d 312 (S.D.N.Y. 2006). For purposes of diversity jurisdiction, a national bank is a citizen only of the state in which its main office is located as designated in its articles of association, and not of the state in which its principal place of business is situated if different.
- 9** *In re James River Coal Co.*, 360 B.R. 139 (Bankr. E.D. Va. 2007). Court held that an independent cause of action for deepening insolvency would not be recognized in Virginia absent breach of some independent duty or commission of an actionable tort that contributed to corporation's continued operation and increased debt. Fact of insolvency does not change the duty directors owe, but merely adds the corporation's creditors as an additional constituency to whom the duty is owed.
- 10** *In re Insilco Technologies, Inc.*, 480 F.3d 212 (3d Cir. 2007). Liquidating trustee's equitable subordination claim against lenders was barred by court-approved settlement between Chapter 11 debtors and creditors' committee, which released lenders from all causes of action "in respect of" their loans.
- 11** *In re Global Home Products, LLC*, 2007 WL 689747 (Bankr. D. Del. 2007). Management and sales bonus plans that satisfied business judgment and reasonableness standards would be approved and were incentive, not retention, plans. Thus, plans were not subject to review under Bankruptcy statute restricting key employee retention and severance plans.
- 12** *In re Calpine Corp.*, 2007 WL 685595 (Bankr. S.D.N.Y. 2007). No-call provisions in loan agreements that prohibited optional prepayment of debt within certain periods of time were unenforceable and did not prevent debtor from refinancing at lower rate of interest.