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Bankruptcy and the Myth of "Uniform Laws"

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Bankruptcy and the Myth of "Uniform Laws"

Daniel A. Austin[*]

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I. INTRODUCTION

The Bankruptcy Clause of the Constitution empowers Congress to enact "uniform Laws on the subject of Bankruptcies."[1] A modern definition of the word uniform is "always the same, as in character and degree" and "unvarying,"[2] while a dictionary closer to the time of the Framers defined the word as "not variable" and "consistent with itself."[3] Yet the rights and remedies of debtors and creditors in a bankruptcy case can vary significantly depending upon the state and

[1] U.S. CONST. art. I, § 8, cl. 4.

[2] THE AMERICAN HERITAGE DICTIONARY OF THE ENGLISH LANGUAGE 1881 (4th ed. 2000).

[3] NOAH WEBSTER, 2 AN AMERICAN DICTIONARY OF THE ENGLISH LANGUAGE (New York, S. Converse 1828).

federal jurisdiction in which the case is filed. The result is that bankruptcy in the United States is not, in fact, uniform.

There are three reasons for the lack of uniformity in bankruptcy. First, certain sections of the Bankruptcy Code[4] ("Code" or "Bankruptcy Code") expressly incorporate state law, which is often different from state to state. Second, courts in different jurisdictions interpret the same sections of the Code differently. Third, bankruptcy courts and trustees are authorized to establish many of their own separate rules and policies, resulting in wide variances in key aspects of bankruptcy practice. And while the Constitution does not require a single national law on all matters that affect a bankruptcy case, the substantial and widespread lack of uniformity in bankruptcy is not sound policy and does not satisfy the constitutional requirement of uniformity.

This Article will proceed as follows: Part II examines the lack of uniformity in contemporary bankruptcy practice and shows that bankruptcy remedies and outcomes are highly dependent upon the state and federal jurisdiction in which a bankruptcy case is filed. Part III looks at uniformity as a matter of sound policy and as a constitutional requirement. As part of this analysis, I explore the meaning of uniformity under the taxing, naturalization, and bankruptcy clauses. Finally, Part IV considers how the patchwork bankruptcy system revealed in Part II compares to the concept of uniformity set forth in Part III.

I conclude that direct incorporation of state law in bankruptcy, the protracted disagreement between courts over fundamental bankruptcy matters, and local rules and practices that make bankruptcy procedure substantially different from one jurisdiction to another, violate bankruptcy uniformity. The fact that separate classes of bankruptcy creditors receive different treatment in the distribution of a debtor's assets does not violate bankruptcy uniformity. However, constitutional bankruptcy uniformity is violated to the extent that parties in a bankruptcy case are subject to substantially different outcomes due to the location where a case is filed.

II. BANKRUPTCY PRACTICE IN THE UNITED STATES: UNIFORM BUT NOT

A. *Federal Bankruptcy Power*

Article I of the Constitution authorizes Congress to "establish . . . uniform Laws on the subject of Bankruptcies throughout the United

[4] Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549 (codified as amended at 11 U.S.C. §§ 101–1532 (2006)).

States."[5] In absence of a national bankruptcy law, states may enact their own insolvency laws.[6] It is the exercise of national bankruptcy power, not the mere existence of it that gives Congress exclusive right to legislate bankruptcy law.[7] However, when Congress does exercise the bankruptcy power through national legislation, then, by operation of the Supremacy Clause,[8] any state laws that have the effect of supplementing or supplanting federal bankruptcy law are preempted.[9]

Congress exercised its bankruptcy powers sparingly in the first hundred years following ratification of the Constitution. Short-term federal bankruptcy laws included the Bankruptcy Act of 1800,[10] the Bankruptcy Act of 1841,[11] and the Bankruptcy Act of 1867.[12] Each of these laws was enacted as a response to specific economic crises, and when the crisis passed, the law was repealed.[13] The first permanent federal bankruptcy law was the Bankruptcy Act of 1898.[14] The Act introduced procedures for corporate reorganization[15] and an adversarial system in which bankruptcy referees played an adjudicative function, with the actual process of reorganization left mostly to the

[5] U.S. CONST. art I, § 8, cl. 4.

[6] Brown v. Smart, 145 U.S. 454, 457 (1892) ("So long as there is no national bankrupt act, each state has full authority to pass insolvent laws binding persons and property within its jurisdiction, provided it does not impair the obligation of existing contracts. . . .").

[7] Ogden v. Saunders, 25 U.S. (12 Wheat.) 213, 368 (1827); Sturges v. Crowninshield, 17 U.S. (4 Wheat.) 122, 199 (1819).

[8] U.S. CONST. art. VI, cl. 2.

[9] Int'l Shoe Co. v. Pinkus, 278 U.S. 261, 265 (1929) ("In respect of bankruptcies the intention of Congress is plain. The national purpose to establish uniformity necessarily excludes state regulation . . . . States may not pass or enforce laws to interfere with or compliment the Bankruptcy Act or to provide additional or auxiliary regulations.").

[10] ch. 19, 2 Stat. 19 (repealed 1803).

[11] ch. 9, 5 Stat. 440 (repealed 1843).

[12] ch. 176, 14 Stat. 517, *amended by* Act of June 22, 1874, ch. 390, § 17, 18 Stat. 178.

[13] *See, e.g.*, Charles Jordan Tabb, *The History of the Bankruptcy Laws in the United States*, 3 AM. BANKR. INST. L. REV. 5, 18 (1995) (noting that the 1841 Act was repealed in early 1843 after the mass of debtors impoverished by the Panic of 1837 had obtained discharges).

[14] ch. 541, 30 Stat. 544, *amended by* Chandler Act of 1938, ch. 575, 52 Stat. 840 (repealed 1978).

[15] DAVID J. SKEEL, JR., DEBT'S DOMINION: A HISTORY OF BANKRUPTCY LAW IN AMERICA 58–60 (2001).

parties.[16] A later amendment[17] allowed for consumer repayment plans and gave referees authority to grant discharges.[18]

The 1978 Bankruptcy Code replaced the Bankruptcy Act, and is the current national bankruptcy law.[19] Unlike many federal statutes, the Code is administered by bankruptcy judges[20] rather than by federal agencies acting through regulations.[21] The Code contains provisions for individual, business, farm, railroad, and municipal bankruptcy.[22] It has been modified many times to address changing political and economic circumstances.[23] Procedures under the Code are governed by the Federal Rules of Bankruptcy Procedure, which contain provisions for deadlines, filing requirements, motions and hearings, adversary proceedings, etc.[24]

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[16] *Id.* at 43.

[17] Chandler Act of 1938, ch. 575, 52 Stat. 840.

[18] SKEEL, *supra* note 15, at 131.

[19] Pub. L. No. 95-598, 92 Stat. 2549 (codified as amended at 11 U.S.C. §§ 101–1532 (2006)).

[20] 28 U.S.C. § 152 (2006). Bankruptcy judges are appointed by the circuit court of appeals that have jurisdiction over the particular bankruptcy court. They are not Article III judges and serve fourteen-year terms. They may be reappointed for subsequent terms, but they do not have lifetime tenure. *Id.* *See generally* Angela Littwin, *The Affordability Paradox: How Consumer Bankruptcy's Greatest Weakness May Account for Its Surprising Success*, 52 Wm. & Mary L. Rev. 1933 (2011) (examining at length the administration of the Bankruptcy Code by judicial process rather than through an agency).

[21] For example, the Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (codified in scattered sections of the U.S. Code), is administered by the Securities and Exchange Commission through extensive regulations at 17 C.F.R. §§ 228–229, 249 (2012). In addition, the Electronic Funds Transfer Act, 15 U.S.C. § 1693 (2006), is regulated by the Board of Governors of the Federal Reserve through Regulation E, 12 C.F.R. § 205 (2012).

[22] Individual debtors may file under Chapter 7, liquidation, 11 U.S.C. § 109(B) (2006), Chapter 13, adjustment of debts of an individual with regular income, *id.* § 109(e), and reorganization under Chapter 11, § 109(d). Businesses may file under Chapter 7, § 109(B); Chapter 11, § 109(d), and cross-border bankruptcies under Chapter 15, *id.* § 1501. Chapter 12, *id.* § 109(f), provides bankruptcy procedures for family farmers and family fishermen, while railroads may file under a special subchapter of Chapter 11, § 109(d). Chapter 9, § 109(c), is for municipal bankruptcies.

[23] For example, § 1113 was added in 1984 to place restrictions on the ability of business debtors to modify collective bargaining agreements after the Supreme Court's decision in *NLRB v. Bildisco & Bildisco*, 465 U.S. 513 (1984) (holding that the decision by a Chapter 11 debtor to reject a collective bargaining agreement was subject to the same standards as rejection of an executory contract). Similarly, § 1114 was added in 1988 to impose procedures and restrictions upon the ability of a debtor to terminate retiree benefits after the LTV Corporation terminated the health and life insurance benefits of 78,000 retirees immediately upon filing bankruptcy. *See* S. REP. NO. 119 (1988), *reprinted in* 1988 U.S.C.C.A.N 683.

[24] FED. R. BANKR. P. 1007, 9001, 7001.

The essence of contemporary bankruptcy practice is the adjustment of the debtor-creditor relationship. For consumer bankruptcy, the purpose of bankruptcy is a "fresh start," which means that the debtor's unsecured debts and obligations are completely or partially discharged.[25] The purpose of business bankruptcy has traditionally been to reduce and restructure debt to allow the business to continue,[26] but liquidation of assets and cessation of the entity is increasingly common.

B. *Structural Cause of Nonuniformity in Bankruptcy*

The state in which a bankruptcy petition is filed can be the most significant variable in determining the rights available to parties in the case. There are three reasons for this. First, a number of sections in the Code incorporate state law, particularly with respect to property rights. These laws often vary from state to state. Second, bankruptcy and appellate courts in different jurisdictions interpret the Code differently. Third, in order to allow bankruptcy law to adapt to local circumstances, bankruptcy courts and trustees are authorized to establish many of their own rules and policies. As a result, contemporary bankruptcy practice is a patchwork of inconsistent and contradictory practices in which the state in which a case is filed makes a significant difference in the rights available to the parties.

1. State Law Incorporated into the Bankruptcy Code

Bankruptcy law is not intended to be an original source of property rights. Rather, bankruptcy is intended to provide for the modification of property rights that exist under nonbankruptcy law prior to the bankruptcy.[27] Thus, many sections of the Code incorporate nonbankruptcy law, which means state or other federal law.[28] For ex-

[25] *See, e.g.*, Local Loan Co. v. Hunt (*In re* Hunt), 292 U.S. 234, 244 (1934) ("One of the primary purposes of the Bankruptcy Act is to 'relieve the honest but unfortunate debtor from the weight of oppressive indebtedness and permit him to start afresh free from the obligations and responsibilities consequent upon business misfortunes.'" (quoting Williams v. U.S. Fidelity & Guaranty Co., 236 U.S. 549, 554–55 (1915))).

[26] *See, e.g.*, *In re* Great Am. Pyramid Joint Venture, 144 B.R. 780, 788 (Bankr. W.D. Tenn. 1992) (holding that the ultimate purpose of a Chapter 11 filing is to "enable[] the debtor to restructure its pre-bankruptcy debts, pay its creditors, and return to active operation as a viable enterprise").

[27] Butner v. United States, 440 U.S. 48, 54–55 (1979) ("Property rights are created and defined by state law.").

[28] HSBC Bank USA v. Branch (*In re* Bank of New England Corp.), 364 F.3d 355, 363 (1st Cir. 2004) ("The phrase 'applicable nonbankruptcy law' can refer to either federal or state law.").

ample, under § 522, the terms of a pre-petition security agreement apply post-petition "to the extent provided by . . . applicable nonbankruptcy law."[29] Section 541(c)(2) provides that a restriction on transfers of beneficial estates "that is enforceable under applicable nonbankruptcy law is enforceable in a case under this title."[30] Under § 365(c), state law is used to determine if a breach of contract occurred pre-petition, which may remove the contract as property of the estate and terminate a debtor's rights in the contract.[31] Even if the Code does not expressly incorporate nonbankruptcy law, state law can still play a role in bankruptcy. For example, consumer bankruptcy rates tend to be higher in states that give creditors greater power to garnish wages.[32]

2. Differences in Case Law Precedent

For many federal statutes, Congress appoints an agency to make regulations and administer the statute. As noted, Congress has not done so with the Bankruptcy Code, but has instead "outsourced" this task to bankruptcy courts. Therefore, case precedent is a major variable in how the Bankruptcy Code works. And this depends upon the federal jurisdiction in which the state where the case is filed is located.

In most circuits, an appeal from a bankruptcy court decision is heard by the district court.[33] However, as authorized by the Judiciary Act, some circuits have established bankruptcy appellate panels (BAPs) to hear bankruptcy appeals instead of the district courts.[34] An appeal from a district court or a BAP goes to the circuit court.

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[29] 11 U.S.C. § 552(b)(1) (2006).

[30] *Id.* § 541(c)(2).

[31] *Id.* § 365(c).

[32] *See* Lars Lefgren & Frank McIntrye, *Explaining the Puzzle of Cross-State Differences in Bankruptcy Rates*, 52 J.L. & ECON. 367, 380 (2009). Data suggests that higher rates of bankruptcy filing in Utah and Tennessee are due in part to those states' more creditor-friendly garnishment laws. *Id.* at 377 tbl.2; *see also* Michelle M. Miller, Who Files for Bankruptcy? State Laws and the Characteristics of Bankrupt Households 36–37 tbl. 2, 39 tbl.3 (Dec. 1, 2011) (unpublished manuscript), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1983503

[33] 28 U.S.C. § 158(a) (2006).

[34] BAPs are currently in use in the First, Sixth, Eighth, Ninth, and Tenth Circuits. *Bankruptcy Appellate Panels*, U.S. CTS., http://www.uscourts.gov/FederalCourts/UnderstandingtheFederalCourts/CourtofAppeals/BankruptcyAppellatePanels.aspx (last visited Apr. 27, 2012). However, not all districts within those circuits have authorized appeals to the panels, which is required under 28 U.S.C. § 158(b)(6). Laura B. Bartell, *The Appeal of Direct Appeal—Use of the New 28 U.S.C. § 158(d)(2)*, 84 AM. BANKR. L.J. 145, 146–47 & 146 n.14 (2010). The

Rulings from a circuit court are binding upon all lower courts in the circuit.[35] However, precedent from a circuit court is not binding upon any court outside that circuit.[36] Additionally, precedent from a district is not binding on any other district court. Indeed, the rulings of district or bankruptcy court judges are not even binding on other judges sitting on the same court.[37]

Because of the decentralized nature of the federal court system, the same Code section can be interpreted differently by different courts. Therefore, bankruptcy outcomes can be highly dependent upon the state in which the case is filed and even upon the federal district within the state where the case is filed.

3. Local Rules and Policies by Courts and Trustees

Bankruptcy courts are authorized to promulgate "local bankruptcy rules," "local bankruptcy forms," and "standing orders."[38] Judges can also require attorneys to follow specific rules in their courtroom. At the same time, Chapter 7 and Chapter 13 trustees may establish many of their own policies in administering bankruptcy cases.

i. Local Bankruptcy Rules, Forms, and Standing Orders

Local bankruptcy rules are district-wide rules that apply to bankruptcy proceedings generally.[39] They are proposed by a majority of

Second Circuit eliminated its BAP in 1999. Judith A. McKenna & Elizabeth C. Wiggins, *Alternative Structures for Bankruptcy Appeals*, 76 AM. BANKR. L.J. 625, 644 (2002).

[35] *See* Jeffrey C. Dobbins, *Structure and Precedent*, 108 MICH. L. REV. 1453, 1460–61 (2010).

[36] *See id.* at 1463.

[37] *Id.* The precedential effect of BAP decisions is unclear. *Id.* at 1483–85.

[38] Bankruptcy Rule 9029(a)(1) provides in relevant part:

> Each district court acting by a majority of its district judges may made and amend rules governing practice and procedure in all cases and proceedings within the district court's bankruptcy jurisdiction which are consistent with—but not duplicative of—Act of Congress and these rules and which do not prohibit or limit the use of the Official Forms.

FED. R. BANKR. P. 9029(a)(1). In addition, Bankruptcy Rule 8018(a) allows district courts to "make and amend rules governing practice and procedures for appeals . . . to the respective bankruptcy appellate panel or district court." FED. R. BANKR. P. 8018(a).

[39] FED. R. OF BANKR. P. 9029(a)(1). The authority of a bankruptcy court to establish local rules is derived from 28 U.S.C. § 2075 by which Congress delegated to the Supreme Court "the power to prescribe by general rules, the forms of process, writs, pleadings, and motions, and the practice and procedure in cases under Title 11." 28 U.S.C. § 2075 (2006). Bankruptcy Rule 9029 allows each district court to "make and amend rules governing practice and procedure in all cases and proceedings within the district court's bankruptcy jurisdiction." FED. R. BANKR. P. 9029.

the district court judges in the district and are subject to a period of public review and comment.[40] The rules are then submitted to the judicial council of the circuit for review[41] and, if approved, are published by the Office of United Courts.[42] Local rules may supplement, but may not vary or contradict the Bankruptcy Rules.[43]

There are no set guidelines as to what subjects may be treated by local rules or forms, and in practice they cover a wide range of matters.[44] For example, the Bankruptcy Court for the Western District of Pennsylvania's website includes thirty pages of local rules, thirty-six separate local forms, dozens of general orders and separate administrative orders, and a forty-nine-page Court Procedures Manual.[45] In addition, all bankruptcy judges maintains their own separate "Chambers'" website giving detailed instructions for motions, hearings, fee applications, and other procedures in their specific courts.[46] By contrast, the local bankruptcy rules for the District of Massachusetts are whopping 281 pages and include over a dozen standard local forms.[47] Local rules and forms for other jurisdictions vary just as much.[48]

Bankruptcy courts also issue orders known as "general procedure orders"[49] or "standing orders."[50] Like local rules, standing orders govern procedures and practices in the bankruptcy court. However,

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[40] 28 U.S.C. § 2071(b) (2006); FED. R. BANKR. P. 9029(a)(1).

[41] 28 U.S.C. § 2071(c) (2006).

[42] § 2071(d). Links to local rules posted on the website of each bankruptcy court are available at *United States Bankruptcy Courts*, U.S. CTS., http://www.uscourts.gov/RulesAndPolicies/FederalRulemaking/LocalCourtRules/USBankruptcyCourts.aspx (last visited Apr. 27, 2012).

[43] FED. R. BANKR. P 9029(a)(1).

[44] *See* COMM. ON RULES OF PRACTICE & PROCEDURE OF THE JUDICIAL CONFERENCE OF THE U.S., REPORT AND RECOMMENDED GUIDELINES ON STANDING ORDERS IN DISTRICT AND BANKRUPTCY COURTS (2009) [hereinafter COMM. ON RULES OF PRACTICE & PROCEDURE], *available at* http://www.uscourts.gov/uscourts/RulesAndPolicies/rules/jc09-2009/2009-09-Appendix-F.pdf (identifying twenty-two separate matters addressed by the district court local rules).

[45] The Local Rules and Forms for the Western District of Pennsylvania can be accessed at http://www.pawb.uscourts.gov/pdfs/CourtProceduresManual.pdf.

[46] *Chambers Information*, U.S. BANKR. CT. FOR W. D. PA., http://www.pawb.uscourts.gov/chambers.htm (last visited Apr. 27, 2012).

[47] The Local Bankruptcy Rules for the District of Massachusetts can be accessed at http://www.mab.uscourts.gov/pdfdocuments/LR_12-09.pdf.

[48] *See infra* Part.II.C.1.iii.

[49] *See, e.g.*, *Index to General Procedure Orders*, U.S. BANKR. CT. FOR D. COLO., http://www.cob.uscourts.gov/gepror.asp (last visited Apr. 27, 2012).

[50] *Index of General Orders Presently in Effect*, U.S. BANKR. CT. FOR W. D. PA., http://www.pawb.uscourts.gov/genordere.htm (last visited Apr. 27, 2012).

unlike local rules, standing orders are issued by bankruptcy courts without approval of the district court judges and without opportunity for public notice and comment. Standing orders are not published nationally and are typically found only on the bankruptcy court's website. Standing orders' topics may include forms, contents, and service requirements for motions for relief, payments to secured creditors, etc.[51]

Individual judges may also issue orders to be followed only in their court.[52] Such orders must be posted on the court's website,[53] but finding the rules can be difficult if they are posted only on the individual judge's webpage. To the extent that individual orders are in PDF format, they are not easily searchable. Furthermore, one judge's rules may be very different from those of another judge. For example, each of the four bankruptcy judges in the Western District of Pennsylvania has different rules for how motions are scheduled as well as for forms of motions, briefs, and orders.[54] A study of local rules and standing orders concluded that they have caused "a lack of uniformity in federal practice, undermining consistency in areas where national rules were meant to provide it."[55] Even the personal opinion of individual judges about debtors' counsel, legal fees, or the

[51] Some judges have criticized the use of standing orders on the grounds that their effect is essentially the same as a local bankruptcy rule but without the procedural requirements of local bankruptcy rules, such as circuit court approval or opportunity for public comment. *In re* Dorner, 343 F.3d 910, 913 (7th Cir. 2003) ("[A]dopting local rules through the device of standing orders contravenes the Rules Enabling Act."); Ford Motor Credit Co. v. Johnson (*In re* Standing Order), 272 B.R. 917, 923–24 (Bankr. W.D. La. 2001) (bankruptcy courts do not have authority to issue standing orders).

[52] Bankruptcy Rule 9029, which directly tracks Federal Rule of Civil Procedure 83(b), provides that "a judge may regulate practice in any manner" that is consistent with federal law, the Bankruptcy Rules, and the Official Bankruptcy Forms. FED. R. BANKR. P. 9029.

[53] E-Government Act of 2002, Pub. L. 107–347, § 205(a), 116 Stat. 2899 (codified as note to 44 U.S.C. § 3501 2006)).

[54] *See Chambers Information*, *supra* note 46. One judge allows for self-scheduling of hearings in Chapter 7, 12, and 13 cases, two allow for self-scheduling of some Chapter 12 and 13 actions (but not others), while the clerk for a fourth judge schedules all hearings regardless under which Chapter the case is filed. One judge requires self-scheduling of some Chapter 7 and 11 matters but not others, while a clerk for another judge schedules all Chapter 7 and 11 hearings. *Id.* The rules for one judge set forth detailed motion and briefing requirements, including specified form orders, two other judges have less detailed rules, and a fourth has no set rules on pleading. *Id.*

[55] COMM. ON RULES OF PRACTICE & PROCEDURE, *supra* note 44, at 1.

number of debtors filing Chapter 7 rather than Chapter 13 can shape how judges apply bankruptcy law throughout an entire district.[56]

ii. Bankruptcy Trustees

Bankruptcy trustees include the United States Trustee, Chapter 7 trustees, and Chapter 13 trustees. They perform administrative functions and provide organization and oversight to bankruptcy cases. The United States Trustee (UST) is within the Department of Justice and a UST is appointed in all federal districts.[57] The trustee has broad duties to oversee and supervise the administration of bankruptcy cases, as well as Chapter 7 and Chapter 13 bankruptcy trustees.[58]

Chapter 7 trustees are private attorneys appointed to administer Chapter 7 cases on a case-by-case basis.[59] They have considerable leeway in how they manage many aspects of a Chapter 7 case, including the type and form of documentation required for valuation of property, administration of exemptions, accounting for property of the estate, and whether to object to debtor's discharge.[60]

Chapter 13 trustees are standing trustees appointed by the UST in each district to administer Chapter 13 cases.[61] Their duties include review and oversight of Chapter 13 plans, receipt of payments from the debtor and disbursement to creditors, accounting for property of the estate, and making a final report on completion of plan payments.[62] Each Chapter 13 trustee has authority to set many of his own policies.[63]

[56] Teresa Sullivan, Elizabeth Warren & Jay Lawrence Westbrook, *The Persistence of Local Legal Culture: Twenty Years of Evidence from the Federal Bankruptcy Courts*, 17 HARV. J.L. & PUB. POL'Y 801, 847 (1994).

[57] 28 U.S.C. § 581 (2006). The six federal districts in Alabama and North Carolina do not have a UST, but are under the Bankruptcy Trustee program.

[58] *Id.* § 586. A detailed description of their function is set forth *infra* Part II.C.2.ii.c.

[59] *Id.* § 701.

[60] *Id.* § 704. A discussion of the role and impact of Chapter 7 trustees is set forth *infra* Part II.C.1.ii.c.

[61] 11 U.S.C. § 586(b) (2006).

[62] *Id.* § 1302(b).

[63] *See* discussion *infra* Part II.C.1.iii.b.

C. *How Bankruptcy Practice Is Not Uniform*

1. Consumer Bankruptcy

The objective of personal bankruptcy is to allow "the honest but unfortunate debtor" to receive a "fresh start," and not be burdened for a lifetime with the financial consequences of misfortune and bad choices.[64] A personal bankruptcy is commenced by filing a voluntary bankruptcy petition,[65] schedules of assets, liabilities, income, expenses, and other forms.[66] Upon filing the petition, any action to collect or enforce debt obligations against the debtor is automatically stayed.[67] All debtor's assets become "property of the estate"[68] and are thereafter subject to court supervision and control until the case is closed.

In Chapter 7 bankruptcy, a trustee is appointed from a panel of local attorneys.[69] The primary duty of the trustee is to secure and sell the debtor's non-exempt assets[70] and to use the proceeds to pay claims of unsecured creditors on a *pro rata* basis.[71] The debtor's remaining unsecured debt is discharged.[72] If a debtor is current on his or her secured obligations, such as a mortgage or car payment, the debtor may retain the collateral[73] and continue making payments.[74] However, if the debtor is in default, the creditor may obtain relief from stay and pursue whatever remedies are allowed under state law, such as foreclosure or levy and sheriff sale.[75] Some debts, such as domestic support orders,[76] debt incurred by fraud,[77] and most taxes[78] are not dischargeable. Although Chapter 7 is often referred to as "liquidation," exemptions under federal or state law allow most debtors to keep some or all of their property.[79]

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[64] Grogan v. Garner, 498 U.S. 279, 279 (1991).
[65] 11 U.S.C. § 301 (2006).
[66] *Id.* §§ 521(a)(1)–(2).
[67] *Id.* § 362(a).
[68] *Id.* § 541(a).
[69] *Id.* § 701.
[70] *Id.* § 704.
[71] *Id.* § 726.
[72] *Id.* § 727.
[73] *Id.* § 521(a)(2)(A).
[74] *Id.* § 522(c)(1).
[75] *Id.* § 362(d).
[76] *Id.* § 523(a)(5).
[77] § 523(a)(4).
[78] § 523(a)(1).
[79] *Id.* § 522(b)(1)–(3).

A Chapter 13 bankruptcy is also commenced by filing a petition and schedules of assets and liabilities. The debtor submits a "plan of reorganization" under which the debtor devotes all of her monthly "projected disposable income" to repay a percentage of unsecured debt over a period of three to five years.[80] In addition, the debtor must remain current on any payments for secured collateral that the debtor wants to retain.[81] A standing Chapter 13 trustee is appointed for each bankruptcy court district to oversee all Chapter 13 cases filed in the district.[82] The primary duty of a Chapter 13 trustee is to receive monthly payments made by debtors and to distribute the proceeds to creditors as provided under the plan.[83]

In 2004, after decades of complaints by creditor interests that it was too easy for consumers to walk away from debt under Chapter 7,[84] Congress enacted the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA).[85] BAPCPA's controversial centerpiece is a complex "means testing" formula used to determine whether the debtor may file a Chapter 7 or if she must seek relief under Chapter 13. Simply put, if the debtor's gross income is above the forum state's median, then the debtor will be presumed to have abused the bankruptcy process if she files a Chapter 7 bankruptcy.[86] If the debtor files a Chapter 13, a similar means test is used to determine the amount of the debtor's "disposable income" that must be paid each month to fund the Chapter 13 plan.[87] To implement means testing, BAPCPA introduced new forms for use by debtors to calculate allowable expenses and disposable income.[88]

The Bankruptcy Code as a statute applies to consumer bankruptcy everywhere. But in practice, consumer bankruptcy varies greatly from state to state. The following will discuss how states differ.

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[80] *Id.* §§ 1322(a)(4); 1325(b)(4)(a).

[81] § 1322(b)(5).

[82] *Id.* § 1302(b).

[83] § 1302(b)(5); *id.* § 1326(a)(2).

[84] *See generally* Susan Jensen, *A Legislative History of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005*, 79 AM. BANKR. L.J. 485 (2005) (examining the role of consumer lenders in enacting stricter standards for discharge of consumer debt).

[85] Pub. L. No. 109-8, 119 Stat. 23 (codified in scattered sections of 11 U.S.C.).

[86] 11 U.S.C. § 707(b)(1) (2006). Debtors with primarily business debts are not subject to means testing.

[87] *Id.* § 1325(b)(2)–(3).

[88] Form B22C for Chapter 13 debtors is online. BANKRUPTCY FORM 22C (2010), *available at* http://www.uscourts.gov/uscourts/RulesAndPolicies/rules/BK%20Forms%201210/B_22C_1210.pdf.

i. Nonbankruptcy Law

A number of Code sections require parties to use the law of the forum state.[89] This Part will discuss how differences in state law can create different results depending upon where the case is filed.

a. Bankruptcy Exemptions

Every state has exemption statutes under which judgment debtors may shield property from creditors. These can include personal property and homestead (personal residence) exemptions. The types and amounts of exemptions available to state court debtors can vary widely. For example, a debtor in Alabama may exempt no more than $5,000 of value in a homestead,[90] while in New York the amount is $150,000 per individual and $300,000 for a married couple.[91] Massachusetts is far more generous at $500,000,[92] while Florida, Iowa, Kansas, Oklahoma, and Texas each have an unlimited homestead exemption.[93] There is no homestead exemption at all in Pennsylvania, although that state, like many others, provides an entireties exemption.[94]

Exemptions in personal property likewise vary by state. Some states have liberal personal property exemptions, such as California ($20,750)[95] and Texas ($60,000 per household),[96] but other states are more parsimonious. For example, New Jersey has a $2,000 exemption,[97] and Pennsylvania allows an exemption of $300 plus a family Bible and certain tools.[98]

The Bankruptcy Code also has an exemption schedule, which is set forth in § 522(d). Federal exemptions include, inter alia, $21,625 for a homestead, $3,450 for a motor vehicle, and $11,525 for household goods, as well as a "wildcard" exemption and partial credit for

[89] *See, e.g.*, Butner v. United States, 440 U.S. 48, 55 (1978) ("Property rights are created and defined by state law.").

[90] ALA. CODE §§ 6-10-2, -4, -39 (2011).

[91] N.Y. C.P.L.R. LAW § 5206 (McKinney 2011).

[92] MASS. GEN. LAWS ch. 188, §§ 1, 1A (2011).

[93] FLA. STAT. ANN. §§ 222.01, 222.02, 222.05 (West 2012); IOWA CODE ANN. § 561.16 (West 2012); KAN. STAT. ANN. § 60.2301 (West 2011); OKLA. STAT. tit. 31, § 2(c) (2011); TEX. PROP. CODE ANN. §§ 41.001, 41.002 (West 2011).

[94] Under an entireties exemption, property jointly owned by spouses may not be used to satisfy a debt owed by just one spouse. *In re* Gallagher's Estate, 43 A.2d 132 (Pa. 1945).

[95] CAL. CIV. PROC. CODE §§ 703.140, 704.020 (West 2012).

[96] TEX. PROP. CODE ANN. § 42.001 (West 2011).

[97] N.J. STAT. ANN. §§ 2A:17-19, 2A:26-4, 38A:4-8 (West 2011).

[98] 42 PA. CONS. STAT. §§ 8123–8125, 8127 (2011).

an unused homestead exemption.[99] Although the federal homestead exemption may not seem lavish compared to some states', the federal personal property exemptions are considerably more generous than most states'.

Section 522(b)(1) permits debtors to choose between state or federal exemptions.[100] However, § 522(b)(2) allows states to "opt out" of the federal scheme, thereby limiting debtors in those states to just state exemptions.[101] All but sixteen states have opted-out of the federal scheme.[102] Accordingly, there is a substantial difference in the exemptions available to debtors depending on the state in which the debtor lives. A well-off debtor in Texas, for example, where there is an unlimited homestead exemption and a $60,000 combined homestead exemption, will fare much better in bankruptcy than one in Alabama, where the exemption is limited to $5,000 for a homestead and $3,000 for personal property, wearing apparel, family portraits, and books.

Some states have a two-tier state exemption system that provides one set of exemptions for civil judgment debtors and a different set for bankruptcy debtors. Michigan allows debtors the choice of federal or state exemptions, but then requires debtors to choose between state exemptions available to all judgment debtors[103] and exemptions available only to bankruptcy debtors,[104] which provide a much more generous homestead exemption.[105] Michigan's dual-exemption scheme has been challenged on the basis of the uniformity clause, with mixed results.[106] West Virginia has opted out of federal exemp-

[99] 11 U.S.C. § 522(d)(1)–(2), (4)–(5) (2006).

[100] § 522(b)(1).

[101] Section 522(b)(2) provides that "property listed in this paragraph is property that is specified under subsection (d), unless the State law that is applicable to the debtor . . . specifically does not so authorize." § 522(b)(2).

[102] States that allow debtors to choose between federal or state exemptions include Alaska, Arkansas, Connecticut, Hawaii, Massachusetts, Michigan, Minnesota, New Jersey, New Mexico, Pennsylvania, Rhode Island, South Carolina, Texas, Vermont, Washington, and Wisconsin, as well as the District of Columbia.

[103] MICH. COMP. LAWS § 600.6023 (2012).

[104] *Id.* § 600.5451.

[105] The bankruptcy-specific exemptions provide a homestead exemption of $34,500 for debtors under the age of sixty-five, and $51,650 for debtors over the age of sixty-five. *Id.* § 600.6541(1)(n). The state homestead exemption, on the other hand, is only $3,500 under § 600.6023(1)(h).

[106] Three bankruptcy judges in the Western District of Michigan have reached different results. *Compare In re* Wallace, 347 B.R. 626 (Bankr. W.D. Mich. 2006) (finding the dual-exemption scheme unconstitutional for violating federal exclusivity), *and In re* Pontius, 421 B.R. 814 (Bankr. W.D. Mich. 2009) (finding the same scheme unconstitutional for violating federal bankruptcy exclusivity and uniformity requirement),

tions, but also has an exemption statute for bankruptcy debtors and a separate one for civil judgment debtors.[107] Notably, the former statute provides for a $25,000 homestead exemption for debtors in bankruptcy and allows the full amount of any unused homestead amount to be applied towards other property.[108] This is five times the homestead allowance for non-bankruptcy debtors in West Virginia and almost $4,000 greater than the federal homestead exemption.[109]

The debtor's choice of exemptions may be different if the debtor has moved recently. If a debtor has lived in her state of residence for less than two years (730 days) before the bankruptcy filing date, then she must use the exemptions available in the state in which she resided for the better part of six months (180 days) immediately prior to the two-year period preceding the bankruptcy filing date.[110] In situations in which these timing issues apply, a debtor's exemptions travel with her, and are, in effect, personal and not geographic.[111]

b. Reaffirmation of Secured Debt

Section 521(a)(2) requires debtors to file a statement of intention for all property subject to a security interest.[112] The debtor must state whether she intends to (1) surrender the collateral to the creditor, (2) "redeem" the collateral by paying the fair market value, or (3) enter into a reaffirmation agreement with the secured creditor to pay the debt.[113] The debtor must then perform the stated intention within thirty days after the date first set for the meeting of creditors.[114] If the debtor fails to do so, then the stay terminates and the creditor may take whatever action is allowed under applicable state law.[115] A debt that is reaffirmed is not discharged, so the debtor loses the sig-

with In re Jones, 428 B.R. 720 (Bankr. W.D. Mich. 2010) (upholding dual exemption laws as uniformity requirement does not exclude state legislation in the area). *But cf.*, *In re* Sassak, 426 B.R. 680 (E.D. Mich. 2010) (Michigan debtors may select exemptions from both general and bankruptcy-specific exemptions).

[107] W. Va. CODE ANN. § 38-10-4 (West 2012).

[108] § 38-10-4(d).

[109] Under 11 U.S.C. § 522(d)(1) and (5), debtors receive a $21,625 homestead exemption, and any unused portion up to $10,825 may be applied to other property.

[110] *Id.* § 522(b)(3)(A).

[111] Robert G. Drummond, *The Exemption Opt-Out: Does It Violate the Constitutional Requirement of Uniformity?*, 26 AM. BANKR. INST. J. 10, 68 (2007).

[112] 11 U.S.C. § 521(a)(2)(A) (2006); BANKRUPTCY FORM 8 (2008), *available at* http://www.wiwb.uscourts.gov/fillable_forms/DebtorsStatementofIntention_B8.pdf.

[113] § 521(a)(2)(A).

[114] § 521(a)(2)(B).

[115] *Id.* §§ 362(h), 521(a)(6)(B).

nal benefit of bankruptcy when she enters into a reaffirmation agreement.

Whether a debtor will reaffirm a debt is very much affected by state law. All states permit the creditor to obtain judgment and/or repossess the collateral if the debtor is in default for nonpayment. But some states also permit a creditor to repossess for ipso facto (nonmonetary default).[116] Almost all consumer credit agreements list insolvency or filing bankruptcy as an event of default even if the debtor is current on payments. In states where a creditor may enforce an ipso facto clause, debtors are far more likely to enter into a reaffirmation agreement than in states that do not permit ipso facto default. Thus, in Massachusetts, which prohibits enforcement of ipso facto provisions,[117] reaffirmation agreements are filed in only eight percent of Chapter 7 cases, whereas in Alabama, which allows repossession for ipso facto default,[118] debtors file reaffirmation agreements in approximately forty-three percent of the cases.[119] Overall, reaffirmation percentages by state correspond closely to whether a state allows enforcement of ipso facto provisions.[120]

ii. Differing Precedent

As noted, the Bankruptcy Code is administered by courts, not by federal agencies. Because of the de-centralized federal judicial system, the Code is often interpreted differently from one jurisdiction to another.

a. Chapter 13 and "Projected Disposable Income"

A Chapter 13 debtor is required to devote all of his or her "projected disposable income" (PDI) to payments under a Chapter 13 plan of reorganization.[121] There has long been disagreement among

[116] A table comparing state ipso facto laws is set forth in DANIEL A. AUSTIN & DONALD LASSMAN, REAFFIRMATION AGREEMENTS IN CONSUMER BANKRUPTCY CASES app. F (2d ed. 2010).

[117] MASS. GEN. LAWS ch. 255B, § 20A (2011).

[118] *See* Sumlin Constr. Co. v. Taylor, 850 So. 2d 303 (Ala. 2002).

[119] Bankruptcy statistics are compiled annually by the Administrative Office of the United States Courts (AO). A table showing the number of reaffirmation agreements by state for 2009 is available online. U.S. CTS., BAPCPA TABLE 4 (2009), *available at* http://www.uscourts.gov/uscourts/Statistics/BankruptcyStatistics/BAPCPA/2009/Table4.pdf.

[120] Austin & Lassman, *supra* note 116, at 6–8. For a table showing reaffirmation percentages for 2007 and 2008, see *id.* app. A.

[121] 11 U.S.C. §1325(b)(1)(2006).

courts over what constitutes PDI. Some courts used the "mechanical application," which calculates the debtor's PDI using the debtor's average monthly income for the six-month period prior to filing the bankruptcy petition.[122] Essentially, this meant relying solely on standardized income and expenses calculations found in Bankruptcy Form 22C. Other courts favored the "forward-looking approach," which calculates future disposable income based upon the debtor's actual expected net income as shown by the debtor's Schedules I (income) and J (expenditures).[123] Yet another approach adopted by the Tenth Circuit was the "rebuttable presumption" approach, in which the six-month averaging based on Form 22C was presumed to apply, but debtors could rebut the presumption by showing the debtor's financial situation had changed (using Schedules I and J).[124] The method of calculation of PDI is vital to debtors as this governs how much they must pay under a Chapter 13 plan. Due to the lack of uniformity among bankruptcy courts in calculating this amount, Chapter 13 debtors could fare quite differently depending on where the case was filed.

In *Hamilton v. Lanning*, the Supreme Court attempted to resolve this issue, essentially adopting the Tenth Circuit's rule that PDI should be calculated using the six-month averaging as a starting point, but adjusting for changes in the debtor's income that are "known or virtually certain" at the time of plan confirmation.[125] However, *Lanning* has failed to put to rest many of the conflicts over PDI.

First, there are still two formulae for defining PDI for a Chapter 13 plan. For below-median income debtors, § 1325(b)(2) defines "disposable income" as current monthly income less "amounts reasonably necessary" for the maintenance of the debtor and dependents, but there are no standardized deductions.[126] In contrast, disposable income for above-median debtors under § 1325(b)(3), and for Chapter 7 debtors, is calculated in accordance with § 707(b)(2) using standardized deductions and allowing for the deduction of secured

[122] This was the rule in the Ninth Circuit. *See* Maney v. Kagenveama (*In re* Kagenveama), 541 F.3d 868, 881 (9th Cir. 2008).

[123] This was the rule in the First, Sixth, and Eighth Circuits, as well as in a number of bankruptcy courts in other circuits. *See* Hildebrand v. Thomas (*In re* Thomas), 395 B.R. 914, 922 (B.A.P. 6th Cir. 2008); Coop v. Frederickson (*In re* Frederickson), 545 F. 3d 652, 559 (8th Cir. 2008); *In re* May, 381 B.R. 498, 506, 509 (Bankr. W.D. Pa. 2008); Kibbe v. Sumski (*In re* Kibbe), 361 B.R. 302, 307–08 (B.A.P. 1st Cir. 2007).

[124] Hamilton v. Lanning (*In re* Lanning), 545 F.3d 1269, 1270 (10th Cir. 2008).

[125] 130 S. Ct. 2464, 2478 (2010).

[126] 11 U.S.C. §1325(b)(2) (2006).

arrearages, administrative expenses, and priority unsecured claims.[127] If these formulae are strictly applied, below-median Chapter 13 debtors may not use any funds for payment of secured arrearages. Yet catching up on mortgage arrearages is likely the very reason why a below-median income debtor might want to file a Chapter 13, since curing mortgage arrears is not permitted in Chapter 7. This appears to produce the same types of unintended "senseless results" that concerned the Supreme Court in *Lanning*.[128] Future cases will have to resolve this issue.

Second, immediately after a judgment was entered in *Lanning* on June 7, 2010, bankruptcy courts diverged on their interpretation of the case. For example, is a debtor required to include social security benefits as income in a Chapter 13 plan? Courts in Idaho, Missouri and Utah, each citing *Lanning*, have reached different conclusions.[129]

b. Discharge of Unscheduled Debt

Courts are divided over whether debts that are inadvertently omitted from schedules in a no-asset Chapter 7 bankruptcy can be discharged. Failure to list a creditor can happen if a debtor loses or forgets the information. In the First Circuit, if a debtor does not list a creditor on her schedules and the creditor does not have actual knowledge of the bankruptcy, the creditor's claims are not discharged.[130] Other courts take a "no harm, no foul" approach and allow discharge of unscheduled debts in no-asset cases.[131] Given that many debtors do not maintain organized records and may have forgotten about, or are unaware of debts, this is a significant difference in the relief available to consumer debtors.

[127] § 1325(b)(3); *id.* § 707(b)(2).

[128] *Lanning*, 130 S. Ct. at 2475–76.

[129] *In re* Thompson, 439 B.R. 140, 142–43 (B.A.P. 8th Cir. 2010) (stating that social security income is not used for disposable income or to determine good faith); *In re* Cranmer, 433 B.R. 391, 400 (Bankr. D. Utah 2010) (stating that social security income is used to determine disposable income and good faith); *In re* Westing, No. 09-03594-TLM, 2010 WL 2774829, at *3 (Bankr. D. Idaho July 13, 2010) (stating that social security is not used to calculate projected disposable income, but can be used to determine debtor's good faith).

[130] Colonial Surety Co. v. Weizman, 564 F.3d 526, 530 (1st Cir. 2009).

[131] Judd v. Wolfe, 78 F.3d 110, 111 (3d Cir. 1996); Stone v. Caplan (*In re* Stone), 10 F.3d 285, 291 (5th Cir. 1994); Beezley v. Cal. Land Title Co. (*In re* Beezley), 994 F.2d 1433, 1437 (9th Cir. 1993).

c. Secured Lender Fees for Post-Petition Costs

Whether a secured lender may charge the debtor for post-petition costs, such as filing a proof of claim or other legal fees, depends upon the jurisdiction in which the case is filed. Section 1322(e) provides that where a Chapter 13 debtor proposes to cure a default under a plan, "the amount necessary to cure the default, shall be determined in accordance with the underlying agreement and applicable nonbankruptcy law."[132] At the same time, § 506(b) states that post-petition interest and costs may be added only if a claim is oversecured and such fees are allowed by the underlying contract and state law. Proof of claim fees and other charges can add hundreds of dollars to the amount owed by the debtor.[133] Bankruptcy courts in Mississippi disfavor allowing fees for claim preparation.[134] In Massachusetts and Pennsylvania, such fees are recoverable only if the lender is oversecured.[135] Courts in North Carolina and Florida take yet another approach, permitting fees for proof of claim preparation and other services if the fees are disclosed.[136] Court policies regarding such fees can even differ within a state. For example, a secured lender's proof of claim fees is permitted in the Bankruptcy Court for the Southern District of Texas,[137] but not the Northern District.[138]

d. Dischargeability of Tax Debt for a Late-Filed Tax Return

The Seventh and Eighth Circuits are split over the effect of late-filed tax returns. Section 523(a)(1)(B) of the Code deems taxes for which no return was filed, or for which a return was due and was filed within two years of the bankruptcy, nondischargeable.[139] In *In re Payne*, the IRS discovered and assessed the debtor in 1995 for taxes

[132] *Id.* § 1322(e).

[133] *See* John Rao, *"Proof of Claim" and Bankruptcy Fees: Are They Really Attorneys' Fees?*, 29 AM. BANKR. INST. J. 2, 12 n.6 (2010).

[134] *In re* Madison, 337 B.R. 99, 105 (Bankr. N.D. Miss. 2006) (denying fees for claim preparation because "preparation and filing a proof of claim . . . is basically a mathematical computation").

[135] *In re* Burrell, 346 B.R. 561, 568 (B.A.P. 1st Cir. 2006); *In re* McGuier, 346 B.R. 151, 158 (Bankr. W.D. Pa. 2006).

[136] *In re* Bartch, No. 09–80623C–13D, 2009 WL 3853215, at *1–2 (Bankr. M.D. N.C. Nov. 16, 2009) (allowing a $350 fee); *In re* Palmer, 386 B.R. 875, 876 (Bankr. N.D. Fla. 2008) (approving a $500 fee).

[137] *See In re* Rangel, 408 B.R. 650, 667 (Bankr. S.D. Tex. 2009).

[138] *See In re* Allen, 215 B.R. 503, 504–05 (Bankr. N.D. Tex. 1997).

[139] 11 U.S.C. § 523(a)(1)(B) (2006).

due in 1989.[140] The debtor filed bankruptcy in 1997, more than two years after the tax assessment.[141] The court held that a tax return filed by the IRS for the purpose of calculating the debtor's tax debt is not "an honest and genuine endeavor to satisfy the law."[142] Thus, it was not a tax return for tax discharge purposes.

The Eighth Circuit reached a different result in *In re* Colsen.[143] The court stated that "[t]o be a return, a form is required to 'evince an honest and genuine attempt to satisfy the laws. This does not require inquiry into the circumstances under which the document was filed."[144]

e. Chapter 13 Property Acquired Post-Filing

Courts disagree over what constitutes "property of the estate" and what constitutes "property of the debtor" after a Chapter 13 plan is confirmed. Upon the filing of a Chapter 13 case, all property to which the debtor holds legal and equitable title becomes "property of the estate" and subject to review and oversight by the Chapter 13 trustee.[145] Section 1306(a) expands upon this by providing that property acquired by the debtor subsequent to filing of the bankruptcy petition also becomes property of the estate.[146] But the bankruptcy estate is not intended to last forever. Section 1327(b) provides that "[e]xcept as otherwise provided in the plan or order confirming the plan, the confirmation of a plan vests all property of the estate in the debtor."[147] On its face, this section appears to return ownership of estate assets back to the debtor upon plan confirmation, thus terminating the estate.

Conflicting with this is the Code's imposition of a number of duties that the Chapter 13 trustee has with regard to property of the estate *after* plan confirmation. These duties include receiving, depositing, and investing estate funds and accounting for all the property of

[140] *In re* Payne, 431 F.3d 1055, 1056 (7th Cir. 2006).
[141] *Id.*
[142] *Id.* at 1057; *see also* Moroney v. United States (*In re* Moroney), 352 F.3d 902, 906 (4th Cir. 2003) (allowing no discharge for late-filed tax return if the discharge would abate tax liability that the IRS has already assessed); United States v. Hindenlang (*In re* Hindenlang), 164 F.3d 1029, 1034–35 (6th Cir. 1999) (allowing no discharge where debtor failed to respond to IRS deficiency letters and the IRS assessed a deficiency; this made a tax return useless for tax purposes).
[143] 446 F.3d 836, 840–41 (8th Cir. 2006).
[144] *Id.* at 840.
[145] 11 U.S.C. §§ 1302(b)(1), 704(a) (2006).
[146] *Id.* § 1306(a).
[147] *Id.* § 1327(b).

the estate.[148] This is the extent to which § 1327(b) vests ownership in the debtor.[149]

Bankruptcy courts employ no fewer than five different approaches to this issue. On one extreme is the "estate termination" rule, whereby the Chapter 13 debtor's bankruptcy estate is deemed to terminate upon confirmation of a Chapter 13 plan and § 1306(a) simply ceases to be operative.[150] The Ninth Circuit BAP has adopted this rule.[151] The opposite extreme is the "estate preservation" model, under which § 1327(a) is largely ignored and all property remains in the Chapter 13 estate until either discharge, dismissal, or conversion.[152]

A third method is the "estate transformation" approach, which "holds that only property necessary for the execution of the plan remains property of the estate after confirmation, and the remaining non-essential property becomes property of the debtor at confirmation."[153] The Eleventh Circuit has adopted this approach.[154]

The First and Eighth Circuits use a different rule, known as the "reconciliation approach." Under this rule, existing property vests in the debtor upon plan confirmation, but property acquired after confirmation is used to fund the Chapter 13 estate, which continues until the case is discharged, converted, or dismissed.[155] The Bankruptcy Court for the Northern District of Texas has articulated a fifth approach, which modifies the reconciliation approach by vesting absolute ownership of all estate property in the debtor immediately upon plan confirmation, but bars the debtor from enjoying this right until she has completed her obligations under the plan.[156] Thus, the bank-

[148] *Id.* §§ 345(a), 347(a), 704(a), 1302(b)–(c).

[149] *Id.* § 1327(b).

[150] *In re* Jones, 420 B.R. 506, 514 (B.A.P. 9th Cir. 2009).

[151] *Id.*

[152] *In re* Fisher, 198 B.R. 721, 724–25 (Bankr. N.D. Ill. 1996), *rev'd*, 203 B.R. 958 (Bankr. N.D. Ill. 1997).

[153] *In re* Rodriguez, 421 B.R. 356, 376 (Bankr. S.D. Tex. 2009).

[154] Telfair v. First Union Mortg. Corp., 216 F.3d 1333, 1340 (11th Cir. 2000).

[155] *See* Barbosa v. Solomon, 235 F.3d 31, 36–37 (1st Cir. 2000); Sec. Bank of Marshalltown v. Neiman, 1 F.3d 687, 689 (8th Cir. 1993). The Eleventh Circuit may also be moving towards this rule. *See* Waldron v. Brown (*In re* Waldron), 536 F.3d 1239, 1243 (11th Cir. 2008) (holding that property acquired post-confirmation remains in the estate with pre-confirmation assets that are essential to the plan until the case is closed).

[156] Woodward v. Taco Bueno Rests., Inc., No. 4:05-CV-804-Y, 2006 WL 3542693, at *8–9 (N.D. Tex. Dec. 8, 2006).

ruptcy estate continues to exist until the debtor has made all plan payments and is entitled to a discharge.[157]

f. No-Discharge Chapter 13

While most debtors file bankruptcy in order to obtain a discharge, some chapter 13 cases are filed by debtors who are neither seeking nor qualify for a discharge. A debtor is ineligible for a Chapter 13 discharge if she received a discharge via Chapter 7 within four years prior to filing or a discharge in Chapter 13 within two years prior to filing.[158] Yet the debtor may still want to file under Chapter 13 in order to strip off a wholly unsecured residential mortgage or modify other debt, which is not allowed under Chapter 7.[159] Bankruptcy courts appear split on whether to allow a debtor to file a Chapter 13 for the sole purpose of lien modification when the debtor cannot obtain a discharge.[160] No circuit court has addressed this issue, and there appears to be no particular pattern indicating how courts make this determination.

iii. Local Practice Differences

a. Local Bankruptcy Rules, Standing Orders, and Individual Judicial Policies

Bankruptcy courts may supplement the Federal Bankruptcy Rules with their own local bankruptcy rules. Courts do so to varying degrees. The Southern District of Alabama Local Rules consist of eight pages, while the local bankruptcy rules for Massachusetts span 281 pages, including procedures and forms for almost every aspect of bankruptcy. For example, under the Massachusetts rules, at least seven days before filing a motion for relief from stay in a Chapter 13, case counsel for the creditor must confer with debtor's counsel to resolve or narrow any disputes at issue in the motion and must file a

[157] *Id.* at *9.

[158] 11 U.S.C. § 1328(f)(1)–(2) (2006).

[159] Dewsnup v. Timm, 502 U.S. 410, 429–30 (1992).

[160] *Compare In re* Fisette, 455 B.R. 177, 182 (B.A.P. 9th Cir. 2011), *In re* Waterman, No. 11–cv–00929–CMA, 2012 WL 872623, at *4 (D Colo. Mar. 13, 2012), *In re* Fair, 450 B.R. 853, 856 (Bankr. E.D. Wis. 2011); *In re* Davis, 447 B.R. 738, 744–45 (Bankr. D. Md. 2011), *In re* Tran, 431 B.R. 230, 233–37 (Bankr. N.D. Cal. 2010), *and*, *In re* Grignon, No. 10–34196–tmb13, 2010 WL 5067440, at *4 (Bankr. D. Or. Dec. 7, 2010), *with In re* Gerardin, 447 B.R. 342, 347–48 (Bankr. S.D. Fla. 2011), *In re* Mendoza, No. 09–22395 HRT, 2010 WL 736834, at *4 (Bankr. D. Colo. Jan. 21, 2010), *In re* Fenn, 428 B.R. 494, 500–01 (Bankr. N.D. Ill. 2010), *and In re* Jarvis, 390 B.R. 600, 605–06 (Bankr. C.D. Ill. 2008).

certificate to this effect along with the motion.[161] The motion must be accompanied by a local form "Real Estate Worksheet,"[162] and if the debtor opposes the motion, she must file a local form "Schedule of Payments in Dispute in response to the motion."[163] The Southern District of Florida Local Bankruptcy Rules, totaling 150 pages, also supplement the federal bankruptcy rules on a wide range of issues, including detailed procedures for valuation of collateral and objections to valuation.[164]

South Carolina's local rules require use of a local form for lien avoidance in Chapter 13[165] and form of notice for Chapter 13 plan modifications.[166] Michigan local rules require, inter alia, supplemental information for Chapter 13 plan confirmation, including directions to the trustee regarding the treatment of executory contracts, details on curing deficiencies, and a plain language explanation of dividends to unsecured creditors.[167] Many courts require debtors to use a local form for Chapter 13 plans.[168] This has resulted in such a multiplicity of forms that bankruptcy counsel for the National Association of Attorneys General has called for the adoption of a single national Chapter 13 form to alleviate the "glaring lack of uniformity within the existing [bankruptcy] system."[169]

In Oregon there is a Chapter 13 trustee in Portland[170] and one in Eugene.[171] Each has different requirements for plan confirmation which are set forth in the local rules.[172] Wyoming's local rules specify

[161] D. MASS. LOCAL BANKR. app. 1, R. 13-16-1(a)(1), (3). The certificate is not required if the debtor assents to the motion or surrenders the collateral in her Chapter 13 plan.

[162] D. MASS. LOCAL BANKR, R. 13-16-1(d); D. MASS. LOCAL BANKR, LOCAL FORM 13.

[163] D. MASS. LOCAL BANKR., R. 13-16-1(e); D. MASS. LOCAL BANKR, LOCAL FORM 14.

[164] S.D. FLA. LOCAL BANKR. R. 3015-3.

[165] S.C. LOCAL BANKR. R. 3015-1.

[166] S.C. LOCAL BANKR. R. 3015-2(a)– (b).

[167] MICH. LOCAL BANKR. R. 3015-1(a)(1)–(9).

[168] *See, e.g.*, DEL. LOCAL BUS. FORM 103a (Chapter 13 Plan Analysis); DEL. LOCAL BUS. FORM 103 (Chapter 13 Plan); MASS. LOCAL BUS. FORM 3; E.D. MO. LOCAL BUS. FORM 13; N.J. LOCAL BUS. FORM. 8; OR. LOCAL BUS. FORM 1300.

[169] Karen Cordry, *It's Time for Real Uniformity: The Need for a Nationwide Chapter 13 Plan*, AM. BANKR. INST., Apr. 2011, at 76.

[170] *See Welcome to Wayne Godare's Chapter 13 Website*, PORTLAND13.COM, http://www.portland13.com (last visited Apr. 27, 2012).

[171] *See Fred Long, Chapter 13 Trustee*, 13NETWORK.COM, http://www.13network.com/trustees/eug/eughome.asp (last visited Apr. 27, 2012).

[172] Or. LOCAL BANKR. R. 3015-3(1) (requiring the debtor to submit a proposed confirmation order in text-based PDF format at least seven days prior to the meeting of creditors for cases administered in the Portland Office); *id.* 3015-3(2) (containing

that a Chapter 13 debtor may not incur new or additional debt without fourteen days prior written notice to the trustee, except that if debt must be incurred in an emergency, the debtor must, within fourteen days, provide notice along with an explanation of the circumstances.[173] The local rules for the District of Hawaii include definitions and procedures for "plan motions" in Chapter 13. These deal primarily with treatment of secured collateral in Chapter 13 and require the debtor to provide additional notice to creditors if the plan proposes treatment "arguably contrary to the Bankruptcy Code."[174]

In addition to local rules, most bankruptcy courts also have standing orders that deal with a range of matters of special interest to the court. A standing order in South Carolina, for example, provides for an interest rate of 5.25% for secured claims in Chapter 13.[175] A Northern District of Florida standing order sets attorney compensation in "routine" Chapter 13 cases at $3,500.[176] And a Vermont standing order requires Chapter 13 debtors to make all plan payments through wage withholding.[177] An Oklahoma court has a standing order regarding motions for relief by a creditor from the co-debtor stay under Chapter 13,[178] and a Washington court has an order stating that if a Chapter 13 debtor proposes to modify the rights of a secured creditor the debtor must make all payments through the Chapter 13 trustee and not directly to the creditor.[179]

Previous studies have noted the influence of local legal culture on the practice of law.[180] This effect is certainly felt in bankruptcy. Consider, for example, reaffirmation in consumer bankruptcy cases. Some judges will not approve a reaffirmation agreement for pro se

detailed specialized provisions governing plan objections for cases administered in the Eugene Office).

[173] WYO. LOCAL BANKR. R. 2083-1(B).

[174] HAW. LOCAL BANKR. R. 3015-1(e)(1).

[175] Bankr. D. S.C., Amended Operating Order 09-02 (Nov. 20, 2009), *available at* http://www.scb.uscourts.gov/pdf/oporder/opor09-02.pdf.

[176] Bankr. N.D. Fla., Fifth Amended Standing Order 9 (Oct. 27, 2009), *available at* http://www.flnb.uscourts.gov/sites/default/files/standing_orders/standing_orders_summary.pdf.

[177] Bankr. D. Vt., Standing Order 10-03 (Sept. 28, 2010), *available at* http://www.vtb.uscourts.gov/orders/ord10-03.pdf.

[178] Bankr. N.D. Okla., General Order 10-GO-01, Amending Local Bankruptcy Rule 4001-1(D) (Feb. 18, 2010), *available at* http://www.oknb.uscourts.gov/ClerksOffice/Rules/General%20Orders/10-GO-01.pdf.

[179] Bankr. E.D. Wash., General Order 10-04 (Dec. 6, 2012), *available at* http://www.waeb.uscourts.gov/GeneralOrders/GO-2010.10-04.1288991798.pdf.

[180] *See, e.g.*, Sullivan, Warren & Westbrook, *supra* note 56.

debtors or where the debtor's expenses appear to exceed her income if the creditor does not offer more favorable terms in the reaffirmation than those provided in the original agreement.[181] Two Arizona bankruptcy judges require pro se debtors to complete a special questionnaire,[182] and another court website includes a link to a talk given by a judge that counsels debtors regarding reaffirmation.[183]

b. Chapter 13 Trustees Procedures

Chapter 13 cases are administered by standing Chapter 13 trustees appointed in each district by the United States Trustee,[184] except for Alabama and North Carolina, which are under the Bankruptcy Administrator Program.[185] The duties of the Chapter 13 trustee are set forth in a statute.[186] These include accounting for property received and distributing payments to creditors, investigating the financial affairs of the debtor (including reviewing the debtor's petition, schedules, and other documents[187]); convening meetings of creditors;[188] appearing in the case and filing and participating in motions, objections, and other proceedings; ensuring the debtor is making payments; and making a final report on the case for the court.[189]

Chapter 13 trustees are not U.S. government employees, and each Chapter 13 office and staff is managed independently by the Chapter 13 trustee under the supervision of the UST or Bankruptcy Administrator. As a result, rules and practices established by trustees can vary widely. For example, of the ninety-four bankruptcy districts

[181] Austin & Lassman, *supra* note 116, at 9. Such terms may include a lower interest rate, reamortization, reduction of the principal amount to reflect the current fair market value of a car, or elimination of late charges and penalties. Arizona and Oregon are notable for this.

[182] *Id.* at app. J; *see also* Joseph C. McDaniel, *An Explanation of Reaffirmation in Bankruptcy Cases, and Why You Don't Want the Judge to Approve the Reaffirmation Agreement on Your Car*, ARIZ. BANKR. ATT'Y BLOG (Mar. 27, 2011, 11:01 PM), http://www.arizonabankruptcyblog.info/2011/03/nice-explanation-of-reaffirmation-in.html.

[183] *The Honorable Eileen W. Hollowell Discusses Reaffirmation*, U.S. BANKR. CT. FOR D.ARIZ., http://www.azb.uscourts.gov/default.aspx?PID=84 (last visited Apr. 27, 2012).

[184] 28 U.S.C. § 586(b) (2006).

[185] Bankruptcy Judges, United States Trustees, and Family Farmer Bankruptcy Act of 1986, Pub. L. No. 99-554, § 302(d)(3)(I), 100 Stat. 3119, 3123 (codified as amended in scattered sections of 11 U.S.C. and 28 U.S.C.).

[186] U.S. DEP'T OF JUSTICE, HANDBOOK FOR CHAPTER 13 STANDING TRUSTEES 3-1 (1998).

[187] *Id.* at 4-1.

[188] *Id.* at 5-1.

[189] *Id.* at 3-1.

(including Puerto Rico and the District of Columbia), trustees in sixty-five districts provide a form Chapter 13 plan for use by debtors,[190] and many districts have other local forms for use in Chapter 13 cases.[191]

Another difference is the fees charged by the trustee. A Chapter 13 trustee's office is funded by a percentage of the payments received from each debtor.[192] The fee is capped by the Code at ten percent, but each trustee decides how much below the cap to charge as a commission, subject to approval by the U.S. Attorney General.[193] Rates charged by Chapter 13 trustees vary by jurisdiction from three percent to ten percent.[194] Unless otherwise directed by the United States Trustee, rates do not have to be the same even among trustees in the same district. Since the commission collected by the trustee is deducted from the funds distributed to creditors, the rate charged by a trustee is an important component of how much each creditor will receive under the plan.

Some debtors may wish to pay secured debt, such as a mortgage, outside the plan, thereby avoiding the trustee's commission. Whether a debtor may do so depends on the policies of individual Chapter 13 trustees. In Massachusetts and the Northern District of Illinois, for example, secured debt is typically paid outside the plan, but in the Western District of Pennsylvania, secured debt must be paid within the plan.[195] Debtors in the Southern District of Indiana and Southern District of Ohio can make mortgage payments outside the plan unless there is an arrearage as of the petition date.[196] In contrast, the trustee for the Northern District of Indiana requires debtors to pay mortgage debt in the plan unless the plan provides for 100% payment to unsecured creditors and there is no mortgage arrearage.[197] The Southern

[190] *See, e.g.*, U.S. Bankr. Ct., S. D. of Cal. Chapter 13 Plan (Recommended Form), *available at* http://www.casb.uscourts.gov/html/csdforms/Chapter13Plan.pdf.

[191] *See, e.g.*, U.S. Bankr. Ct., W. D. of Ky., Local Form Q, Certification of Plan Completion and Request for Discharge, *available at* http://www.kywb.uscourts.gov/fpweb/pdf/local_form_q_fillable.pdf.

[192] 28 U.S.C. § 586(e)(1)(B)(i) (2006).

[193] U.S. DEP'T OF JUSTICE, *supra* note 186, at 11-1.

[194] *See* SCHEDULE OF ACTUAL ADMINISTRATIVE EXPENSES OF ADMINISTERING A CHAPTER 13 PLAN (2012), *available at* http://www.justice.gov/ust/eo/bapcpa/20120501/bci_data/docs/ch13_exp_mult.xls

[195] W.D. PA. LOCAL BANKR. R. 3015-1; W.D. PA. LOCAL BUS. FORM 10.

[196] Bankr. S.D. Ind., General Order 09-0005 (Aug. 1, 2009), *available at* http://www.insb.uscourts.gov/WebForms/genorder/090005.pdf; S.D. Ohio LOCAL BANKR. R. 3015-1(d)(1).

[197] There is no written rule for this, but it is customary local practice.

District of Georgia and Western District of Kentucky allow debtors to pay the current payments outside the plan, but mortgage arrearages must be paid through the plan.[198] In Oregon, the debtor is required to pay within the plan, but may request the trustee to waive this requirement.[199]

Clearly, the commission rate and whether payments are made in or outside a plan can greatly affect how much a debtor pays, how much creditors will receive, and, in some cases, whether a proposed plan is even feasible. As for the plans themselves, some districts use "pool" plans and some use "percent payment" plans. A "pool" plan looks to the total amount the debtor pays into the plan and deducts attorney fees, administrative costs, and unsecured priority payments from this. Any money left over is paid to unsecured creditors.[200] In contrast, courts requiring a "percentage payment" plan look to the percentage of payment to unsecured creditors, which must be disclosed in the plan.[201] If the plan does not pay a specified percentage, then the plan (and the debtor's expenses) will be subject to greater scrutiny by the court.[202]

Another difference is the manner in which plan payments are made. Section 1325(c) of the Code authorizes the court to order the debtor's employer to deduct the amount from the debtor's paycheck and forward the payments directly to the trustee.[203] Local bankruptcy rules in the Western District of Pennsylvania and the Southern District of Ohio require the debtor to submit a wage attachment or payroll deduction order along with the plan.[204] The local rules for the Western District of Kentucky do not require wage attachment, but the Chapter 13 trustee does.[205] In Oregon, the debtor must propose a

[198] *See, e.g.*, CHUCK SYDENSTRICKER, CHAPTER 13 RECOMMENDED PRACTICES IN THE WESTERN DISTRICT OF KENTUCKY 2 (2008), *available at* http://www.louchapter13.com/Images/Chapter13Practices.pdf.

[199] OR. LOCAL BANKR. R. 3015-1(7).

[200] *See, e.g.*, E.D. KY. LOCAL BUS. FORM 2.

[201] *See, e.g.*, SYDENSTRICKER, *supra* note 198, at 4.

[202] In the Western District of Kentucky, if the plan proposes to pay unsecured creditors less than seventy percent, the debtor must appear in person for a plan confirmation hearing. If the plan pays more than seventy percent, it will be confirmed without a separate hearing. *Id.*

[203] The Chapter 13 Handbook asserts that a debtor is more likely to successfully complete a plan if payments are made through voluntary wage orders and encourages such orders "in all cases where appropriate." U.S. DEP'T OF JUSTICE, *supra* note 186, at 6-6. I am unaware of any studies or evidence that actually support this.

[204] W.D. PA. LOCAL BANKR. R. 3015-2; S.D. OHIO LOCAL BANKR. R. 3015-1(e).

[205] *See Chapter 13 Attorney Top 10 List*, LOUCHAPTER13.COM, http://www.louchapter13.com/Top_Ten/Top_Ten.html (last visited Apr. 27, 2012).

payroll deduction order within seven days of the meeting of creditors, but at the meeting of creditors, may request the trustee to waive the wage attachment requirement.[206] In contrast, neither the Northern District of Illinois, the District of New Jersey, nor the Middle District of Tennessee requires payroll deduction.

In most districts, the Chapter 13 trustee relies upon debtors and attorneys to provide an appropriate valuation for personal property listed on Schedule B. The Chapter 13 trustee in the Western District of Kentucky (Louisville Division), however, contracts with an appraiser to inspect the debtor's personal property. The appraisal is filed on the docket in the debtor's case, and the cost of the appraisal is charged as an administrative claim against the bankruptcy estate.[207]

Chapter 13 trustees provide online access to payment history, debt balances, and other information for each Chapter 13 case. Generally, only bankruptcy attorneys or other authorized persons may obtain a username and password to access this information, but specific rules governing access are up to the trustee. There are at least four proprietary websites that host this data, and it is up to the trustee to select which site her office will use.[208]

The Bankruptcy Code permits debtors to deduct charitable contributions from income for determining eligibility to file a Chapter 7[209] and for calculating "disposable income" in Chapter 13.[210] Chapter 13 and Chapter 7 trustees can set their own requirements for documenting charitable contributions before the trustee allows the deduction. For example, some trustees require documentation of charitable contributions for one year, while others allow proof of payments

[206] Or. LOCAL BANKR. R. 3015-1(b)(2).

[207] *See, e.g.*, Appraisal. (Anderson, CPA, Randall), *In re* O'Neal, No. 08-35278 (Bankr. W.D. Ky. Jan. 1, 2009), ECF Nos. 12 and 13.

[208] *See Welcome to the 13Network*, BANKR. SOFTWARE SPECIALISTS, http://www.13network.com (last visited Apr. 27, 2012); *Exclusive Source of Consolidated Chapter 13 Case and Claims Data*, NAT'L DATA CENTER, https://www.13datacenter.com (last visited Apr. 27, 2012); *Chapter 13 Trustee Online Case Status System*, TRUSTEE13.COM, http://www.trustee13.com (last visited Apr. 27, 2012); *Home Page*, BANKR. LINK, http://www.bankruptcylink.com (last visited Apr. 27, 2012).

[209] 11 U.S.C. § 707(b)(1) (2006) ("In making a determination whether to dismiss [for bankruptcy abuse] the court may not take into consideration whether a debtor has made or continues to make, charitable contributions . . . .").

[210] Section 1325(b)(2)(A)(ii) allows charitable contributions up to fifteen percent of gross annual income to be deducted from the debtor's "disposable income" for determining the amount that must be paid into a Chapter 13 plan each month. *Id.* 1325(b)(2)(A)(ii).

for a much shorter period.[211] Some trustees receive statements directly from the organization, and others will accept evidence from the debtor, such as cancelled checks.[212] Other trustee offices have more detailed policies. In the Western District of Kentucky, if the monthly charitable contribution is $200 or less, no further evidence is required.[213] If the contribution is more than $200, the trustee requires a copy of the debtor's Schedule A of the prior-year tax return.[214] But if the debtor claims a monthly contribution amount of over $400, the trustee requires an on-going quarterly statement from the organization receiving the contribution.[215] If the trustee does not get this documentation after the plan has been confirmed, then he will file a motion to increase the plan payment by the amount claimed as a charitable contribution.[216] There are no specific rules or guidelines for documenting charitable contributions, and each trustee determines her own policies.

c. Chapter 7 Trustees

Chapter 7 cases are administered by a Chapter 7 "panel" trustee. Section 701(a)(1) provides that "promptly after the order for relief, the United States trustee shall appoint one disinterested person that is a member of the panel of private trustees established under section 586(a)(1) of title 28."[217] The main duty of the trustee is to collect and liquidate property of the estate and to distribute the proceeds to creditors.[218] The trustee's specific duties include reviewing the debtor's petition, schedules, and other bankruptcy documents;[219] convening and conducting the "meeting of creditors";[220] collecting and liquidating non-exempt assets and accounting for the property received;[221] objecting to exemptions;[222] opposing the discharge of the

[211] Email from Lydia S. Meyer, Chapter 13 Trustee, N.D. of Ill., to author (Mar. 23, 2011, 4:03 EST) (on file with author).
[212] *Id.*
[213] SYDENSTRICKER, *supra* note 198, at 2.
[214] *Id.*
[215] Email from Chuck Sydenstricker, Office of Chapter 13 Trustee, W.D. of Ky, to author (Mar. 23, 20122, 4:55 EST) (on file with author).
[216] *Id.*
[217] 11 U.S.C. § 701(a)(1)(2006).
[218] U.S. DEP'T OF JUSTICE, HANDBOOK FOR CHAPTER 7 TRUSTEES 6-1 (2001).
[219] *Id.* at 6-5, 6-8.
[220] 11 U.S.C. § 341(a) (2006).
[221] *Id.* § 704(a)(1)–(2).
[222] FED. R. BANKR. P. 4003(b).

debtor when appropriate;[223] reviewing the debtor's attorney's fees;[224] reviewing the case for "substantial abuse";[225] and filing a final report and accounting.[226] For administering a no-asset Chapter 7 case, the trustee receives sixty dollars.[227]

Chapter 7 trustees have considerable discretion in how they administer bankruptcy cases. For example, a Chapter 7 debtor must file financial information such as schedules of assets, liabilities, income, and expenses.[228] The trustee may determine what type of evidence, if any, must be provided to document these figures. This can include tax returns, business financial statements, loan documents, deeds, titles, insurance policies, and wage and bank statements.[229]

As noted, § 707(b)(1) permits a Chapter 7 debtor to claim a deduction for charitable contributions to a "qualified religious or charitable entity."[230] The Code does not state for how long the debtor must have been making the contributions prior to filing. Some Chapter 7 trustees simply never question whether the debtor has made such contributions in the past, interpreting the purpose of the provision and the "fresh start" objective of Chapter 7 to allow the contribution. Other trustees may insist that the payments have been made for a year or longer, and require documentation such as cancelled checks, a copy of IRS Schedule A (if the debtor itemizes deductions), or a letter or some other proof from the charitable organization.

Valuation of the debtor's property is an issue in many Chapter 7 cases, particularly if it appears that the debtor has neared or exceeded her exemptions. The Chapter 7 Handbook states that "value can be determined in a variety of ways."[231] In a no-asset case, trustees generally accept the Schedule B valuations for smaller items of personal property, such as clothing, appliances, and household goods. The

[223] *Id.* § 704(a)(6). Grounds for opposing discharge include, inter alia, abuse of the bankruptcy process and failure to disclose assets. *Id.*

[224] U.S. DEP'T OF JUSTICE, *supra* note 218, at 6-9.

[225] *Id.* at 6-11 to 6-13. Under section 707(b) of the Code, the bankruptcy court, after notice and hearing, must dismiss the debtor's petition if it is found that granting relief would be an abuse of Chapter 7 bankruptcy. *Id.* at 707(b).

[226] *Id.* § 704(a)(9).

[227] *Id.* § 330(b).

[228] *Id.* § 521(a)(1)(A)–(B).

[229] U.S. DEP'T OF JUSTICE, *supra* note 218, at 7-1.

[230] *Id.* § 707(b)(1). The deduction is listed on Schedule J, Line 10.

[231] U.S. DEP'T OF JUSTICE, *supra* note 218, at 8-3. Examples provided in the Handbook include the pay-off statement, price lists, physical inspections, appraisals, and "common sense." *Id.*

trustee may be more likely to require a third-party valuation for unique items such as antiques or original artwork, or for the debtor's interest in a business. However, there is no standard policy or method, and different trustees have different policies for whether and how they will obtain separate valuations for property. For example, some trustees accept printed real estate valuations from Zillow.com. Or, if the debtor recently purchased or refinanced the property, the trustee may accept the loan appraisal. Many trustees, however, will demand that the debtor obtain a broker's price opinion or even a professional appraisal, which may cost the debtor several hundred dollars to obtain.[232] For the valuation of motor vehicles, most Chapter 7 trustees accept printouts from online valuation services, such as NADA or Kelly Blue Book, but some trustees require the debtor to bring her vehicle to a designated appraiser for valuation.[233]

d. Bank Practices

Section 541 provides that all "legal or equitable interests of the debtor" become property of the bankruptcy estate upon commencement of a case.[234] In a Chapter 7 case, this means that the debtor may not sell, give away, or otherwise dispose of estate property without approval of the bankruptcy court.[235] Taking this to the extreme, some banks place a freeze on a Chapter 7 debtor's bank accounts immediately upon receipt of notice of filing (irrespective of any right of setoff), until requested by the trustee to release them.[236] This may impose a serious hardship upon the debtor, who can no longer get access to her funds for daily personal or family use. The policy is not imposed uniformly,[237] and jurisdictions differ on whether doing so violates the automatic stay. The Ninth Circuit BAP has held that freezing the debtor's account when there is no contractual right of setoff violates the automatic stay.[238] Other courts disagree and have refused

[233] Interview with Donald R. Lassman, Chapter 7 Trustee, Dist. of Mass., Bos. Div. (Nov. 8, 2010) (on file with author).

[234] 11 U.S.C. § 541(a)(1) (2006).

[235] All of the debtor's interests in such property remain "property of the estate" until the trustee abandons the property, a creditor obtains relief from stay as to its collateral, or until the case is closed. § 541(a).

[236] Based on anecdotal information and available case law, it appears that Wells Fargo is the only national bank that does this.

[237] The author's informal survey of bankruptcy attorneys suggests that this is not likely in California, Montana, Massachusetts, and Pennsylvania, but more common in New Mexico, Tennessee, Virginia, and Washington.

[238] *In re* Mwangi, 432 B.R. 812, 822 (B.A.P. 9th Cir. 2010).

to sanction a bank for freezing the debtor's personal bank account upon notice of a bankruptcy filing.[239]

2. Business Bankruptcy

The classic model of Chapter 11 is a business using the respite from creditors under the automatic stay to restructure operations and negotiate a plan of reorganization,[240] often with modified debt or new capital.[241] The business then emerges from Chapter 11 a more efficient, on-going enterprise with its identity and operations intact.

The traditional model is becoming increasingly atypical, with a variety of alternatives taking its place. These include "pre-packaged" bankruptcy ("pre-packs"), in which the debtor has negotiated the key terms of a bankruptcy exit plan with major secured creditors prior to filing for bankruptcy. Pre-packs now account for up to half of all large Chapter 11 bankruptcies.[242] Other models include liquidation of estate assets prior to confirmation[243] or pursuant to a confirmed plan.[244] Another variant is a so-called "structured dismissal" in which the case is dismissed, but where the dismissal order includes provisions such as releases, protocols for reconciling or paying claims, and other terms.[245] Some bankruptcy courts appoint a Chief Restructuring Officer in cases in which debtor's management has resigned or is otherwise not capable of managing the affairs of the debtor.[246] Bankruptcy courts have responded differently to these developments, with some courts accepting them wholly, in part, or not at all.[247] Whichever hybrid is before the court, the location of the case can make a con-

[239] *In re* Young, 439 B.R. 211 (Bankr. M.D. Fla. 2010); *In re* Phillips, 443 B.R. 63 (Bankr. M.D.N.C. 2010); *In re* Bucchino, 439 B.R. 761 (Bankr. D.N.M. 2010).

[240] *See, e.g.*, *In re* Whitaker, 341 B.R. 336, 341 (Bankr. S.D. Ga. 2006).

[241] To be confirmed, a plan must comply with the requirements of 11 U.S.C. §§ 1123 and 1129.

[242] *Survey Finds Free-Fall Bankruptcies Becoming More Rare*, WALL ST. J. (June 15, 2011, 4:47 PM), http://blogs.wsj.com/bankruptcy/2011/06/15/survey-finds-free-fall-bankruptcies-becoming-more-rare/tab/print.

[243] 11 U.S.C. § 363(b) (2006).

[244] *Id.* § 1129(b)(2)(A)(ii)–(iii).

[245] *See* Norman L. Pernick & G. David Dean, *Structured Chapter 11 Dismissals: A Viable and Growing Alternative After Asset Sales*, 29 AM. BANKR. INST. J. 1, 56–58 (2010). For a highly critical view of structured dismissals, see Nan Roberts Eitel, T. Patrick Tinker & Lisa L. Lambert, *Structured Dismissals, or Cases Dismissed Outside of Code's Structure?*, 30 AM. BANKR. INST. J. 20, 20 (2011).

[246] Anthony Horvat, *Defining the Role of the CRO*, 24 AM. BANKR. INST. J. 46. (2005).

[247] *See* Ronit J. Berkovich et al., *Prepackaged and Prenegotiated Chapter 11 Cases*, *in* RECENT DEVELOPMENTS IN DISTRESSED DEBT, RESTRUCTURING & WORKOUTS 637, 637(PLI Comm. L. & Practice, Course Handbook Ser. No. 35267, 2012) .

siderable difference in a case's outcome. As with consumer bankruptcy, these differences are due to the use of nonbankruptcy law, conflicting judicial precedent, and variances in court rules and procedures.[248]

i. Nonbankruptcy law

As noted, many sections of the Code require the court to apply "nonbankruptcy law." Section 510(a) provides that a pre-bankruptcy subordination agreement is enforceable in bankruptcy "to the same extent that such agreement is enforceable under applicable nonbankruptcy law."[249] This requires bankruptcy courts to apply state law when considering such agreements.[250] But state laws on subordination vary. For example, subordination agreements are readily enforceable under Illinois law,[251] but face far more restrictions under Michigan law.[252] In Ohio, a subordination agreement can be an informal "bargain of the parties as found in their language or by implication from other circumstances including course of dealing or use of trade or course of performance."[253] The Ninth Circuit has held that California law, which grants a purchase money deed of trust priority over all other liens, constitutes a subordination agreement within the meaning of § 510(a).[254] Similarly, a Kentucky court found that a clause in a lease subordinating a tenant's leasehold interest to a bank's mortgage qualified as a subordination agreement and was

[248] The discussion that follows is by no means a complete treatment of all the differences in bankruptcy between state and federal jurisdictions. Subjects not treated here include, among others, whether bankruptcy courts apply conflicts of law rules based on federal common law or forum state law, rejection of collective bargaining agreements under 11 U.S.C. § 1113, payment of retiree benefits under § 1114, and whether a "free and clear" sale of assets under § 363(f) divests in personam claims.

[249] 11 U.S.C. § 510(a) (2006).

[250] *In re* Bank of New Eng. Corp., 646 F.3d 90, 94 (1st Cir. 2011) (holding that bankruptcy courts are to apply "general principles of state contract law when enforcing subordination agreements" and may not create "bankruptcy-specific rules of contract interpretation").

[251] *In re* Chi. S. Shore & S. Bend R.R., 146 B.R. 421, 425 (Bankr. N.D. Ill. 1992) (holding that subordination agreements are enforceable under Illinois state law).

[252] *In re* Holly's, Inc., 140 B.R. 643, 678–79 (Bankr. W.D. Mich. 1992) ("Section 510(a) does not provide carte blanche to a creditor under the guise of a subordination agreement to collect a debtor's postpetition earnings to be applied to prepetition debt."); *In re* Cliff's Ridge Skiing Corp., 123 B.R. 753, 765 (Bankr. W.D. Mich. 1991) (stating that the court will scrutinize whether subordination agreement is based on sufficient consideration).

[253] *In re* Envtl. Aspects, Inc., 235 B.R. 378, 396 (Bankr. E.D.N.C. 1999) (citing OHIO REV. CODE ANN. § 1301.01).

[254] *In re* Sunset Bay Assocs., 944 F.2d 1503, 1508 (9th Cir. 1991).

within the scope of § 510(a).[255] In contrast, Pennsylvania law requires a formal document with specific language executed by both parties.[256]

State law under § 510(a) can even trump the powers of a trustee under the Bankruptcy Code. The Second Circuit found that under Vermont law, a trustee's subrogation powers under § 544(a)(1) and § 551 do not extend to subordination agreements protected by § 510(a).[257]

Even when not directly incorporated into the Code, state law plays a role in bankruptcy. For example, "deepening insolvency" is a tort of recent vintage whereby corporate officers, directors, and auditors can be subject to liability to creditors in a bankruptcy case for artificially attempting to prolong the life of an already insolvent company.[258] To establish a cause of action, a plaintiff must prove that the company was in the "zone of insolvency," and that actions by the directors and officers to continue the enterprise breached a fiduciary duty to creditors and the debtor itself.[259] Whether liability exists under a given set of facts depends upon state laws governing fiduciary duty, and some states do not even recognize the tort.[260]

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[255] *In re* Buttermillk Towne Ctr., LLC, No. 10–21162, 2010 WL 5559411, at *3 (Bankr. E.D. Ky. Dec. 30, 2010).

[256] *In re* Dan-Ver Enters., Inc., 86 B.R. 443, 447 (Bankr. W.D. Pa. 1988) (determining that written but unexecuted distribution agreements are not sufficient to constitute a valid subordination agreement).

[257] *In re* Kors, Inc., 819 F.2d 19, 23 (2d Cir. 1987) (concluding that, under Vermont law, subordination agreements are enforceable only among creditors entitled to priority who enter into such agreements).

[258] Kyung S. Lee et al., Deepening Insolvency Doctrine: An Emerging Remedy Against Contemporary Corporate Malfeasances 1 (Nov. 18–19, 2004) (unpublished manuscript) (on file with author)("The premise underlying deepening insolvency theory is that even an insolvent company has value, which could be salvaged if the company is liquidated or restructured in a timely manner.").

[259] Official Comm. of Unsecured Creditors v. R.F. Lafferty & Co., 267 F.3d 340, 347 (3d Cir. 2001) (defining the tort of deepening insolvency as "fraudulent expansion of corporate debt and prolongation of corporate life"); *cf.* Seitz v. Detweiler, Hershey & Assoc., P.C. (*In re* CitX Corp., Inc.), 448 F.3d 672, 680 n.11 (3d Cir. 2006) (suggesting that the Third Circuit should reconsider the case en banc).

[260] *See, e.g.*, Office Comm. of Unsecured Creditors of VarTec Telecom, Inc. v. Rural Tel. Fin. Coop. (*In re* VarTec Telecom, Inc.), 335 B.R. 631, 634–35 (Bankr. N.D. Tex. 2005). In that case, creditors accused VarTec's lender of making improper loans to the debtor and fraudulently inducing the debtor to pay down those loans shortly before VarTec filed for bankruptcy. *Id.* The bankruptcy court dismissed the case on motion of the lender for failure to state a claim, since it determined that Texas courts would not recognize deepening insolvency as an independent cause of action. *Id.* at 646; *see also* N. Am. Catholic Educ. Programming Fund, Inc. v. Gheewalla, 930 A.2d 92, 94 (Del. 2007) (holding that directors and officers owed no duties to creditors while corporation was in the "zone of insolvency").

ii. Case Precedent

a. Secured Creditor Right to Credit Bid

A foreclosure creditor under state law has the right to credit-bid for its collateral at a foreclosure sale. This means that the creditor does not have to offer actual money, but may simply bid the amount of its lien.[261] This is because the creditor would be entitled to the proceeds of the sale, up to the amount of its lien.[262] Section 363(k) of the Code preserves the right of a creditor to bid its lien in a sale of estate assets held during the pendency of a bankruptcy (before a reorganization plan is filed) pursuant to § 363(b) of the Code.[263]

A "363 sale" differs from a sale of assets conducted under the terms of a confirmed Chapter 11 plan. If the debtor proposes to sell assets as part of its plan of reorganization, and the creditor does not consent to the sale, the debtor has three alternatives. First, the plan can provide that the creditor's lien will be retained until the present value of the lien is paid in full.[264] Second, the plan can provide "for the sale, subject to 363(k) . . . of any property that is subject to the liens."[265] Third, the plan can provide for the "realization by [the creditor] of the indubitable equivalent" of its claim.[266]

Given the express provision for the sale of assets set forth in option two, courts and practitioners have long assumed that a creditor has the inherent right to credit bid in a sale of assets under a Chapter 11 plan.[267] But this practice was recently rejected by the Third Circuit

[261] *See, e.g.*, *In re* Midway Invs., Ltd., 187 B.R. 382, 390–91 (Bankr. S.D. Fla. 1995) ("The right to credit bid the full amount of a secured claim is essential to the protection of a non-recourse secured creditor.").

[262] Louisville Joint Stock Land Bank v. Radford, 295 U.S. 555, 594–95 (1935) ("[The secured lender has] the following property rights under the law of Kentucky: . . . [t]he right to protect its interest in the property by bidding at such sale whenever held, and thus to assure having the mortgaged property devoted primarily to the satisfaction of the debt, either through receipt of the proceeds of a fair competitive sale or by taking the property itself.").

[263] Code section 363(k) provides in part, "At a sale under [this section] of property that is subject to a lien . . . if the holder of such claim purchases such property, such holder may offset such claim against the purchase price of such property." 11 U.S.C. § 363(k) (2006).

[264] *Id.* § 1129(b)(2)(A)(i).

[265] § 1129(b)(2)(A)(ii).

[266] § 1129(b)(2)(A)(iii).

[267] *See, e.g.*, Ralph Brubaker, *Cramdown of an Undersecured Creditor Through Sale of the Creditor's Collateral: Herein of Indubitable Equivalence, the § 1111(b)(2) Election, Sub Rosa Sales, Credit Bidding, and Disposition of Sale Proceeds*, 29 BANKR. L. LETTER No. 12, Dec. 2009, at 1, 7–8.

in *In re Philadelphia Newspapers, LLC.*[268] That case held that the debtor could sell a secured asset under option three *without* allowing the creditor the right to credit bid.[269] The Fifth Circuit has also held that a creditor has no absolute right to credit bid in a Chapter 11 sale.[270]

This is a substantial change from past practice[271] and favors debtors and insiders at the expense of creditors.[272] This shift particularly affects creditors who are undersecured because credit bidding protects against sales at the bottom of the market. It also undermines the strategy of "loan-to-own" investors who buy secured debt at discount prices with the intent to eventually credit bid to acquire the assets if the debtor does not pay.[273] Moreover, in an illiquid market with debtors and creditors seeking scarce investment funds, the ability to credit bid is a huge component of asset sales and restructuring.[274]

As a Third Circuit Court of Appeals case, *Philadelphia Newspapers* is binding on the Delaware bankruptcy court. Therefore, it is likely to have a disproportionate effect on business bankruptcy. To date, no courts outside the Third and Fifth Circuits have embraced the rule.[275] Debtors that have a choice of venue will weigh the advantages of filing in a circuit that allows sales pursuant to a Chapter 11 plan without credit bidding. Creditors will be stuck with the consequences.

b. Cram-Down Interest Rates

A Chapter 11 plan may be confirmed if it meets the requirements of § 1129(a)(1) to (16). Among these is the requirement that all creditors whose claims are "impaired" (adversely affected) consent

[268] 599 F.3d 298 (3d Cir. 2010).

[269] *Id.* at 311.

[270] Bank of N.Y. Trust Co., NA v. Official Unsecured Creditors' Comm. (*In re* Pacific Lumber Co.), 584 F.3d 229 (5th Cir. 2009).

[271] Michael H. Torkin & Douglas P. Bartner, *Major Legal and Financial Factors Impacting Chapter 11 Restructuring in 2011*, 2011 WL 586140, *4 (2011). As the authors state, "Until very recently, the right to credit bid has been more or less taken for granted." *Id.*

[272] *See, e.g.*, *In re* Phila. Newspapers, LLC, 599 F.3d 298, 337 (3d Cir. 2010) (Ambro, J., dissenting) ("Such a result would undermine the Bankruptcy Code by skewing the incentives of the debtor to maximize benefits for insiders, not creditors.").

[273] Torkin & Bartner, *supra* note 271, at *4.

[274] *Id.* at *3.

[275] *See, e.g.*, *In re* River Rd. Hotel Partners, LLC, No. 09 B 30029, 2010 WL 6634603, at *1 (Bankr. N.D. Ill. Oct. 5, 2010) (refusing to allow debtor to sell assets under Chapter 11 plan without credit bidding and finding "Judge Ambro's well-reasoned dissent in *Philadelphia Newspapers* more persuasive").

to the plan.[276] A plan can still be confirmed under § 1129(b) if all other § 1129(a) conditions are met except for consent of all creditors.[277] Confirmation of a plan under § 1129(b) (referred to as a "cram-down") allows the claims of secured and unsecured creditors to be paid over time with interest.[278] The rate of interest is a significant component of the cost—and hence the feasibility—of a plan.

The Bankruptcy Code does not specify how the cram-down rate of interest is to be determined, and courts have employed various methods including the "formula rate,"[279] "forced loan" rate,[280] "presumptive contract rate,"[281] and "cost of funds rate."[282] In 2004, the Supreme Court considered the matter of cram-down interest in *Till v. SCS Credit Corp.*[283] After examining the pros and cons of various approaches, the Court adopted the formula rate.[284] Under this approach, the bankruptcy court starts with the prime rate and then adds a "plus" premium for the added risk of default by the debtor.[285] The Court declined to state what the amount of the risk factor should be

[276] 11 U.S.C. § 1129(a)(8) (2006).

[277] § 1129(b)(1).

[278] Section 1129(b)(2)(A)(i)(II) provides that a holder of a secured claim receive "deferred cash payments . . . of a value, as of the effective date of the plan, of at least the value of such holder's interest." For unsecured creditors, § 1129(b)(2)(B)(i) provides that the creditor "receive or retain . . . property of a value, as of the effective date of the plan, equal to the allowed amount of the claim." § 1129(b)(2)(B)(i) . "This 'value' is generally understood to be a market rate of interest, considering the terms, quality of the security and any risk to be borne by the affected creditor." *In re* Linda Vista Cinemas, L.L.C., 442 B.R. 724, 748 (Bankr. D. Ariz. 2010).

[279] The Second Circuit in *In re Valenti*, 105 F.3d 55, 63 (2d Cir. 1997), adopted the formula method. It was endorsed, but not formally adopted, by the Ninth Circuit in *In re Fowler*, 903 F.2d 694, 698 (9th Cir. 1990), and the Eighth Circuit in *United States v. Doud*, 869 F.2d 1144, 1146 (8th Cir. 1989).

[280] Under this approach, the court projects that the creditor has foreclosed the loan and reinvested the proceeds in loans of equivalent duration and risk. The Seventh Circuit used this method in a Chapter 12 case. Koopmans v. Farm Credit Servs. of Mid-Am., ACA, 102 F.3d 874, 875 (7th Cir. 1996).

[281] This approach is similar to the "forced loan" approach, except that the contract rate is presumed to be the market rate for the "coerced loan." *In re* Till, 301 F.3d 583, 594 (7th Cir. 2002), *rev'd*, 541 U.S. 465 (2004). The rate could then be adjusted upward or downward if the creditor or debtor can show that the contract rate is lower (or higher) than the market rate. *Id.* Other courts using this approach are the Fifth Circuit, *In re* Smithwick, 121 F.3d 211, 214 (5th Cir. 1997), and the Third Circuit, GMAC v. Jones, 999 F.2d 63, 66–67 (3d Cir. 1993).

[282] This is the rate that the creditor would have to pay to borrow funds equal to the value of the collateral. *In re Valenti*, 105 F.3d at 64.

[283] 541 U.S. 465 (2004).

[284] *Id.* at 471.

[285] *Id.*

but noted that many courts using this "formula rate" generally approve risk adjustments of one to three percent.[286]

The *Till* "formula rate" rule might have been dispositive, even with its ambiguous "plus" factors. The case was decided by a plurality of four justices, however, and thus its precedential value is questionable.[287] In contrast, four dissenting justices felt that the interest rate set forth in the contract between the parties should be the presumptive cram-down rate,[288] while Justice Thomas, concurring only in the result, wrote that the interest rate should be zero.[289] Furthermore, *Till* dealt with a cram-down claim in Chapter 13. Although the Court asserted that it was "likely" that Congress intended the cram down interest rate to be the same for Chapter 11 and 13,[290] in a footnote the Court suggested that cram-down interest rate in Chapter 11 was different from that in Chapter 13 because there is a market for Chapter 11 debtor financing.[291] Thus, it is unclear whether the Court intended *Till* to apply to Chapter 11 cram-down interest.[292] As a result, many bankruptcy courts continue to apply pre-*Till* circuit court precedent.[293]

Since *Till*, courts have employed a variety of methods to calculate cram-down interest rates. These include the "efficient market

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[286] *Id.* at 480.

[287] On the questionable precedential value of a plurality opinion, the Supreme Court has stated that

> an affirmance by an equally divided court is, as between the parties, a conclusive determination and adjudication of the matter adjudged; but the principles of law involved not having been agreed upon by a majority of the court sitting prevents the case from becoming an authority for the determination of other cases either in [the Supreme Court] or in inferior courts.

Hertz v. Woodman, 218 U.S. 205, 213–14 (1910); *see also* Texas v. Brown, 460 U.S. 730, 737 (1983) (stating that reasoning not adopted by a majority of the court is not binding precedent).

[288] *In re Till*, 541 U.S. at 494.

[289] *Id.* at 491.

[290] *Id.* at 474.

[291] *Id.* at 477 n.15.

[292] *See In re* Prussia Assocs., 322 B.R. 572, 585, 589 (Bankr. E.D. Pa. 2005) ("*Till* is instructive, but it is not controlling, insofar as mandating the use of the 'formula' approach . . . in every Chapter 11 case.").

[293] *In re* Cook, 322 B.R. 336, 345 (Bankr. N.D. Ohio. 2005) ("It is necessary to look to Sixth Circuit case law for the proper rate of interest as no other Supreme Court case addresses the issue, and the *Till* plurality does not overrule the binding precedent of the circuit."); *see also* Combined Props./Greenbriar Ltd. P'ship v. Morrow, 58 F. Supp. 2d 675, 680–81 (E.D. Va. 1999) (finding that since a fragmented Supreme Court decision was not entitled to precedential weight, Fourth Circuit case law on point remained controlling).

rate," *Till* "formula rate," the *Till* formula rate but only as a default, the "presumptive contract" approach, and more recently, a "blended rate" approach, when an actual market for the debt at issue does not exist.

The "efficient market" rate draws on the dicta from *Till* that there is a market for Chapter 11 debtor in possession (DIP) financing, and that therefore, the court can calculate the proper cram down rate based on what rate a commercial lender would charge for a loan to the debtor for a loan equal to the value of the secured debt that is to be repaid under the Chapter 11 plan.[294] Using this approach, the court considers (usually based on the testimony of experts) what a standard market rate would be for a loan that is equal to the amount of the creditor's claim, assuming that the debtor had a normal capital structure.[295] This is the preferred method of calculating cram down interest rates for courts in the Third and Sixth Circuits.[296]

The formula method, endorsed by the plurality in *Till*, requires the court to start with a risk-free market rate, such as the prime rate of a U.S. Treasury instrument with a maturity corresponding to the debtor's repayment schedule, and then add a risk premium based on the risk of repayment under the plan. This is the favored approach in the Tenth Circuit.[297] Risk factors identified in *Till* include "the circumstances of the estate, the nature of the security, and the duration and feasibility of the reorganization plan."[298] Some courts will add additional risk factors such as the debt service coverage ratio, loan to value ratio, and the quality of any guarantors.[299] While *Till* indicated that the increase over the prime rate due to risk factors might be from one to three percent, other courts have observed that this amount may be unrealistically low and have allowed for higher

[294] *In re* Am. HomePatient, Inc., 420 F.3d 559, 568 (6th Cir. 2005).

[295] *Id.* at 569.

[296] *See In re* Cantwell, 336 B.R. 688 (Bankr. D.N.J. 2006); *In re* Seaspan Dev. Corp. Nos. 04-21339, 04-21340, 2:05-CV-315, 2006 WL 2672298 (E.D. Tenn. Sept. 18, 2006); *In re Prussia Assocs.*, 322 B.R. at 585.

[297] *In re* Inv. Co. of the S.W., 341 B.R. 298, 326 (B.A.P. 10th Cir. 2006).

[298] *In re* Till, 541 U.S. 465, 479 (2004).

[299] *In re* Griswold Bldg., LLC, 420 B.R. 666, 693 (Bankr. E.D. Mich. 2009); *see In re* Deep River Warehouse, No. 04-52749, 2005 WL 2319201, at *11 (Bankr. M.D. N.C. Sept. 22, 2005) ("Risk is increased significantly when the loan to value ratio is 100%, but a high grade tenant positively affects that risk."); *In re* Gramercy Twins Assocs., 187 B.R. 112, 124 (Bankr. S.D.N.Y. 1995) ("[T]he relatively high loan to value ratio in this case, which is approximately 85%, increases the risk factor.").

amounts.[300] In short, even under the Supreme Court case of *Till*, there is no uniform or set criteria for calculating cram-down interest rates. Perhaps for this reason, many courts in the First, Fifth, Sixth and Seventh Circuits use *Till* only if they determine that no applicable market interest rate exists.[301]

In seeking to establish a market rate, some courts use a "blended rate" approach. This involves a more creative analysis to consider if hypothetical cram-down financing for the debtor could exist.[302] Under this approach, the court attempts to determine if the debtor could obtain a loan through a combination of different tranches of financing. The interest rates of the tranches would then be blended to determine an appropriate rate.[303] Thus, in *In re 20 Bayard Views, LLC*, the debtor's secured creditor proposed a three-tier hypothetical structure including a $13.65-million loan secured by a first mortgage at 7.5% interest, a $3.15-million mezzanine loan secured by a second mortgage at 13.5% interest, and an equity investment of $3.63 million based on a return rate of twenty-two percent.[304] This resulted in a blended rate of 11.68%, compared to the debtor's much lower proposed rate of 3.9%.[305]

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[300] *See, e.g.*, *In re Griswold Bldg.*, 420 B.R. at 696 (applying a five-percent risk adjustment); *In re* N.W. Timberline Enters., 348 B.R. 412, 434 (Bankr. N.D. Tex. 2006).

[301] *See, e.g.*, *In re* 20 Bayard Views, LLC, 445 B.R. 83, 111 (Bankr. E.D.N.Y. 2011) ("Since there is no applicable market interest rate, it is appropriate to consider the formula approach set forth in *Till*."); *In re* Bryant, 439 B.R. 724, 741–42 (Bankr. E.D. Ark. 2010); Mercury Capital Corp. v. Millford Conn. Assocs., L.P., 354 B.R. 1, 11–13 (Bankr. D. Conn. 2006); *In re N.W. Timberline Enters., Inc.*, 348 B.R. at 434; Bank of Montreal v. Official Comm. of Unsecured Creditors (*In re* Am. HomePatient, Inc.), 420 F.3d 559, 568 (6th Cir. 2005); *In re* Greenwood Point, LP, 445 B.R. 885, 918 (Bankr. S.D. Ind. 2011) ("[W]here there is no efficient marketplace to establish the rate of interest in a cramdown, the Court will use the current Prime Rate and add basis points thereto to the extent that the loan is determined to be risky, and in a number sufficient to compensate for the unusual risk.").

[302] "The blended rate approach . . . is not an attempt to mirror an actual market that exists. Rather, it is an attempt by principled approach to create a proxy for a market extrapolated from current data such that the court can reach the ultimate question of 'present value.'" *In re* N. Valley Mall, LLC, 432 B.R. 825, 835 (Bankr. C.D. Cal. 2010).

[303] *See, e.g.*, Pac. First Bank v. Boulders on the River, Inc. (*In re* Boulders on the River, Inc.), 164 B.R. 99, 103, 107 (B.A.P. 9th Cir. 1994) (noting that the bankruptcy court applied blended rate of nine percent); *In re N. Valley Mall, LLC*, 432 B.R. at 832–36 (applying blended rate of 8.5%); *In re* Cellular Info. Sys., 171 B.R. 926, 944 (Bankr. S.D.N.Y. 1994) (denying plan confirmation because cram down interest rate was lower than the blended rate).

[304] *In re 20 Bayard Views*, 445 B.R. 83.

[305] *Id.* at 110, 112 (denying plan confirmation where debtor's proposed cram down rate was not an appropriate risk adjustment).

Still another approach is the presumptive contract approach. Under this approach, the interest rate is the contract rate between the parties under their pre-bankruptcy agreement.[306] The Sixth Circuit has ruled that the contract rate of interest must be used if the debtor is solvent.[307] Drawing on this authority, a Texas district court held that the contract rate of fifteen percent was an appropriate cram-down rate where the creditor is oversecured.[308] This resulted in an interest rate that was likely far higher than if the court had utilized the *Till* "prime rate plus" formula. Other courts likewise have found the contract rate to be appropriate, even where the debtor was insolvent.[309]

The Nebraska Bankruptcy Court has promulgated a local bankruptcy rule to govern interest rates in Chapter 11 cases.[310] This *Wichmann* formula creates a presumption that the interest rate shall be two percentage points higher than the national average of the prime rate published in *The Wall Street Journal* on the day prior to the confirmation hearing.[311]

Courts have acknowledged the difficulty in obtaining certainty and consistency in finding a market rate even where an efficient market may exist, and thus the last resort for establishing a rate may be simply to employ the court's equity power and whatever factors the court may consider to be important in a particular instance.[312]

c. Class Gifting and the Absolute Priority Rule

A recent development in bankruptcy is the practice of asset reallocation, commonly known as "gifting." Gifting refers to the process in which a secured creditor will contribute — "gift"—a portion of estate property that is fully encumbered by the creditor's security to a lower-priority class upon plan confirmation, bypassing the intermedi-

[306] *In re* Del-A-Rae, Inc., 448 B.R. 303, 305 (Bankr. S.D. Ga. 2011).

[307] *In re* Dow Corning Corp., 456 F.3d 668, 679 (6th Cir. 2006).

[308] Good v. RMR Inv., Inc., 428 B.R. 249, 256 (Bankr. E.D. Tex. 2010).

[309] *In re* T-H New Orleans Ltd. P'ship, 116 F.3d 790, 800 (5th Cir. 1997) (affirming the rate set by the bankruptcy court).

[310] NEB. R. BANKR. P. 3023-1.

[311] NEB. R. BANKR. P. 3023-1(b). This formula approach was adopted following *In re Wichmann*, 77 B.R. 718 (B.A.P. 9th Cir. 1994), and was approved by the Supreme Court in *Till v. SCS Credit Corp.*, 541 U.S. 465 (2004). The rule also applies to interest rates in Chapter 9, 12, and 13.

[312] *In re* SJT Ventures, LLC, 441 B.R. 248, 255 (Bankr. N.D. Tex. 2010) ("[A]n attempt to poll the local market for a consistent rate may yield unworkable results. . . . A court of equity must seek out the approach that will most fairly and accurately account for the characteristics of the debtor and the market value of the creditor's claim.").

ate class of creditors.[313] The secured creditor, it might agree to a gifting plan in order to resolve litigation which attacks its security interest. Many reorganization professionals view gifting as a powerful tool in resolving litigation and achieving consensus among diverse interests in plan confirmation.[314]

The Bankruptcy Code sets up priorities in the allocation and distribution of assets to creditors of the estate. As a general premise, secured creditors have recourse to their collateral.[315] Unsecured creditors receive a distribution of any unencumbered assets based on the priority of their claim.[316] Chapter 11 permits a bankruptcy debtor to establish classes of creditors consistent with the Code's priority scheme.[317] Claims within a class must be substantially similar to each other,[318] and many plans have a graduated order of senior and junior claims, consistent with the claims priority scheme set forth in § 507.[319]

Section 1129(b) of the Code lists the requirements to confirm a plan of reorganization over the objection of creditors.[320] Among these is the "absolute priority rule" in § 1129(b)(2)(B)(ii).[321] The absolute priority rule provides that junior creditors may not receive any property on account of their claims if the claims of any senior class have not been paid in full (unless the senior class consents to less-than-full payment).[322] Since equity interests are the lowest priority claim in bankruptcy,[323] this rule has traditionally been applied to prevent equity holders from retaining their interests if all other classes of claims are not paid in full, unless the senior creditors have consented to less-than-full payment.[324]

A question arises whether gifting violates the absolute priority rule because it allows junior creditors to receive a distribution for their claims when the claims of an intermediate-creditor class have

[313] Leah M. Eisenberg, *Gifting and Asset Reallocation in Chapter 11 Proceedings: A Synthesized Approach*, 29 AM. BANKR. INST. J. 50, 54–55 (2010).
[314] *Id.*.
[315] 11 U.S.C. § 1129(b)(2) (2006).
[316] *Id.* § 507.
[317] *Id.* § 1122.
[318] *Id.*
[319] *Id.* § 507.
[320] *Id.* § 1129(b).
[321] § 1129(b)(2)(B)(ii).
[322] § 1129(b)(2)(B).
[323] This is based on nonbankruptcy law, which historically provides that creditors of a firm are entitled to be paid in full before the equity owners of a firm. CHARLES JORDAN TABB, THE LAW OF BANKRUPTCY § 11.33 (2009).
[324] *Id.*

not been paid in full—even though the distribution comes from a class senior to the intermediate class and even though the distribution to the intermediate class is not changed as a result of the gifting. The answer depends on how strictly the court applies the absolute priority rule.

The Third Circuit in *In re Armstrong World Industries* refused to confirm a plan under which one class of unsecured creditors would grant part of its distribution in the form of stock warrants to the equity class while a second class of unsecured creditors had not been paid in full.[325] Such a plan, the court held, would "read the § 1129(b) requirements out of the Code."[326] The Second Circuit likewise rejected plans with gifting provisions in *In re DBSD North America*, where the court reversed the district court's ruling which allowed a plan that proposed to give unsecured creditors shares in the reorganized company (worth no more than forty-six percent of their claims) while at the same time providing shares and warrants to the lower priority equity class.[327] The court found this to be a "fatal" violation of the absolute priority rule, which does not permit a junior class to receive *any* property on account of its interest if a class with higher priority is not paid in full.[328]

Even after the ruling in *In re Armstrong*, however, bankruptcy courts in the District of Delaware, which is in the Third Circuit, have approved gifting plans if the gift comes solely from the collateral of a secured lender[329] or from a third party.[330] Such decisions suggest that judges in this court will construe *In re Armstrong* as narrowly as possible. These types of plans would not be permissible in the First Circuit.[331]

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[325] 320 B.R. 523, 525–26 (Bankr. D. Del. 2005), *aff'd*, 432 F.3d 50 (3d Cir. 2005).

[326] *Id.* at 540 (citing *In re* Sentry Operating Co. of Tex., 264 B.R. 850, 865 (Bankr. S.D. Tex. 2001)).

[327] 634 F.3d 79, 108 (2d Cir. 2011).

[328] *Id.* at 97–98.

[329] *See, e.g.*, *In re* Wash. Mutual, Inc., 442 B.R. 314 (Bankr. D. Del. 2011); *In re* World Health Alternatives, Inc., 344 B.R. 291 (Bankr. D. Del. 2006) (approving carve-out of secured creditor's collateral as fund for unsecured creditors to investigate and pursuit of claims against other parties).

[330] *In re* TSIC, Inc., 393 B.R. 71 (Bankr. D. Del. 2008) (stalking horse bidder providing value to unsecured creditors in exchange for agreement to not object to withdrawal of a bid).

[331] For example, in *In re CGE Shattuck*, LLC, 254 B.R. 5 (Bankr. D.N.H. 2000), the bankruptcy court denied confirmation of a plan where there was a separate agreement (not in the plan) between secured lender and unsecured lenders, finding that "[t]he economic substance and effect of the [gifting] would be to sanction a distribution scheme that discriminates between creditors in the same class." *Id.* at 19.

The response to gifting plans by courts in other circuits has been mixed. Courts in the First Circuit are consistently favorable to gifting plans,[332] while courts in Texas[333] and Ohio have ruled both ways.[334] Results from other bankruptcy courts are likewise mixed, with courts in Missouri[335] and California[336] approving gifting, while courts in Louisiana[337] and Virginia rejecting them.[338] As these cases show, whether gifting will be permitted in a Chapter 11 case depends on the forum in which the case is filed.

d. Enforcement of Pre-Petition Intercreditor Agreements

Pre-bankruptcy intercreditor agreements are agreements between junior and senior lenders when the debtor incurs multiple tiers of debt. Such agreements provide for subordination of one creditor's

[332] Official, Unsecured Creditors' Comm. v. Stern (*In re* SPM Mfg. Corp.), 984 F.2d 1305, 1313 (1st Cir. 1993) (stating that secured creditor in Chapter 7 case is permitted to share sale proceeds with unsecured creditors while IRS priority unsecured claim was unpaid on the grounds that sale proceeds belonged to secured creditor).

[333] *Compare In re* MCorp. Fin., Inc., 160 B.R. 941 (S.D. Tex. 1993) (affirming a plan under which senior bondholder gifted a portion of its claim to fund settlement between debtor and FDIC over junior bondholders), *and In re* IDEARC, Inc., 423 B.R. 138 (Bankr. N.D. Tex. 2009) (noting that a gift from lender's collateral to general unsecured creditors over unsecured note holders was only minor discrimination between classes), *with In re* Sentry Operating Co. of Tex., 264 B.R. 850 (Bankr. S.D. Tex. 2001) (rejecting a plan which provided for gift of 100% recovery to trade creditors but only one percent recovery to non-trade creditors because trade creditors were not essential to reorganization).

[334] *Compare In re* Schwab Indus., Inc., No. 10-60702-rk, 2010 Bankr. LEXIS 5970 (Bankr. N.D. Ohio Dec. 15, 2010) (affirming a plan under which there was a gift from prepetition lenders to unsecured creditors of $850,000 plus fifteen percent of net sale proceeds), *with In re* Synders Drug Stores, Inc., 307 B.R. 889 (Bankr. N.D. Ohio 2004) (disallowing debtor's gift of proceeds of avoidance actions to unsecured trade creditors over unsecured non-trade creditors because avoidance proceeds are property of the estate for all creditors and because debtor failed to prove critical vendor status for favored class).

[335] *In re* Union Fin. Servs. Grp., Inc., 303 B.R. 390 (Bankr. E.D. Mo. 2003) (approving a gift from secured lender's collateral to unsecured trade creditors over unsecured non-trade creditors where the favored class was necessary to the reorganization).

[336] *In re* Fanita Ranch, L.P., No. 10-05750-MM11, 2010 WL 4955892 (Bankr. S.D. Cal. Nov. 5, 2010) (approving a gift of bankruptcy dividends from secured lender to certain unsecured creditors and to the exclusion of other unsecured creditors).

[337] *In re* OCA, Inc., 357 B.R. 72 (Bankr. E.D. La. 2006) (disallowing a gift of right to a percentage of new common stock from secured lender to equity holders after objections of general unsecured creditors).

[338] *In re* On-Site Sourcing, Inc., 412 B.R. 817 (Bankr. E.D. Va. 2009) (denying DIP lender's gift to general unsecured creditors pursuant to § 363 asset sale after the objections of priority creditors as an attempt to evade Chapter 11 plan confirmation process).

security interest to the other creditor, and are presumed to be enforceable under § 510(a) of the Code.[339] But these agreements can also include "stay-silent" or "no-contest" provisions whereby the junior or subordinated creditor agrees not to challenge the senior creditor's priority of its interest in collateral, promises to vote in favor of a bankruptcy plan approved by the secured lender, to waive rights to enforce subordinated obligations, or to waive rights to a post-petition financing DIP agreement.[340] These are common elements of multi-tier financing, but they are inconsistent with the rights granted to the parties under the Bankruptcy Code. Are such terms enforceable under § 510(a)? Courts are split.

One of the first cases to address this issue was *In re Hart Ski Manufacturing Co.*, in which a Minnesota bankruptcy court refused to enforce an intercreditor agreement that, the senior creditor alleged, prohibited the junior creditor from seeking adequate protection or termination of the automatic stay.[341] Finding such terms to be at odds with the rights granted under the Bankruptcy Code, the court stated that "[t]here is no indication that Congress intended to allow creditors to alter, by a subordination agreement, the bankruptcy laws unrelated to distribution of assets."[342]

More recently in *In re Ion Media Networks*, the debtor issued $850 million of first-lien debt in addition to second-lien debt, both secured by substantially all assets of the company, which the court valued between $310 and $445 million.[343] An intercreditor agreement set forth the priorities of the parties to the collateral and provided that nonperfection of any lien would not affect those priorities.[344] After the bankruptcy was filed, the junior lien creditors sought to challenge whether the senior lender's liens over certain FCC licenses had been duly perfected.[345] The court refused to allow the challenge, holding that it would "not disturb the bargained-for rights . . . governing the second lien debt."[346]

[339] 11 U.S.C. § 510(a) (2006).

[340] *See* Mark N. Berman & Jo Ann Brighton, *An Update on Second-Lien Financings and Intercreditor Agreements: Part I*, 29 AM. BANKR. INST. J. 10, 40–41, 95–96 (2011).

[341] 5 B.R. 734, 735 (Bankr. D. Minn. 1980).

[342] *Id.*

[343] 419 B.R. 585, 592 (Bankr. S.D.N.Y. 2009).

[344] *Id.* at 594.

[345] *Id.* at 593–94.

[346] *Id.* at 595.

In contrast, the court in *In re TCI 2 Holdings, LLC* ruled the opposite.[347] In that case, there was a $488 million first lien debt and $1.25 billion in second lien notes.[348] The intercreditor agreement provided that the second lien creditor could not receive any payments until the first lien was paid in full.[349] After the bankruptcy was filed, both creditors submitted competing plans of reorganization.[350] The second lien creditor's plan, which was supported by the debtor, provided for distributions and subscription rights in favor of the second creditor equal to seventy percent of the reorganized debtor, while the first lien creditor would receive partial payment of its debt in cash and a note for the remainder.[351] The senior lienholder objected to the plan on the basis that it breached the intercreditor agreement.[352] The court confirmed the plan notwithstanding the objection, finding that all the requirements for plan confirmation under § 1129(a) and (b) of the Code were satisfied.[353]

Results in other courts are likewise mixed. A Texas court denied a motion by subordinated creditors to appoint a bankruptcy examiner where the intercreditor agreement prohibited such action.[354] Although the Code clearly allows for such appointment, the court determined that "[i]t is well-settled that rights under statute may be contractually waived."[355] An Illinois court reached the exact opposite conclusion in declining to uphold a provision in an intercreditor agreement pursuant to which the subordinated creditor assigned its right to vote in plan confirmation to the senior creditor.[356] The court held that "[i]t is generally understood that prebankruptcy agreements do not override contrary provisions of the Bankruptcy Code."[357] Other courts limit intercreditor agreements to enforcement of pay-

[347] 428 B.R. 117 (Bankr. D.N.J. 2010).
[348] *Id.* at 129.
[349] *Id.* at 138.
[350] *Id.* at 128.
[351] *Id.* at 130–31.
[352] *Id.* at 139.
[353] *In re TCI 2 Holdings*, 428 B.R. at 140–41.
[354] *In re* Erickson Ret. Cmtys., 425 B.R. 309 (Bankr. N.D. Tex. 2010).
[355] *Id.* at 316.
[356] Bank of Am., Nat'l Ass'n. v. 203 N. LaSalle St. P'ship (*In re* 203 N. LaSalle St. P'ship), 246 B.R. 325 (Bankr. N.D. Ill. 2000).
[357] *Id.* at 331; *see also In re* SW Bos. Hotel Venture, LLC, 460 B.R. 38, 51 (Bankr. Mass. 2011) (holding that junior lender's pre-petition assignment of bankruptcy plan voting rights to senior lender was not enforceable).

ment priorities only,[358] while some uphold other provisions, such as assignment of the junior creditor's voting rights to the senior creditor,[359] or waiver of rights by a lienholder to adequate protection of collateral.[360]

e. Assumption of Executory Contracts and Unexpired Leases

Section 365(a) of the Code permits a debtor to assume or reject an "executory contract or unexpired lease."[361] Once the debtor has assumed the contract or lease, the debtor may then "assign" (transfer or sell) the contract or lease to a third party, even if the contract itself prohibits such assignment without consent of each party.[362] The power to assume or reject a contract or lease can be of great benefit to the debtor by allowing it to get rid of unprofitable obligations, continue beneficial ones, and even sell a lease or contract that may not be beneficial to it, but that nevertheless has market value and can be sold for cash.

The authority to assign a contract or lease is qualified by § 365(c)(1), which provides that the debtor "may not assume or assign" the contract or lease if "applicable [nonbankruptcy] law excuses a party . . . from accepting performance from or rendering performance to an entity other than the debtor . . ." and the non-debtor "party does not consent to the assumption or assignment."[363] This provision recognizes traditional state law doctrine that contracts such as personal-services contracts cannot be assigned without the non-assignor's permission,[364] as well as federal law, which prohibits the assignment of non-exclusive intellectual property rights[365] and government contracts.[366]

[358] *In re* Ocean Blue Leasehold Prop., LLC, 414 B.R. 798, 804 (Bankr. S.D. Fla. 2009).

[359] *In re* Aerosol Packaging, LLC, 362 B.R. 43, 46 (Bankr. N.D. Ga. 2006); *In re* Curtis Ctr. Ltd. P'ship, 192 B.R. 648, 660 (Bankr. E.D. Pa. 1996).

[360] Aurelius Capital Master, Ltd. v. Tousa, Inc., Nos. 08-61317-CIV, 08-61335, 2009 WL 6453077, at *4 (S.D. Fla. Feb. 6, 2009); *In re* Metaldyne Corp., No. 09-13412 MG, 2009 WL 2883045, at *6 (Bankr. S.D.N.Y. June 23, 2009).

[361] 11 U.S.C. § 365(a) (2006). If a contract or lease is not assumed, then by operation of statute it becomes automatically rejected (terminated) and is no longer of any force or effect.

[362] § 365(f).

[363] § 365(c)(1)(a), (b).

[364] *See, e.g.*, RESTATEMENT (SECOND) OF CONTRACTS § 317 (1981).

[365] *See, e.g.*, *In re* Patient Educ. Media, Inc., 210 B.R. 237, 242–43 (Bankr. S.D.N.Y. 1997).

[366] 41 U.S.C. § 15 (2006).

Yet § 365(c)(1) appears to address more than just the *assignment* of contract rights. If read strictly, the statute bars the debtor from even *assuming* the contract if forum-state law allows the non-debtor party to refuse to accept the contract or render performance. For example, an exclusive software or patent (IP) license is freely transferable and so can be assumed or assigned by the debtor in bankruptcy whether or not the licensor consents.[367] However, a non-exclusive IP license is not assignable over the objection of the licensor, and thus could not be assumed by a debtor even if the debtor has no intention of assigning the license.[368] This can be a major issue in a bankruptcy case where the debtor has significant IP licenses.

While a restriction on the assignment of certain contracts is logical, extending the prohibition to allow the non-debtor party to veto the debtor's assumption of a contract is not. Without the right to assume such contracts, "some debtors-in-possession may be unable to effect the successful reorganization that Chapter 11 was designed to promote."[369] Additionally, the restriction could give a windfall to the nondebtor, who does not have the right to renege on its agreement outside of bankruptcy.[370] "[B]ut if the debtor seeks bankruptcy protection, then the nondebtor obtains the power to reclaim—and resell at the prevailing, potentially higher market rate—the rights it sold to the debtor."[371]

It is not surprising that courts are split over the effect of § 365(c). The main fault line is between the "hypothetical test" and the "actual test." Courts adopting the hypothetical test read the statute literally to prohibit even the assumption of a contract when the other party would be excused from performance if the contract was assigned.[372] Courts adopting this test include the Third,[373] Fourth,[374] Ninth,[375] and Eleventh[376] circuits, and an Illinois district court.[377]

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[367] *In re* Gold Books Family Entm't, Inc., 269 B.R. 311, 314 (Bankr. D. Del. 2001).

[368] *Id.* at 316.

[369] N.C.P. Mktg. Grp., Inc. v. BG Star Prods., Inc., 129 S. Ct. 1577, 1577 (2009) (denying petition for certiorari).

[370] *Id.*

[371] *Id.*

[372] *In re* Jackson, 465 B.R. 102, 105 (Bankr. N.D. Miss. 2011) (declining to apply the hypothetical test).

[373] *In re* West Elecs., Inc., 852 F.2d 79, 83 (3d Cir. 1988) ("[I]f non-bankruptcy law provides that the [non-debtor party] would have to consent to an assignment of the . . . contract to a third party . . . then . . . the debtor in possession, cannot assume that contract."); Allentown Ambassadors, Inc. v. N. E. Am. Baseball, LLC (*In re* Allentown Ambassadors, Inc.), 361 B.R. 422 (Bankr. E.D. Pa. 2007).

In contrast, other courts use the "actual test," holding that § 365(c) should instead be read to prohibit assumption only if the debtor intends to assign the contract to a third party. The First[378] and Fifth[379] Circuits have adopted this test, as have lower courts in the Second,[380] Sixth,[381] Eighth,[382] and Tenth circuits.[383] The Supreme Court has taken notice of the split in authority, but has not addressed the issue.[384]

f. Critical Vendors

A core premise of bankruptcy is that all non-priority general unsecured creditors are treated equally, which means that they each receive the same pro rata share of any distribution from the bankruptcy estate.[385] Over the years, however, a doctrine has emerged known as the "doctrine of necessity" or, alternatively, the "critical vendor rule." This rule allows a debtor to pay prepetition claims to vendors whose goods or services are deemed essential to the continued operation of the debtor if the vendor would refuse to provide the services or goods

[374] RCI Tech. Corp. v. Sunterra Corp. (*In re* Sunterra Corp.), 361 F.3d 257 (4th Cir. 2004); Breeden v. Catron (*In re* Catron), 158 B.R. 629 (E.D. Va. 1993), *aff'd without opinion*, 25 F.3d 1038 (4th Cir. 1994).

[375] Perlman v. Catapult Entm't, Inc. (*In re* Catapult Entm't, Inc.), 165 F.3d 747 (9th Cir. 1999).

[376] City of Jamestown v. James Cable Partners, L.P. (*In re* James Cable Partners), 27 F.3d 534 (11th Cir. 1994); Wellington Vision, Inc. v. Pearle Vision, Inc. (*In re* Wellington Vision, Inc.), 364 B.R. 129 (Bankr. S.D. Fla. 2007).

[377] *In re* Morgan Sangamon P'ship, 269 B.R. 652 (Bankr. N.D. Ill. 2001).

[378] Summit Inv. & Dev. Corp. v. Leroux, 69 F.3d 608, 613 (1st Cir. 1995) ("[W]here a debtor . . . bears the burden of performance under an executory contract, the nondebtor party to whom performance is due must make an individualized showing that it would not receive the 'full benefit of [its] bargain' were an entity to be substituted for the debtor from whom performance is due.")

[379] Bonneville Power Admin. v. Mirant Corp. (*In re* Mirant Corp.), 440 F.3d 238, 248 (5th Cir. 2006); *In re* Jacobsen, 465 B.R. 102, 106 (Bankr. N.D. Miss. 2011).

[380] *In re* Footstar, Inc., 323 B.R. 566 (Bankr. S.D.N.Y. 2005) (holding that a trustee cannot assume or assign, but a DIP can assume without assigning where contract is non-assignable under applicable law).

[381] *In re* Ohio Skill Games, Inc., No. 08-60560, 2010 WL 2710522, at *7 (Bankr. N.D. Ohio July 8, 2010).

[382] *In re* GP Express Airlines, Inc., 200 B.R. 222, 232 (Bankr. D. Neb. 1996).

[383] C.O.P. Coal Dev. Co. v. C.W. Mining Co. (*In re* C.W. Mining Co.), 422 B.R. 746 (B.A.P. 10th Cir. 2010); *In re* Aerobox Composite Structures, LLC, 373 B.R. 135 (Bankr. D.N.M. 2007).

[384] N.C.P. Mktg. Grp. V. BG Star Prods., Inc., 129 S. Ct. 1577, 1578 (2009) ("[T]he division in the courts over the meaning of § 365(c)(1) is an important one to resolve . . . .").

[385] TABB, *supra* note 323, § 1.23.

without the payment.[386] This obviously violates the equal treatment principal and reduces the funds available for non-favored creditors.

A number of courts have authorized payments to critical vendors based upon the equitable powers granted to a bankruptcy court under § 105(a) or other sections of the Code.[387] While there are no opinions from the First or Second Circuit, lower courts in these jurisdictions generally grant critical vendor motions,[388] as do courts in the Sixth,[389] Eighth,[390] and Tenth[391] Circuits. Courts in the Eleventh Circuit have allowed critical vendor payments, but only under very strict criteria.[392] The Third Circuit has questioned whether § 105(b) permits the court to elevate critical vendor claims,[393] but bankruptcy courts in that circuit routinely allow such payments.[394] Rulings in the Fourth and Fifth Circuits are mixed,[395] but the Seventh Circuit is firmly against this rule.[396]

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[386] *Id.* § 11.12.

[387] *Id.* Section 105(a) of the Code provides that "[t]he court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title." 11 U.S.C. §105(a) (2006). Other courts have relied on other sections of the Bankruptcy Code. *See, e.g.*, *In re* CoServ, L.L.C., 273 B.R. 487, 497 (Bankr. N.D. Tex. 2002) (relying on § 1107); *In re* Payless Cashways, Inc., 268 B.R. 543, 547 (Bankr. W.D. Mo. 2001) (relying on § 364); *In re* Ionosphere Clubs, Inc., 98 B.R. 174, 176 (Bankr. S.D.N.Y. 1989) (relying on § 363(b)).

[388] J.M. Blanco, Inc. v. PMC Mktg. Corp., No. 09-1781(GAG), 2009 WL 5184458, at *5–6 (D.P.R. Dec. 22, 2009). *But see In re* Zenus Is Jewelry, Inc., 378 B.R. 432, 433 (Bankr. D.N.H. 2007) (stating that the doctrine of necessity restricted to railroads and is not applicable to critical vendors).

[389] *In re* Corner Home Care, Inc., 438 B.R. 122, 127–29 (Bankr. W.D. Ky. 2010); *In re* Quality Interiors, Inc., 127 B.R. 391, 396–97 (Bankr. N.D. Ohio 1991).

[390] *In re* Payless Cashways, Inc., 268 B.R. 543 (Bankr. W.D. Mo. 2001); *In re* Wehrenberg, Inc., 260 B.R. 468 (Bankr. E.D. Mo. 2001).

[391] *In re* Rancher Energy Corp., No. 09-32943-MER, 2010 WL 6570895 (Bankr. D. Colo. Nov. 16, 2010).

[392] *In re* Tropical Sportswear Int'l Corp., 320 B.R. 15, 20 (Bankr. M.D. Fla. 2005) (granting critical vendor payments pursuant to 11 U.S.C. §§ 105 and 363 only in "appropriate circumstances"); *In re* Fultonville Metal Prods. Co., 330 B.R. 305, 313 (Bankr. M.D. Fla. 2005) ("[R]equests [for critical vendor payments] should be carefully scrutinized, and only granted when the circumstances establish that the selected payments are necessary to the reorganization case and will ultimately benefit all of the creditors of the estate.").

[393] *See* S. Ry. Co. v. Johnson Bronze Co., 758 F.2d 137, 141–42 (3d Cir. 1985).

[394] *In re* Motor Coach Indus. Int'l., Inc., No. 09-078-SLR, 2009 WL 330993, at *3 (D. Del. Feb. 10, 2009); *In re* Columbia Gas Sys., Inc., 171 B.R. 189, 192 (Bankr. D. Del.1994).

[395] Within the Fourth Circuit's jurisdiction, compare Official Comm. of Equity Sec. Holders v. Mabey, 832 F.2d 299, 302 (4th Cir. 1987) (stating that § 105 does not grant power to deviate from the statutory distribution scheme), with *In re* United Am. Inc., 327 B.R. 776, 781–84 (Bankr. E.D. Va. 2005) (setting forth three-prong test for the doctrine of necessity), and *In re* Synteen Techs., Inc., No. 00-02203-W, 2000 WL

iii. Bankruptcy Trustees and Local Practice Differences

a. Bankruptcy Trustees

A bankruptcy case requires both adjudicative and administrative action. In order to enhance the perception of impartiality in decision-making, many of the administrative functions of bankruptcy are delegated to the Office of the UST.[397] Their duties in Chapter 11 include convening the meeting of creditors, and reviewing and monitoring debtors and creditors (and their counsel.Since 1986, the six federal districts in Alabama and North Carolina have been exempt from the UST Program.[398] Bankruptcy administration in those districts is performed under the Bankruptcy Administrator Program by the Administrative Office of U.S. Courts.[399] There are a number of differences between a UST and a Bankruptcy Administrator. For example, the Code directs that a UST appoints interim Chapter 7 trustees,[400] Chapter 13 trustees,[401] and committee members in Chapter 11 cases.[402] Bankruptcy Administrators have no such powers. Additionally, they are appointed and governed by the circuit court and are subject to rules promulgated by the Judicial Conference of the United States.[403] Furthermore, unlike the UST program, the Bankruptcy

33709667, at *2 (Bankr. D.S.C. Apr. 14, 2000) (finding that § 105(a) allows payment of pre-petition creditor claims "when essential to the continued operation of the debtor").

Within the Fifth Circuit's jurisdiction, compare *In re* Oxford Mgmt., Inc., 4 F.3d 1329, 1333–34 (5th Cir. 1993) (finding no authority under § 105(a) to use post-petition funds to pay pre-petition claims), with *In re* CoServ, L.L.C., 273 B.R. 487, 497 (Bankr. N.D. Tex. 2002) (finding that the doctrine of necessity is permissible pursuant to the trustee's duty under § 1107 to preserve on-going concern value).

[396] *In re* Kmart Corp., 359 F.3d 866, 871 (7th Cir. 2004) (finding that § 105(a) does not allow for unequal payments to any unsecured creditors).

[397] H.R. REP. NO. 95-595, at 89–91 (1977); *see also* Richard B. Levin & Kenneth N. Klee, *The Original Intent of the United States Trustee System*, 1 NORTON BANKR. L. ADVISOR, Jan. 1993, at 2–3.

[398] *See* Dan J. Schulman, *The Constitution, Interest Groups, and the Requirements of Uniformity: The United States Trustee and the Bankruptcy Administrator Programs*, 74 NEB. L. REV. 91, 94–98 (1995).

[399] Bankruptcy Judges, United States Trustees, and Family Farmer Bankruptcy Act of 1986, Pub. L. No. 99–554, 100 Stat. 3088 (2006).

[400] 11 U.S.C. § 701 (2006).

[401] *Id.* § 1302.

[402] *Id.* § 1102.

[403] *See* 28 U.S.C. §§ 331, 601, 604 (2006). For a 1997 study by the National Bankruptcy Review Commission comparing the U.S. Trustee Program with the Bankruptcy Administrator Program, see Memorandum from Lawrence P. King, Prof. of Law, N.Y.U. Univ. Sch. of Law and Elizabeth I. Holland, to the Nat'l Bankr. Review Comm'n (Aug. 6, 1997), *available at*

Administrator program is not self-funding; instead, it uses fees appropriated to the judicial branch.[404] At least one circuit has found the Bankruptcy Administrator program to be unconstitutional for lack of uniformity,[405] but no other court has agreed.[406]

The same 1986 statute that allowed the federal districts in Alabama and North Carolina to opt out of the UST program also included a number of amendments to the Bankruptcy Rules in order to further implement the UST program. For example, Bankruptcy Rule 9035 provides that the 1986 rule amendments do not apply to cases filed in or transferred to those districts.[407] Such rules include rules for transmission of documents and notices, UST reporting and monitoring requirements, and more importantly, the UST's powers to appoint and oversee Chapter 7 and 13 trustees, and Chapter 11 committees.[408] In districts where the bankruptcy administrator program is in place, the bankruptcy court performs the appointment and oversight functions.[409]

b. Local Practice Differences

The differences in styles and attitudes of bankruptcy judges can influence where business debtors file their cases. Professor Lynn LoPucki has identified a number of these inherent differences.[410] For example, LoPucki asserts that when the 1978 Bankruptcy Code went into effect, the Bankruptcy Court for the Southern District of New York drew a disproportionate number of large Chapter 11 cases primarily because of the "pro-debtor" and "pro-reorganization" values of Judge Burton R. Lifland.[411] Beginning in 1990, however, that momentum shifted to the District of Delaware bankruptcy court largely because of the attitudes of a particular judge, Judge Helen Balick.[412]

http://www.abiworld.org/AM/Template.cfm?Section=Home&Template=/CM/ContentDisplay.cfm&ContentID=36526.

[404] U.S. GOV'T ACCOUNTABILITY OFFICE, GAO/GGD-92-113, BANKRUPTCY ADMINISTRATION: JUSTIFICATION LACKING FOR CONTINUING TWO PARALLEL PROGRAMS 1 (1992).

[405] St. Angelo v. Victoria Farms, Inc., 38 F.3d 1525 (9th Cir. 1994).

[406] *See, e.g.*, *In re* Swinney, 300 B.R. 388 (Bankr. M.D. Ga. 2003), *aff'd*, 309 B.R. 638 (Bankr. M.D. Ga. 2004).

[407] FED. R. BANKR. P. 9035.

[408] FED R. BANKR. P. 9035 advisory committee's note.

[409] *Id.*

[410] LYNN LOPUCKI, COURTING FAILURE: HOW COMPETITION FOR BIG CASES IS CORRUPTING THE BANKRUPTCY COURTS (2005).

[411] *Id.* at 45–47.

[412] *Id.* at 72–75.

This may reflect Delaware's focused policy of being a corporate haven.[413] Bankruptcy judges' policies in Delaware, therefore, would be intended to preserve and enhance Delaware's status as a dominant forum for incorporation.[414] Specifically, Judge Balick ruled that a corporation's venue for bankruptcy purposes could be its state of incorporation, thereby allowing any corporation incorporated in Delaware to file bankruptcy in the Delaware bankruptcy court.[415] More fundamentally, Judge Balick adopted procedural innovations such as the "first-day motion."[416] These are motions made by the debtor contemporaneously with the filing of a case to grant such key authorizations as authority to employ counsel and other professionals, use collateral (for example, money in bank accounts subject to a creditor's security interest), pay employees, and pay "critical vendors."[417] These pro-debtor policies gave immediate results. By 1996, thirteen of the fifteen largest corporate bankruptcies that year were filed in Delaware.[418] But it appears that major case filings are again shifting back to the Southern District of New York, perhaps due to a perception of "cronyism" between management and judges in that district.[419]

While the rise of Delaware and the Southern District of New York as prime bankruptcy forums is not disputed, the reasons for it are debated. Kenneth Ayotte and David A. Skeel argue that Delaware's attraction as a corporate bankruptcy forum is due to superior judicial expertise, speed, and efficiency of the Delaware bankruptcy courts.[420] Factors cited include fewer extensions of creditor voting deadlines thereby allowing less distortion and influence by creditors,[421] greater judicial experience with large, complex cases,[422] and greater allowance for DIP financial control over entrenched management.[423]

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[413] *Id.* at 8.

[414] Todd J. Zwicki, *Is Forum Shopping Corrupting America's Bankruptcy Courts?*, 94 GEO. L.J. 1141, 1160 (2006).

[415] *In re* Ocean Props. of Del., Inc., 95 B.R. 304, 305 (Bankr. D. Del. 1988).

[416] LOPUCKI, *supra* note 410, at 38.

[417] *Id.*

[418] *Id.* at 50.

[419] William McGrane, *A Creditor Strategy to Pre-Empt S.D.N.Y. Venue*, 30-5 AM. BANKR. INST. J. 46, 46–47 (2011).

[420] Kenneth Ayotte & David A. Skeel, *An Efficiency-Based Explanation for Current Reorganization Practice*, 73 U. CHI. L. REV. 425, 454 (2006); *see also* David A. Skeel, Jr., *What's So Bad About Delaware?*, 54 VAND. L. REV. 309, 325–26 (2001).

[421] Ayotte & Skeel, *supra* note 420, at 457–58.

[422] *Id.* at 461.

[423] *Id.* at 463–64.

Differences in judicial attitudes may also affect the treatment of creditors. One commentator asserts that unsecured creditors will get better results if they force debtors into involuntary bankruptcy in courts outside of large cities, where case precedent and judicial attitudes are less favorable to large-scale debtors.[424] This may explain the relatively harsh punishment meted out to a former star Wall Street lawyer who was convicted of fraud and sentenced to prison in a Wisconsin bankruptcy court for practices that would have garnered no more than a civil fine in the Southern District of New York.[425]

III. UNIFORMITY AS POLICY AND AS A CONSTITUTIONAL REQUIREMENT

A. *Uniformity as Sound Policy*

Lack of uniformity in national bankruptcy law is bad policy. Drawing on Madison's belief that commerce and bankruptcy are inextricably linked,[426] creating essentially ninety-four different bankruptcy regimes is like creating ninety-four different commerce regimes. There are sound reasons why bankruptcy law in the United States should be uniform.

1. Efficiency in Contractual Relations

The purpose of contract law is to shape the expectations of parties in structuring their economic relations.[427] The underlying regime of contract expectations *outside* the four corners of a contract allows parties to economically engage in transactions because they do not have to re-formulate basic expectations for every new transaction. While contract law in the United States is governed primarily by state law, it is highly uniform because of the enactment, with few variations, of the Uniform Commercial Code in every state. To the extent that there are substantive differences in contract law among states, parties can anticipate and adjust for this by including choice-of-forum clauses or choice-of-law clauses.[428] A transparent and uniform contract law makes transactions more efficient and economical.

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[424] McGrane, *supra* note 419, at 47.

[425] Ronald R. Peterson, *Criminal Liability for the Bankruptcy Practitioner*, *in* ATTORNEY LIABILITY IN BANKRUPTCY 316–17 (Corrine Cooper & Catherine E. Vance eds., 2006). Other studies have noted variations in regional practice due to local legal culture. *See* JOHN P. HEINZ & EDWARD O. LAUMANN, CHICAGO LAWYERS: THE SOCIAL STRUCTURE OF THE BAR (1982); MICHAEL J. POWELL, FROM PATRICIAN TO PROFESSIONAL ELITE: THE TRANSFORMATION OF THE NEW YORK CITY BAR ASSOCIATION (1988).

[426] *See infra* notes 552–54 and accompanying text.

[427] 1 ARTHUR L. CORBIN, CORBIN ON CONTRACTS § 1.1 (rev. ed. 2002).

[428] RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 6(f) (1971).

Bankruptcy also shapes the expectations of parties. Whereas contract law anticipates positive economic relations between parties, bankruptcy law is a mechanism whereby those relations can be dissolved or modified.[429] Bankruptcy is a legal manifestation of the risk component inherent in a modern economic relationship. Since parties know at the outset of their contractual relations that a future bankruptcy by a party is possible, bankruptcy law forms part of the framework within which parties formulate their contractual interests. It also provides a framework for debt negotiation and resolution outside of bankruptcy.[430]

While contract and bankruptcy law are both regimes that shape the economic expectations of parties, there is an ineluctable difference between contract and bankruptcy law. In bankruptcy law, unlike contract law, there is no "choice of bankruptcy law" option. Parties, anticipating that their future economic relationship might devolve into bankruptcy, cannot at the outset of their relations prescribe which bankruptcy law will apply. In the United States there is only one national bankruptcy law—the Code. Parties do not have the choice of opting out of the Code, selecting an alternative bankruptcy law, or even specifying which federal court precedent will govern interpretation of the Code. The types of choice-of-law options that are common in contract law are not available to parties with respect to bankruptcy.

Just as bankruptcy does not allow parties to contract for choice of bankruptcy law, it also does not allow the parties to specify by contract which venues may or may not be permissible. For a business debtor, bankruptcy venue is proper where the debtor's domicile, principal place of business, or principal assets are located,[431] or where there is a pending Chapter 11 case filed by an affiliate.[432] For a business that has assets, offices, or subsidiaries in different locations, this can result in a range of potential venues for filing bankruptcy. As has been shown, the location of a bankruptcy case may well be dispositive of the rights of the parties. But parties cannot specify by contract prior to a bankruptcy which bankruptcy venues are allowable and

[429] United States v. Energy Res. Co., 495 U.S. 545, 549 (1990) ("[B]ankruptcy courts . . . have broad authority to modify debtor-creditor relationships.").

[430] *See* Thomas H. Jackson, *Bankruptcy, Non-Bankruptcy Entitlements, and the Creditor's Bargain*, 91 YALE L.J. 857, 867 (1982).

[431] 28 U.S.C. § 1408(1) (2006).

[432] *Id.* § 1408(2).

which ones are not.[433] This lack of a choice of venue for bankruptcy takes away bargaining power from the non-debtor party because the debtor can strategically select the bankruptcy forum that is most favorable to it. This undermines the transparency that contracts provide.

The logic of bankruptcy uniformity, therefore, is the same as the logic of contract uniformity: both facilitate transparency and predictability in financial relations. Uniformity increases the information equality of the parties and allows them to negotiate, account for risk, and contract efficiently. Because bankruptcy venue can be such a large factor in determining bankruptcy outcomes, the efficiencies that would be gained from a unified bankruptcy regime are lost. This result is not optimal and supports bankruptcy uniformity.

2. Judicial Efficiency

American law has long recognized the efficiency of a uniform federal court system. Prior to 1938, pleadings and practice in federal courts were required to conform to those of the state in which the federal court was located.[434] This made it difficult for courts to apply federal law. Additionally, clients had to obtain separate counsel in each state, and appellate courts had to accommodate multiple procedural regimes arising under state law.[435] To address these problems, the Supreme Court, pursuant to the Rules Enabling Act,[436] issued the Federal Rules of Civil Procedure to govern the administration of federal courts. There are clear efficiencies to this uniformity.[437]

The efficiencies resulting from uniformity in federal courts apply with greater force in bankruptcy. The Code was created to be administered by a singular judicial system—the bankruptcy courts—unlike most other federal statutes that are primarily administered by federal agencies. The bankruptcy court system, in turn, exists to administer a

[433] *In re* Charys Holding Co., 443 B.R. 628, 634 (Bankr. D. Del. 2010) (holding that forum selection clauses should not be enforced in core bankruptcy matters); *cf.* Hunt v. Bankers Trust Co., 799 F.2d 1060 (5th Cir. 1986) (holding that court-approved forum-selection agreement between creditor and debtor prior to the bankruptcy restricted where the debtor could file for bankruptcy).

[434] Conformity Act of 1872, ch. 255, § 5, 17 Stat. 196, 197, *superseded by* Rules Enabling Act of 1934, 28 U.S.C. §§ 2071–2077 (2006).

[435] Myron J. Bromberg & Jonathan M. Korn, *Individual Judges' Practices: An Inadvertent Subversion of the Federal Rules of Civil Procedure*, 68 ST. JOHN'S L. REV. 1, 4 (1994).

[436] 28 U.S.C. § 2072 (2006).

[437] Erwin Chemerinsky & Barry Friedman, *The Fragmentation of Federal Rules*, 46 MERCER L. REV. 757, 780–83 (1995).

single statute, the Bankruptcy Code, and in accordance with a single set of procedural rules, the Federal Bankruptcy Rules. And while bankruptcy judges sit in every federal district and serve debtors in every state, the bankruptcy courts are not intended or equipped to be the interpreters of multiple sets of laws. In this, they differ from the state courts (which deal with a broad range of laws in their forum state) and from federal district courts (which have jurisdiction over actions arising from many federal statutes and regulations). The efficiency of a bankruptcy court is that it is dedicated to adjudicating only cases arising under the Bankruptcy Code. This efficiency is lost to the extent that parties, attorneys, and bankruptcy courts must process multiple and conflicting precedents, state-specific laws, and myriad systems of local rules and procedures.

The lack of unified bankruptcy law also makes it more difficult for lawyers to practice. They must learn different local rules and orders, and become knowledgeable about state laws and federal precedent in the jurisdictions that will affect the case. This increases costs for clients and makes it more difficult for lawyers to practice nationally. As a result, it shields local practitioners from the full effects of competition. In practice, the current bankruptcy regime functions less like a single court system and more like ninety-four separate ones. As such, the potential efficiencies of a unified court system are lost.

3. Fairness

The definition of "fairness" is elusive in the law, but it in part requires that courts treat similar situations in similar ways. When courts treat two similar cases differently, it gives the appearance at least one unfair decision being produced.[438] Thus, it is inherently unfair if the outcome of a bankruptcy case is based upon the accident of location when the facts of a case are otherwise similar.[439] Uniform treatment of parties under the law, regardless of location, mitigates the perception that the law is irrational and unfair.[440] Such equality is "a hall-

[438] Oona A. Hathaway, *Path Dependence in the Law: The Course and Pattern of Legal Change in a Common Law System*, 86 IOWA L. REV. 601, 652–53 (2001).

[439] Chemerinsky & Friedman, *supra* note 437, at 782.

[440] Evan H. Caminker, *Precedent and Prediction: The Forward-Looking Aspects of Inferior Court Decisionmaking*, 73 TEX. L. REV. 1, 39 n.146 (1994) (citing Griffith v. Kentucky, 479 U.S. 314, 323 (1987) ("[S]elective application of new rules violates the principle of treating similarly situated defendants the same.")); Sandra D. O'Connor, *Our Judicial Federalism*, 35 CASE. W. RES. L. REV. 1, 4 (1985) ("[A] single sovereign's laws should be applied equally to all . . . ."); Stephen R. Perry, *Judicial Obligation, Precedent and the Common Law*, 7 OXFORD J. LEGAL STUD. 215, 244 (1987) ("[T]he state cannot

mark of fairness in a regime committed to the rule of law."[441] To be sure, geographical variances in the definition of legal rules might make sense in some contexts, such as adjustment of environmental regulations to local conditions. Variances in the application of a uniform rule caused by geographic location and divergent judicial interpretations, however, may readily be perceived as irrational and unfair.[442]

As a close corollary to fairness, uniformity in bankruptcy would reduce the incentive of debtors (or creditors, in involuntary cases) to forum shop in order to place the case in a venue that favors their interests to the detriment of other parties. Forum shopping is undesirable because of the perception that results depend on geography and not the substance of the case.[443]

The lack of uniformity in U.S. bankruptcy law is inherently unfair. The biggest beneficiaries are large business debtors that have a range of choices where to file and can use forum selection in ways that other debtors cannot.[444] These debtors can make the most of favorable case precedent and state laws. Wealthy consumer debtors can also fare better in bankruptcy than other debtors if they live in states with unlimited homestead exemptions and/or high personal-property exemptions.[445] The biggest losers from the lack of uniformity are consumer debtors in states with low property exemptions or where case precedent or trustee policies are more favorable to creditors.[446]

4. Coherence

A detailed analysis of the Supreme Court's considerations in selecting cases for certiorari is beyond the scope of this Article. A major factor in granting certiorari, however, is uniformity in the application of federal law. Professor Peter Strauss writes that "[t]he premise of certiorari jurisdiction is that the Court will select for hearing those cases whose resolution is likely to make the largest contribution to

justifiably permit the parties in one of its courtrooms to be treated in a manner that is at variance with how they (or any other set of litigants) would be treated in the courtroom next door.").

[441] Caminker, *supra* note 440, at 39.

[442] *Id.*

[443] *Id.*

[444] *See supra* notes 431–32 and accompanying text.

[445] *See supra* notes 90–102 and accompanying text.

[446] *See supra* notes 90–102, 116–20 and accompanying text.

the uniformity and cohesion of national law."[447] Principles of justice and the Supremacy Clause of the Constitution "all speak of an integrated and coherent body of law."[448] According to Strauss, the telling symptom of lack of coherence is the "balkanization" of federal law where geographical factors influence the ways that courts weigh decisions.[449] As a result, parties whose activities cross circuit (or state) boundaries can be subject to conflicting regimes of the same federal law.[450]

Professor Evan Carminker presents additional arguments in favor of uniform interpretation of federal law. First, he notes, rules allow parties to structure their relationships in a socially productive way.[451] Parties must be able to rely on rules in advance; therefore, the rules must be knowable and predictable. In systems such as the United States with multiple potential legal venues for dispute resolution, uniformity is a prerequisite to predictability.[452]

In addition, uniform interpretation and implementation of federal law allows for more effective administration by the executive branch. Without uniform interpretation and implementation of these laws, those who administer the laws in different jurisdictions face different options and even different duties when confronted with similar situations.[453]

Finally, uniform interpretation of federal law promotes overall respect for judicial authority. If the same federal law means one thing in one court, and another thing in another court, people may perceive that courts are either unprincipled, incompetent, or that the law is indeterminate. Any of these undermines judicial credibility.[454]

Not all writers concede to the virtue of uniformity. Professor Amanda Frost believes that uniformity is overvalued.[455] She argues

[447] Peter L. Strauss, *One Hundred Fifty Cases Per Year: Some Implications of the Supreme Court's Limited Resources for Judicial Review of Agency Action*, 87 COLUM. L. REV. 1093, 1100–01 (1987).

[448] *Id.* at 1097.

[449] *Id.* at 1107.

[450] *Id.*

[451] Caminker, *supra* note 440, at 38.

[452] *Id.* at 38–39.

[453] *Id.* at 39.

[454] *Id.* at 40 n.148 ("If interpretation of [the Constitution], which manifests our agreement on long term associational values, varies from state to state, respect for and confidence in the document is undermined." (quoting Leonard G. Ratner, *Majoritarian Constraints on Judicial Review: Congressional Control of Supreme Court Jurisdiction*, 27 VILL. L. REV. 929, 941 (1982))).

[455] Amanda Frost, *Overvaluing Uniformity*, 94 VA. L. REV. 1567 (2008).

that there is no evidence that the sociological legitimacy of federal law is undermined by differing judicial interpretations[456] and that the federalist system establishes that citizens of different states will be treated differently based on state law.[457] Additionally, she finds that differences in judicial interpretations of federal law may be even more legitimate than one single interpretation because "they better reflect the diverse preferences of federal legislators and their constituencies."[458] Furthermore, she observes, nowhere does Article III of the Constitution assign to federal courts the task of establishing uniform interpretations of federal law.[459] Yet Frost acknowledges that uniformity may be required for some laws. She notes that because Article I provides Congress with the power to establish "an uniform Rule of Naturalization" and "uniform Laws on the subject of Bankruptcies" and requires that all duties, imposts, and excises shall be uniform, this shows that "the Framers were concerned about uniformity of federal law . . . in these narrow areas."[460] Thus, even a critic of uniformity acknowledges that congressional exercise of these powers should be uniform.

B. Uniformity as a Constitutional Mandate

Article I of the Constitution grants specific powers to Congress.[461] Of the enumerated powers, three are qualified by the requirement that laws or rules made pursuant thereto be "uniform."[462] These powers include taxation, naturalization, and bankruptcy.[463] Article I provides as follows:

> The Congress shall have Power To lay and collect Taxes, Duties, Imposts and Excises . . . ; but all Duties, Imposts and Excises shall be uniform throughout the United States;
>
> . . . .
>
> To establish a uniform Rule of Naturalization, and uniform Laws on the subject of Bankruptcies throughout the United States.[464]

The naturalization power is exercised as a "rule," the bankruptcy power through "laws,"[465] and the taxing power is described by its

[456] *Id.* at 1593.
[457] *Id.* at 1594–95.
[458] *Id.* at 1589.
[459] *Id.* at 1620.
[460] *Id.*
[461] U.S. CONST. art. I, § 8.
[462] *Id.*
[463] *Id.*
[464] *Id.*

forms—taxes, duties, imposts, and excises. Notwithstanding the different manner in which these powers are manifest, they are alike in that each is to be "uniform." No other powers in the Constitution are qualified in this way. The Framers considered whether "[t]o establish an uniform & general system of discipline for the Militia of these States," but the proposal was rejected due to the perceived need for variety and autonomy among the states.[466] This suggests that in the minds of the Framers, "uniformity" was inconsistent with state autonomy (i.e., a "uniform" federal power preempts state law). In addition, uniformity was also likely intended to prevent Congress from discriminating in favor of one state or region—a key theme of the Constitutional Convention.[467]

It can be asked whether the Framers intended the word "uniform" to have the same meaning for each of these three powers. As a general rule of construction, the same word used in the same statute is considered to have the same meaning with each use.[468] Another rule states that if there is no legal or technical definition of a word in the Constitution, the Framers intended the word to have its "plain meaning."[469] A 1828 dictionary defined the word "uniform" as "having the same form or manner, not variable," "consistent with itself," and "conforming to one rule or mode."[470] Thus, applying the "plain meaning" rule, the uniformity requirement means just what it says: laws enacted pursuant to the taxing, naturalization, and bankruptcy

[465] As to the reason for bankruptcy "laws," Kurt H. Nadelmann explains that the plural was intended so that Congress could pass different types of laws for different types of debtors. Kurt H. Nadelmann , *On the Origins of the Bankruptcy Clause*, 1 AM. J. LEGAL HIST. 215, 227 (1957). In contrast, as there is only one type of naturalization, it is logical that the power is exercised as a "rule."

[466] Judith Schenck Koffler, *The Bankruptcy Clause and Exemption Laws: A Reexamination of the Doctrine of Geographic Uniformity*, 58 N.Y.U. L. Rev. 22, 39 (1983) (quoting 2 THE RECORDS OF THE FEDERAL CONVENTION OF 1787, at 386 (Max Farrand ed., 1911)) (alteration in original) (internal quotation marks omitted).

[467] *Id.* at 37–38. Professor Koffler believes that the word "uniform" is a restriction on congressional power. She describes uniformity as "circumscribing" and limiting congressional power so that Congress could not use these specified powers to discriminate against particular states or regions. *Id.*

[468] *See, e.g.*, Firstar Bank, N.A. v. Faul, 253 F.3d 982, 990 (7th Cir. 2001) ("Where a word is given a consistent meaning throughout the United States Code, then the courts assume that it has the same meaning in any particular instance of that word.").

[469] Anthony J. Bellia, *State Courts and the Interpretation of Federal Statutes*, 59 VAND. L. REV. 1501, 1532 (2006). Professor Bellia suggests that under modes of statutory construction in the early republic, in absence of specific legal, technical, or statutory evidence to the contrary, the Framers would have intended their words to be interpreted according to plain meaning. *See id.* at 1532–33.

[470] Webster, *supra* note 3.

powers must be consistent and not subject to substantially different variations in practice.

The fact that the Framers used "uniform" three times in close proximity shows that they intended something consistent and particular about the exercise of these three powers, as distinct from the other powers.[471] The following discussion will consider how uniformity applies to the revenue, naturalization, and bankruptcy powers.

1. Revenue Uniformity

There are relatively few decisions that address what uniform taxing power means.[472] Commentators suggest that uniformity in connection with the taxing power was intended to prevent states from "ganging up" to impose discriminatory taxes on less powerful states.[473] This served as reassurance for centralization and "virtual abandonment of 'states' rights' principles."[474]

A leading case on tax uniformity is *Knowlton v. Moore*.[475] In that case, the plaintiffs were beneficiaries of a decedent's estate.[476] While the estate was valued at over $2,600,000, the various beneficiaries received amounts ranging from $1,500,000 to less than $10,000.[477] The War Revenue Act of 1898 imposed a graduated tax upon legacies, beginning with no tax on legacies of less than $10,000 and going up to 2.25% on amounts over $100,000.[478] The IRS collector fixed the tax rate for all distributions based on the value of the entire estate, which substantially increased the amount of tax paid compared to the rate that would have applied if the legacies were taxed separately.[479] The executor paid the tax under protest and then sought recovery

[471] For example, there is no requirement that the commerce powers be exercised in a uniform manner. Ry. Labor Execs. Ass'n v. Gibbons, 455 U.S. 457, 468–69 (1982).

[472] In one of the early cases, *Hylton v. United States*, 3 U.S. 171, 174 (1796), the Court rejected a challenge by New York plaintiffs to a tax imposed on carriages on the grounds that there were more carriages in New York than in less populous states such as Virginia, finding that the uniformity clause required "geographic," not "intrinsic" uniformity.

[473] *See* Thomas B. Colby, *Revitalizing the Forgotten Uniformity Constraint on the Commerce Power*, 91 VA. L. REV. 249, 276–77 (2005); Gale Ann Norton, *The Limitless Federal Taxing Power*, 8 HARV. J.L. & PUB. POL'Y. 591, 599 (1985).

[474] Norton, *supra* note 473, at 600.

[475] 178 U.S. 41 (1900).

[476] *Id.* at 43.

[477] *Id.* at 44.

[478] *Id.* at 45.

[479] *Id.* at 44–45

through the district court.[480] The district court demurred, and the demurer was sustained by the circuit court.[481]

The Supreme Court reversed and remanded, finding that the tax must be imposed on a graduated basis.[482] The first issue in the case was whether Congress has the power to impose a "death tax."[483] The Court answered in the affirmative, as it was an excise tax and not a direct tax.[484] The second issue concerned whether the Act's graduated tax rate violated the uniformity clause.[485] The Court weighed two approaches. The first approach was "intrinsic uniformity," which means that wherever and however a tax is imposed, it must impose exactly the same burden on anyone subject to the tax.[486] Thus, if the legacy tax required intrinsic uniformity, then the same burden of 2.25% per person would have to be imposed irrespective of the amount of the legacy.[487] The other option considered by the Court was "geographic uniformity."[488] Under geographic uniformity,

> whatever plan or method Congress adopts for laying the tax in question, the same plan and the same method must be made operative throughout the United States; that is to say, that wherever a subject is taxed anywhere, the same must be taxed everywhere throughout the United States, and at the same rate.[489]

The Court found that "uniformity" could not mean inherent uniformity, as this type of equality in taxation had never been the rule in England or in any of the states.[490] Additionally, an inherent equality standard would effectively prevent the government from exercising any taxing power because it could not tax one type of goods without taxing another.[491] Thus, the Court adopted the rule of geographic uniformity, finding that such a rule forbids discrimination "between the states, by the levying of duties, imposts, or excises upon a particular subject in one state and a different duty, impost or excise

[480] *Id.* at 45.
[481] *Knowlton*, 178 U.S. at 45.
[482] *Id.* at 110.
[483] *Id.* at 43.
[484] *Id.* at 83.
[485] *Id.*
[486] *Id.* at 84.
[487] *Knowlton*, 178 U.S. at 84–85.
[488] *Id.* at 85.
[489] *Id.* at 84.
[490] *Id.* at 88–89, 92–93.
[491] *Id.*

on the same subject in another."[492] This determination was informed in part by the opinion in the *Head Money Cases*, which addressed whether a tax imposed on the owners of steam vessels for each passenger from a foreign port landing in New York was void for violation of the uniformity requirement.[493] The Court in that case held,

> The tax is uniform when it operates with the same force and effect in every place where the subject of it is found. The tax in this case . . . is an excise duty on the business of bringing passengers from foreign countries into this [country] by ocean navigation, is uniform and operates precisely alike in every port of the United States where such passengers can be landed.[494]

The Court noted that opponents of the taxing clause likewise understood "uniformity" to mean geographic uniformity.[495] Some delegates were concerned that geographic uniformity would result in unequal taxation because if a particular type of product was to be taxed, "a greater quantity of that article might be found in one state than in other states."[496] Thus, a tax that may generate greater revenue from one state and little or none from another state would still meet the uniformity requirement if it is "laid to the same amount on the same articles in each state."[497]

Lastly, the Court addressed the argument that states' interests could be accommodated by imposing the tax only on objects found equally throughout all the states, so that one state is not burdened by the federal excise more than any other state.[498] The Court found that if the interest of states were to be considered in this way, it would "relegate the taxing power of Congress to the impotent condition in which it was during the confederation."[499]

Congress may impose a tax that impacts different regions of the country in different ways. In *United States v. Ptasynski*, the Court rejected a challenge to a federal law that exempted a separate class of "Alaskan oil" from a federal crude oil windfall profits tax.[500] The tax exemption did not violate the uniformity clause for the reason that, due to its "unique climatic and geographic conditions," Congress

[492] *Id.* at 90.
[493] 112 U.S. 580, 594 (1984).
[494] *Id.*
[495] *Knowlton*, 178 U.S. at 86–87.
[496] *Id.* at 98.
[497] *Id.* at 106.
[498] *Id.* at 107–08.
[499] *Id.* at 109.
[500] 462 U.S. 74, 78 (1983).

could treat "Alaskan oil" as a separate class of oil.[501] The Court observed, however, that any tax treatment that appeared to frame a tax in geographic terms would be examined closely to ensure that there was a nongeographic basis for the tax.[502]

Courts and commentators have cautioned against analogizing tax uniformity too closely with bankruptcy uniformity.[503] Yet, even the Supreme Court in *Ptasysnki* found reason to compare the two by drawing upon its prior discussion of bankruptcy uniformity in the *Regional Railroad Reorganization Act Cases*, which themselves relied upon the Court's discussion of tax uniformity in the *Head Money Cases*.[504] The Sixth Circuit in *In re Hood* also equated uniformity in imposing taxes and duties with that of naturalization and bankruptcy, finding that state retention of power to legislate in these areas violated the requirement of uniformity.[505] Therefore, lessons from the tax uniformity cases can be instructive in understanding uniformity in the context of bankruptcy.

The tax uniformity cases suggest that where classes of taxpayers are created by a federal statute, different taxpayer *classes* can be treated differently, even if the effect of the treatment has a disparate impact because of geographic location. Thus in *Knowlton*, the rate of tax that beneficiaries pay under a death tax statute could be different (graduated) based upon the dollar amount received by each class.[506] In the *Head Money Cases*, the tax that each immigrant paid was the same wherever he or she landed.[507] And in *Ptasynski*, a category of oil designated as "Alaskan oil" was exempt from the windfall profits tax that applied to other types of crude oil.[508] But none of these cases holds that different taxpayers within the same class may be treated differently solely on the basis of geography. This would violate the core principle of *Knowlton*: "[*A*] *tax is uniform when it operates with the same force and effect in every place where the subject is found*."[509]

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[501] *Id.* at 84.

[502] *Id.* at 85.

[503] Schultz v. United States, 529 F.3d 343, 355 (6th Cir. 2008) ("[T]he taxing power is wholly inapposite to that of the Bankruptcy Clause."); *see also* Randolph J. Haines, *The Uniformity Power: Why Bankruptcy Is Different*, 77 AM. BANKR. L.J. 129, 166–67 (2003).

[504] *Ptasysnki*, 462 U.S. at 83–84.

[505] 319 F.3d 755, 768(6th Cir. 2003), *aff'd on other grounds*, 541 U.S. 440 (2004).

[506] Knowlton v. Moore, 178 U.S. 41, 90 (1900).

[507] *Head Money Cases*, 112 U.S. 580, 594 (1884).

[508] *Ptasynski*, 462 U.S. at 78.

[509] *Id.* at 86 (emphasis added) (quoting *Head Money Cases*, 112 U.S. at 594) (internal quotation marks omitted).

The tax cases also teach that substantive deference to state law in determining the scope of bankruptcy rights, such as bankruptcy exemptions and fundamental and prolonged differences in federal circuit precedent and local rules and practices—to the extent that these result in substantively different bankruptcy outcomes—violate uniformity. The fact that separate classes of bankruptcy creditors may receive different treatment in the distribution of the debtors' assets does not violate bankruptcy uniformity in the same way as allowing separate classes of taxpayers to be taxed differently does not violate uniformity of the taxing power. Under the meaning of uniformity as drawn from the taxing cases, however, uniformity is violated to the extent that members of the same class of creditors or the same type of debtors are subject to substantially different outcomes in bankruptcy, depending upon where the case is filed.

2. Naturalization Uniformity

Congress is empowered to enact a "rule" of naturalization.[510] But that authority is qualified in that such rule must be uniform.[511] And, as with the taxing and bankruptcy clauses, the Framers intended uniformity to remedy problems caused by inconsistent state laws dealing with immigrants.[512] James Madison explained:

> The dissimilarity in the rules of naturalization, has long been remarked as a fault in our system, and as laying a foundation for intricate and delicate questions . . . . In one State, residence for a short term confers all the rights of citizenship; in another, qualifications of greater importance are required . . . . The new Constitution has accordingly, with great propriety, made provision against them, and all others proceeding from the defect of the Confederation on this head, by authorizing from the federal government to establish an uniform rule of naturalization throughout the United States.[513]

Similarly, Alexander Hamilton believed that uniformity meant that federal power regarding naturalization must be exclusive "be-

[510] U.S. CONST. art. I, § 8, cl. 4.

[511] *Id.*

[512] *See, e.g.*, James E. Pfander & Theresa R. Wardon, *Reclaiming the Immigration Constitution of the Early Republic: Prospectivity, Uniformity, and Transparency*, 96 VA. L. REV. 359, 384–87 (2010); Iris Bennett, Note, *The Unconstitutionality of Nonuniform Immigration Consequences of 'Aggravated Felony' Convictions*, 74 N.Y.U. L. REV. 1696, 1704–05, 1704 n.34 (1999) (collecting authorities on the varied naturalization practices among the states and concluding that these inconsistencies lead to the adoption of the uniformity rule).

[513] THE FEDERALIST NO. 42, at 237 (James Madison) (Robert A. Ferguson ed., 2006).

cause if each state had power to prescribe a Distinct Rule there could be no Uniform Rule."[514]

Cases dealing with uniformity and naturalization generally address whether state criminal or domestic relations statutes will be used to interpret provisions of the Immigration and Nationality Act (INA).[515] A typical case may address whether a violation of a state criminal statute can be grounds for deportation where the state law punishes the crime more harshly or differently than a corresponding federal statute. Some cases have deferred to state law, but many courts treat the crime according to its federal definition.[516]

In *Nemetz v. INS*, the Fourth Circuit considered whether a naturalization petitioner could be excluded from the United States on the grounds of "moral turpitude" pursuant to the INA when the behavior at issue was consensual homosexual activity that constituted the criminal act of sodomy under Virginia law.[517] The court opined that reference to state law for federal immigration purposes might be appropriate if "crimes against the public are treated fairly uniformly throughout the country."[518] However, the court noted that a number of states had decriminalized consensual sodomy and that similar statutes in several other states had been ruled unconstitutional.[519] Thus, if the petitioner had lived in one of those states, his naturalization petition would not have been challenged by the INS and he would have already been a citizen. The court found that a law of naturalization based upon "an 'accident of geography' . . . . [h]ardly contributes to any principle of uniformity and is, in fact, incongruous with common sense."[520] Indeed, the use of state law to define moral turpitude un-

[514] THE FEDERALIST NO. 32 at 169 (Alexander Hamilton). Accordingly, authority over immigration and naturalization is exclusively federal power. United States v. Wong Kim Ark, 169 U.S. 649, 701 (1898).

[515] 8 U.S.C. §§ 1101–1525 (2006). Although federal naturalization power initially addressed conditions for naturalization and the entry and removal of foreign nationals, the scope of federal regulation of immigration-related matters has grown over the years to include the INA and other federal statutes governing the entry, removal, naturalization, and employment eligibility of aliens in the United States. Yule Kim, *The Limits of State and Local Immigration Enforcement and Regulation*, 3 ALB. GOV'T L. REV. 242, 245 (2010).

[516] *See* Bennett, *supra* note 512, at 1707–11; *see also In re* Briedis, 238 F. Supp. 149, 150 (N.D. Ill. 1965) (holding that defining adultery according to state law "would lead to an absurb [sic] patchwork result, resting a petitioner's right to United States citizenship upon the whims and idiosyncrasies of individual state legislatures").

[517] 647 F.2d 432 (4th Cir. 1981).

[518] *Id.* at 436.

[519] *Id.* at 435.

[520] *Id.*

der the federal act undermines a uniform rule of naturalization. "Such a practice would 'permit state law to govern the creation of a relationship (citizenship) . . . over which Congress has exclusive authority, a result that is directly contrary to the one intended by the framers of the naturalization clause.'"[521] The uniformity standard is violated when dispositive acts "are the subject of radically different legislative treatment by the states."[522] Additionally, "[w]hen use of federal law defeats the uniformity requirement . . . the court must devise a federal standard by other means."[523]

The Fifth Circuit in *Nehme v. INS* interpreted the uniformity standard similarly.[524] In *Nehme*, whether the petitioner was a citizen depended upon whether his parents had been "legally separated," as set forth in the INA, prior to petitioner's eighteenth birthday.[525] The court emphasized that because of the constitutional requirement of uniformity, it was inappropriate that "the law of any one state should govern the determination of whether an alien's parents were 'legally separated.'"[526] Therefore, the court formulated a federal standard to interpret the term "legal separation" for purposes of the INA.[527] Other courts have adopted the reasoning in *Nehme*.[528]

While federal interests are paramount in the field of immigration, not every state or local enactment that affects the rights of aliens necessarily interferes with the federal interest. A state law only infringes upon immigration if it amounts to a determination of who should or should not be admitted into the country, and the conditions under which a legal entrant may remain. In *DeCanas v. Bica*, the

[521] *Id.* at 435–36 (citation omitted).
[522] *Id.* at 436.
[523] *Nemetz*, 647 F.2d at 436.
[524] 252 F.3d 415 (5th Cir. 2001).
[525] *Id.* at 419.
[526] *Id.* at 423–24.
[527] *Id.* at 426.
[528] *See* Brisset v. Ashcroft, 363 F.3d 130, 133 (2d Cir. 2004) ("Because the Constitution gives Congress the power to 'establish an uniform Rule of Naturalization,' naturalization laws must 'be construed according to a federal, rather than state, standard.'" (quoting *Nehme*, 252 F.3d at 422)); Alsol v. Mukasey, 548 F.3d 207, 219 (2d Cir. 2008) (finding that conviction for controlled substance possession under state law was not a felony under the Controlled Substances Act for immigration purposes). In *Mississippi Band of Choctaw Indians v. Holyfield*, the Court rejected the use of state law definitions for purposes of the Indiana Child Welfare Act, since the ICWA was intended to be uniform throughout the United States. 490 U.S. 30, 43–44 (1989). "[T]he cases in which we have found that Congress intended a state-law definition of a statutory term have often been those where uniformity clearly was not intended." *Id.* at 43–44.

Court remanded for reconsideration a challenge to a California law that prohibited employment of persons unlawfully present in the United States, finding that states have broad authority under their police powers to regulate the employment relationship to protect workers within the state, and that the California law was "within the mainstream of such police power regulation."[529] Because the law appeared to focus directly upon "local problems" and was tailored to combat the perceived problems, the case was remanded to determine whether the law was preempted by the INA.[530]

More recently, in *Chamber of Commerce of United States v. Whiting*, the Court acknowledged federal preemption over laws affecting immigration, but observed that states have authority to "regulate the employment relationship to protect workers within the state."[531] In upholding an Arizona law that allowed suspension and revocation of business licenses for employing unauthorized aliens,[532] the Court found that the Immigration Reform and Control Act (IRCA)[533] expressly excepted state "licensing and similar law" from preemption.[534] More importantly, the Arizona law in no way impeded or supplemented the IRCA. For example, the law adopted the federal definition of an unauthorized alien as well as other key definitions in the IRCA, prohibited state investigators from making a final determination on whether an alien is authorized to work in the United States, and directed that state courts "shall consider *only* the federal government's determination" when deciding whether an employee is an unauthorized alien.[535] Accordingly, the Court found that "there can by definition be no conflict between state and federal law as to worker authorization, either at the investigatory or adjudicatory stage."[536] Therefore, the state law did not conflict with federal immigration law.[537]

[529] 424 U.S. 351, 356 (1976).

[530] *Id.* at 357.

[531] 131 S. Ct. 1968, 1974 (2011).

[532] The Legal Arizona Workers Act of 2007 allows Arizona courts to suspend or revoke the licenses necessary to do business in the state if an employer knowingly or intentionally employs an unauthorized alien. ARIZ. REV. STAT. ANN. §§ 23-211, -212, -212.01 (2010).

[533] Pub. L. No. 99-603, 100 Stat. 3359 (codified as amended in scattered sections of 8 U.S.C.) The IRCA amended the Immigration and Naturalization Act (INA), 8 U.S.C. §§ 1101–1537 (2006) .

[534] *Whiting*, 131 S. Ct. at 1977.

[535] *Id.* at 1981–83.

[536] *Id.*

[537] *Id.* at 1987.

Court cases dealing with naturalization establish that uniformity and federal exclusivity over immigration law are paramount. Uniformity under the naturalization clause helps illuminate the meaning of "uniform" with respect to the bankruptcy power. As one bankruptcy court has stated, "Given the structure of the Constitution and the Framers' decision to use the word 'uniform' in both cases, it appears that the Framers intended to treat the powers given to Congress over naturalization and bankruptcy as identical in scope."[538]

The Arizona state law in *Whiting* is analogous to the authority that a state court has to determine whether a debt has been discharged in a bankruptcy proceeding. As with business licensing, enforcing property rights is a typical state function. Thus, it is properly within the authority of a state court to review a bankruptcy case docket to determine if a debt has been discharged for purposes of ruling whether a creditor can use state law means to enforce a debt. A state court does not have authority to decide whether a debt may be discharged in bankruptcy, just as Arizona state courts do not have authority to decide whether a worker may be authorized to work in the United States. Employment authorization, as with discharge of debt, is exclusively under federal jurisdiction, pursuant to the uniformity clause. Laws that make immigration status subject to state law violate the naturalization uniformity requirement. Applying the same analogy to bankruptcy law, laws that make discharge of debt subject to state law violate the bankruptcy uniformity requirement.

3. Bankruptcy Uniformity

i. Background of the Bankruptcy Clause

The history of the Bankruptcy Clause has been treated in detail elsewhere.[539] What the clause was specifically intended to accomplish is unclear because there is very little recorded debate on the subject of bankruptcy during the Constitutional Convention.[540] The clause was included in the Constitution on motion by Charles Pinckney following a discussion on conflicts in interstate commerce.[541] Thus, it

[538] Gray v. Fla. State Univ. (*In re* Dehon, Inc.), 327 B.R. 38, 54 (Bankr. D. Mass. 2005) (quoting *In re* Hood, 319 F.3d 755, 766 (6th Cir. 2003)).

[539] *See, e.g.*, BRUCE H. MANN, REPUBLIC OF DEBTORS: BANKRUPTCY IN THE AGE OF AMERICAN INDEPENDENCE (2002); Nadelmann, *supra* note 465.

[540] *See, e.g.*, *In re* Dehon, Inc., 327 B.R. 38, 52 (Bankr. D. Mass. 2005) ("Therefore, in looking to the convention debates alone, this Court can discern no clear intent of the Framers regarding the retention or alteration of the States' sovereign immunity with respect to the bankruptcy power.").

[541] Nadelmann, *supra* note 465, at 217–20.

appears that the Framers believed uniform national bankruptcy laws were necessary for effective interstate commerce.

> The power of establishing uniform laws of bankruptcy, is so intimately connected with the regulation of commerce, and will prevent so many frauds where the parties or their property may lie, or be removed into different states, that the expediency of it seems not likely to be drawn into question.[542]

Among other things, the Framers were concerned about the patchwork of different bankruptcy laws among the states,[543] including the fact that debtors who had been discharged from debts in one state could be imprisoned for the same debts upon travelling to another state.[544] A national bankruptcy law would help alleviate these impediments to commerce.

While commentators agree that commerce was the reason behind the Bankruptcy Clause, there is disagreement as to the intended purpose of uniformity of the bankruptcy law. A leading theory in this debate is "proceduralism," which asserts that bankruptcy is intended to be a procedural forum in which to adjudicate the state law rights of creditors.[545] In contrast, Judge Randolph Haines argues that the word "uniform" in the Bankruptcy Clause was intended as a grant of power, not a restriction of power, and that the Framers' purpose in using the word was to supersede state sovereignty in bankruptcy law (i.e., that

[542] THE FEDERALIST NO. 42, at 238 (James Madison); *see* James Monroe Olmstead, *Bankruptcy: A Commercial Regulation*, 15 HARV. L. REV. 829, 831 (1902) ("The Bankruptcy Clause in the Constitution . . . was akin to or closely related to commerce.").

[543] *See* MANN, *supra* note 539, at 59–60 (noting that some states had no insolvency laws, while others provided for release from debtor's prison but not for discharge of debt). Pennsylvania allowed for discharge of unpaid debts but only for commercial debtors. *Id.*; *see also* Thomas E. Plank, *The Constitutional Limits of Bankruptcy*, 63 TENN. L. REV. 487, 518–25 (1996) (reviewing the difference in state bankruptcy laws prior to the Constitution).

[544] Nadelmann, *supra* note 465, at 224–25.

[545] *See, e.g.*, Jackson, *supra* note 430, at 901. Professor Jackson states that the purpose of bankruptcy law is to uphold the rights that creditors negotiated with the debtor under state law prior to the bankruptcy. *Id.* at 873 n.77. Douglas G. Baird believes that bankruptcy law is a procedure through which state-created rights are recognized. Douglas G. Baird, *Bankruptcy Procedure and State-Created Rights: The Lessons of* Gibbons *and* Marathon, 1982 SUP. CT. REV. 25, 47. Charles W. Mooney articulates a fully developed theory of proceduralism. Charles W. Mooney, *A Normative Theory of Bankruptcy Law: Bankruptcy As (Is) Civil Procedure*, 61 WASH. & LEE L. REV. 931, 944 (2004) ("[N]onbankruptcy law creates, defines, and shapes the contours of the legal entitlements of a debtor's rightsholders . . . ."). For a concise discussion of the "proceduralist" model, see Jonathan C. Lipson, *Debt and Democracy: Towards a Constitutional Theory of Bankruptcy*, 83 NOTRE DAME L. REV. 605, 617–19 (2008).

states would be subject to national bankruptcy law).[546] Professor Jonathon Lipson suggests that the real purpose of the Bankruptcy Clause was to enable Congress to preempt rogue or extreme state bankruptcy laws in the event that states began to enact bankruptcy laws that were overly protective of their own debtors or creditors.[547] Similarly, Professor Judith Schenck Koffler sees the Bankruptcy Clause as a grant of power to safeguard the nation's interest in establishing and maintaining a single market for the extension of credit without interference from parochial action by states.[548] Still another commentator concludes that the purpose of bankruptcy uniformity was to place adjudication of the complex disputes that arise in administering a bankruptcy case in a single federal court.[549]

Given the scant historical record left by the Framers, it is not surprising that there is disagreement regarding uniformity and the Bankruptcy Clause. Unfortunately, court opinions on the subject are not very illuminating either.

ii. The Supreme Court on Bankruptcy Uniformity

The list of Supreme Court cases directly relevant to uniformity in bankruptcy is short. Only two cases, *Hanover National Bank v. Moyses*[550] and *Central Virginia Community College v. Katz*,[551] attempt an original analysis of what bankruptcy uniformity requires, and those cases are amenable to radically different interpretations. There are a handful of other decisions that color in some details and merit a brief discussion.

a. *Hanover National Bank v. Moyses*

The *Moyses* case addressed a constitutional challenge to the 1898 Bankruptcy Act.[552] The Act provided for discharge of personal debts, but incorporated the state law exemptions of the state where the case was filed.[553] Moyses, a citizen of Missouri, executed a promissory note that was indorsed to the plaintiff, Hanover Bank, in New

[546] Randolph J. Haines, *The Uniformity Power: Why Bankruptcy Is Different*, 77 AM. BANKR. L.J. 129, 171, 176 (2003).
[547] Lipson, *supra* note 545, at 605, 631.
[548] Koffler, *supra* note 466, at 41.
[549] 1 HAROLD REMINGTON, A TREATISE ON THE BANKRUPTCY LAW OF THE UNITED STATES § 13, at 17 (James M. Henderson ed., 5th ed. 1950).
[550] 186 U.S. 181 (1902).
[551] 546 U.S. 356 (2006).
[552] *Moyses*, 186 U.S. 181.
[553] *Id.* at 189.

York.[554] Moyses defaulted under the note and Hanover Bank obtained judgment in a Missouri state court.[555] Thereafter, Moyses moved to Tennessee and filed a petition for bankruptcy.[556] The district court granted a discharge of his debt, allowing him to use the Tennessee exemptions.[557] Hanover Bank appealed, alleging that the Bankruptcy Act was unconstitutional because, inter alia, by incorporating state exemption laws, which varied from state to state, the Act did not establish "uniform laws" on bankruptcies.[558] The Court rejected the bank's "personal uniformity" argument and found instead that "uniformity is geographical,"[559] which meant that the Act was uniform in the constitutional sense "when the trustee takes in each state whatever would have been available to the creditor if the bankruptcy law had not been passed. The general operation of the law is uniform although it may result in certain particulars differently in different states."[560]

Under this standard, bankruptcy law satisfies the uniformity requirement if a creditor would be treated in the same fashion in bankruptcy as he would be outside of bankruptcy under state law, even if the laws in different states provide for different treatment.[561] This view essentially represents the "proceduralist" model cited above.[562]

The legacy of *Moyses* (at least until *Katz*) is that "geographic uniformity" has been the standard for analyzing uniformity under the Bankruptcy Code.[563] Under *Moyses*, the requirement of uniformity prevents Congress from enacting geographically specific bankruptcy laws but does not require Congress to prohibit "interstate bankruptcy variance."[564] Notwithstanding its longevity as precedent, *Moyses* suffers

[554] *Id.* at 182.
[555] *Id.*
[556] *Id.*
[557] *Id.* at 183.
[558] *Moyses*, 186 U.S. at 185.
[559] *Id.* at 188.
[560] *Id.* at 190.
[561] *Id.* As the Court explained, "no creditor can reasonably complain if he gets his full share of all that the law . . . places at the disposal of creditors." *Id.* at 189.
[562] *See, e.g.*, Lipson, *supra* note 545.
[563] *See, e.g.*, Stellwagon v. Clum, 245 U.S. 605, 613 (1918) (noting that a bankruptcy law may be uniform and yet "recognize the laws of the state in certain particulars, although such recognition may lead to different results in different states"); Schultz v. United States, 529 F.3d 343, 351 (6th Cir. 2008) ("The Court . . . has consistently described the Bankruptcy Clause's uniformity requirement as 'geographical, and not personal.'" (quoting *Moyses*, 186 U.S. at 188)).
[564] Joseph Pace, Note, *Bankruptcy as Constitutional Property: Using Statutory Entitlement Theory to Abrogate State Sovereign Immunity*, 119 YALE L.J. 1568, 1592 (2010).

from a number of flaws. First, the Court attempted to delineate between state and federal bankruptcy powers, stating that

> "[s]o long as there is no national bankruptcy act, each state has full authority to pass insolvent laws binding persons and property within its jurisdiction, provided it does not impair the obligation of existing contracts; but a state cannot by such a law discharge one of its own citizens from his contracts with citizens of other States . . . ."[565]

This part of the *Moyses* opinion refers to the fact that while federal laws may impair contract obligations, the states are prohibited from doing so. Yet, this is exactly the effect of incorporating state exemption laws into federal bankruptcy law. By allowing the individual states to control the scope of assets exempt from a debtor's bankruptcy estate, the states discharge their citizens from obligations to creditors from other states. Thus, the 1898 Bankruptcy Act failed the Court's own definition of uniformity. As discussed above, the current Bankruptcy Code gives states power to impose their exemptions in bankruptcy.[566] Therefore, the present Bankruptcy Code would also fail the uniformity requirement cited in *Moyses*.

Professor Judith Koffler has identified additional problems with *Moyses*. As she points out, the Court adopted its geographic uniformity standard from two circuit court decisions that arose under the Bankruptcy Act of 1867—*In re Beckerford*[567] and *In re Deckert*.[568] In doing so, the Court ignored its own detailed discussion of uniformity just two years earlier in *Knowlton v. Moore*.[569] This was a shaky foundation for a constitutional construct of uniformity. First, the 1867 Act contained both federal exemptions and state exemptions, unlike the 1898 Act, which used state exemptions only.[570] More importantly, the *Beckerford* and *Deckert* opinions do not support the holding in *Moyses*.

In *Beckerford*, the court reasoned that incorporation of state exemptions did not violate the uniformity provision because, "[t]hough the states vary in the extent of their exemptions, yet, what remains [of] the bankruptcy law distributes equally among the creditors."[571] Since no creditor could receive more from his debtor under state law than the unexempted part of the debtor's assets, the court concluded

[565] *Moyses*, 186 U.S. at 188 (quoting Brown v. Smart, 145 U.S. 454, 457 (1892)).
[566] *See* discussion *supra* Part II.C.1.i.a.
[567] 3 F. Cas. 26 (C.C.D. Mo. 1870) (No. 1209).
[568] 7 F. Cas. 334 (C.C.E.D. Va. 1874) (No. 3728); *Moyses*, 186 U.S. at 189–90.
[569] Koffler, *supra* note 466, at 75.
[570] *Id.* at 60.
[571] *Id.* at 62 (citing *In re Beckerford*, 3 F. Cas. at 27).

that the law was uniform.[572] Put another way, the bankruptcy law is uniform because it uniformly incorporates the exemption law of each state. Yet, as Professor Koffler points out, under this logic, a bankruptcy law would be uniform even if it allowed each state to exempt all of a debtor's property, none of a debtor's property, or even to determine whether to grant bankruptcy debtors a discharge at all.[573] A complete exemption of all property would frustrate creditors completely and dry up credit in the state, whereas no exemptions or no discharge would significantly undermine the federal policy of a "fresh start."[574]

The second case cited by the *Moyses* Court, *Deckert*, dealt with an 1873 amendment to the 1867 Act. The Court cited dicta from *Deckert* to the effect that bankruptcy law is "uniform" if it allows "all the creditors of the bankrupt [to] reach all his property subject to levy" under state law.[575] But this was not the issue in the case. In 1872, the Virginia Supreme Court ruled that the Virginia homestead and personal property exemptions violated the federal contract clause.[576] In response, Congress passed an amendment to the Bankruptcy Act stating that the exemptions under the Act should be the exemptions as they existed under the laws of each state in 1871.[577] Thus, debtors filing bankruptcy in Virginia subsequent to the 1873 amendment could claim exemptions that were no longer available under Virginia law.[578] The *Deckert* court found the amendment to be in violation of the constitutional mandate of uniformity because it provided "that there shall be one amount or description of exemption in Virginia and another in Pennsylvania . . . . It changes existing rights between the debtor and creditor. Such changes, to be warranted by the Constitution, must be uniform in their operation."[579] As Professor Koffler observes, *Deckert* read the word "uniform" to prohibit Congress from exercising its power to impair contracts, which is clearly wrong.[580] Accordingly, *Deckert* does not lend any support for the decision in *Moyses*.

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[572] *Id.*
[573] *Id.* at 63, 65–66.
[574] *Id.*
[575] *Moyses*, 186 U.S. at 190 (quoting *In re* Deckert, 7 F. Cas. 334, 336 (C.C.E.D. Va. 1874) (No. 3728).
[576] The Homestead Cases, 63 Va. (22 Gratt) 26 (1872).
[577] *See* Koffer, *supra* note 481 at 69.
[578] *Id.* at 62.
[579] *In re Deckert*, 7 F. Cas. 334, 336 (C.C.E.D. Va. 1874) (No. 3728).
[580] Koffler, *supra* note 466, at 71.

Finally, although both *Moyses* and *Knowlton* are based on the doctrine of "geographic uniformity," each case used the term quite differently. Under *Knowlton*, geographic uniformity means that all similarly situated taxpayers must pay the same rate under a federal tax law irrespective of their geographic location. It does not require that different *classes* of taxpayers pay the same rate of tax.[581] In contrast, geographic uniformity in *Moyses* means that the remedy that a creditor has against a debtor in a bankruptcy case must be the same remedy that the creditor would have against the same debtor in a state court proceeding.[582] The theory behind this rule is to prevent vertical forum shopping between state court and bankruptcy court *within* the same state.[583] The very act of filing for bankruptcy, however, establishes that the debtor has rights in relation to a creditor that the debtor would not have outside of bankruptcy; this is precisely why a debtor files for bankruptcy. As a result, this type of intrastate "forum shopping" will occur anyway. Additionally, differences in bankruptcy relief between states can and do give rise to *interstate* forum shopping.[584] Therefore, using uniformity as a means to alleviate intrastate forum shopping is misguided from the start.

b. *Central Virginia Community College v. Katz*

The central issue in that case was whether the Chapter 7 trustee administering the bankruptcy of a bookstore chain was barred by the doctrine of state sovereign immunity from bringing a preference complaint against a state-sponsored college pursuant to § 547 of the Code.[585] The trustee brought an adversary complaint to recover an alleged preferential transfer against Central Virginia Community Col-

[581] Knowlton v. Moore, 178 U.S. 41, 105–06 (1900).

[582] *Moyses*, 186 U.S. at 190.

[583] This was the reason cited in *Butner v. United States*, 440 U.S. 48, 55 (1979) ("Uniform treatment of property interests by both state and federal courts within a State serves to reduce uncertainty, to discourage forum shopping, and to prevent a party from receiving 'a windfall merely by reason of the happenstance of bankruptcy.'"(quoting Lewis v. Mfrs. Nat'l Bank, 364 U.S. 606, 609 (1961)).

[584] Robert K. Rassmussen & Randall S. Thomas, *Timing Matters: Promoting Forum Shopping By Insolvent Corporations*, 94 NW. U. L. REV. 1357, 1365 (2000).

[585] Cent. Va. Cmty. Coll. v. Katz, 546 U.S. 356, 360 (2006). Section 547 allows a trustee in bankruptcy to recover certain transfers by the debtor to a pre-petition creditor made within ninety days prior to filing for bankruptcy. 11 U.S.C. § 547 (2006). For an in-depth recitation of the facts and case law history leading up to *Katz*, see Daniel A. Austin, *The Bankruptcy Clause and the Eleventh Amendment: An Uncertain Boundary Between Federalism and State Sovereignty*, 42 U.S.F. L. REV. 383, 412–24 (2007).

lege (CVCC).[586] CVCC moved to dismiss the case on the grounds that § 106 of the Code, which provides that the sovereign immunity of a governmental unit is abrogated with respect to certain sections of the Bankruptcy Code (including recovery of preferential payments under § 547),[587] was unconstitutional.[588] The bankruptcy court denied CVCC's motion to dismiss, and the district court and Sixth Circuit affirmed.[589] CVCC appealed.

The Court ruled that CVCC and any other state agencies are bound by bankruptcy court jurisdiction in the same way as other creditors. The Court reached this decision by first finding that the Framers' purpose in drafting the uniform bankruptcy clause was to harmonize the "patchwork of insolvency and bankruptcy laws" that were particular to the American divided (state) authority.[590] Second, based on the historical record, the Court determined that the Framers intended the term "subject of Bankruptcies" to be broadly construed and to include all aspects of the "relations between an insolvent or nonpaying or fraudulent debtor and his creditors, extending to his and their relief."[591] Therefore, the bankruptcy power must include, inter alia, authority to avoid preferential transfers and recover property on behalf of the estate.[592] Third, given the broad needs of bankruptcy jurisdiction, in ratifying the Constitution, the states had

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[586] Katz v. Cent. Va. Cmty. Coll., 546 U.S. 356, 360 (2006).

[587] Section 106 provides in part:

> (a) Notwithstanding an assertion of sovereign immunity, sovereign immunity is abrogated as to a governmental unit to the extent set forth in this section… .
>
> . . . .
>
> (2) The court may hear and determine any issue arising with respect to the application of such provisions to governmental units.

11 U.S.C. § 106(a)(2)(2006).

[588] *Katz*, 546 U.S. at 360.

[589] *Id.* at 356.

[590] *Id.* at 366 (noting that the "uncoordinated actions of multiple sovereigns, each laying claim to the debtor's body and effects" made a single discharge of a debtor impossible).

[591] *Id.* at 371 (emphasis omitted) (quoting Wright v. Union Cent. Life Ins. Co., 304 U.S. 502, 513–14 (1938)). Regarding the scope of bankruptcy power, the Supreme Court stated as follows in *In re Klein*:

> [The bankruptcy power] extends to all cases where the law causes to be distributed the property of the debtor among his creditors; this is its least limit. Its greatest, is a discharge of the debtor from his contracts. And all intermediate legislation, affecting substance and form, but tending to further the great end of the subject—distribution and discharge—are in the competency and discretion of Congress.

In re Klein, 42 U.S. (1 How.) 265, 281(1843).

[592] *Katz*, 546 U.S. at 372.

agreed to refrain from asserting the sovereign immunity defense in proceedings brought pursuant to "Laws on the subject of Bankruptcies."[593] In other words, the states agreed to subordinate their sovereign immunity to the extent necessary to effectuate the jurisdiction of the bankruptcy court.[594] Therefore, it was within the authority of Congress to provide for waiver of state sovereign immunity under § 106.[595]

This analysis would have been sufficient to dispose of the issue before the Court, but the majority in *Katz* went further. In a footnote, the Court stated that uniformity under the bankruptcy clause means that "Congress has the power to enact bankruptcy laws the purpose of which are to ensure uniformity in treatment of state and private creditors."[596] To provide support for this conclusion, the Court reached back 185 years to *Sturges v. Crowninshield*, in which the Court said of the uniformity clause, "Congress is not authorized merely to pass laws, the operation of which shall be uniform, but to *establish* uniform laws on the subject throughout the United States."[597] Pushed to its logical conclusion, this would seem to *require* Congress to harmonize the bankruptcy laws so that the treatment of parties in a bankruptcy case is indistinguishable from the standpoint of geography. This is because, as the Court found, bankruptcy uniformity cannot tolerate states-creditors being treated differently from non-state creditors. If bankruptcy uniformity demands that there be no differentiation between creditors based on private versus state status—notwithstanding that state sovereign immunity is enshrined in the Eleventh Amendment—then it must also demand that there be no differentiation between creditors based on state boundaries. This is a radical extension of prior uniformity jurisprudence. Not surprisingly, *Katz* has drawn both criticism[598] and praise.[599]

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[593] *Id.* at 377.

[594] *Id.* at 378.

[595] *Id.* at 379.

[596] *Id.* at 377 n.13.

[597] *Katz*, 546 U.S. at 377 n.13 (quoting *Sturges v. Crowninshield*, 17 U.S. (4 Wheat.) 122, 193–94 (1819)).

[598] *See, e.g.*, Ralph Brubaker, *Explaining* Katz*'s New Bankruptcy Exception to State Sovereign Immunity: The Bankruptcy Power as a Federal Forum Power*, 15 AM. BANKR. INST. L. REV. 95 (2007); Martin H. Redish & Daniel M. Greenfield, *Bankruptcy, Sovereign Immunity and the Dilemma of Principled Decision Making: The Curious Case of* Central Virginia Community College v. Katz, 15 AM. BANKR. INST. L. REV. 13 (2007).

[599] *See, e.g.*, Randolph J. Haines, *Federalism Principles in Bankruptcy After* Katz, 15 AM. BANKR. INST. L. REV. 135 (2007); Susan E. Hauser, *Necessary Fictions: Bankruptcy Jurisdiction After* Hood *and* Katz, 82 TUL. L. REV. 1181, 1233 (2008).

c. *Vanston*, *Butner*, and the *Rail Road Cases*

There are several decisions that did not attempt to formulate the meaning of uniformity, but assist in illuminating its application.

The question in *Vanston Bondholders Protective Committee v. Green* was whether interest owed by the debtor on certain bonds would be paid at a higher rate pursuant to the law of New York, where the bonds were signed and payable, or at a lower rate under the law of Kentucky, where the bankruptcy court was located.[600]

The Court stated as a general premise that the claims of creditors and obligations of the debtor "at the time a petition in bankruptcy is filed" should, in absence of an overruling federal law, be determined by reference to state law.[601] The Court, however, would use a different rule once the debtor was in bankruptcy:

> In determining what claims are allowable and how a debtor's assets shall be distributed, a Bankruptcy court does not apply the law of the state where it sits . . . . [b]ut bankruptcy courts must . . . determine how and what claims shall be allowed under equitable principles.[602]

In this case, the Court found that payment of interest on interest under the New York law was "not consistent with equitable principles."[603] But a concurring opinion by Justice Frankfurter suggests that he may have been uncomfortable with a wholesale adoption of federal or equitable principles in construing property rights in bankruptcy. He stated that "[t]he existence of a debt between the parties to an alleged creditor-debtor relationship is independent of bankruptcy and precedes it. Parties are in a bankruptcy court with their rights and duties already established, except insofar as they subsequently arise during the course of bankruptcy administration . . . ."[604]

While Justice Frankfurter confirms the rights and duties are "already established" before bankruptcy, he acknowledges that those rights can be amended in the course of "bankruptcy administration."[605] A later comment by Justice Frankfurter is equally ambiguous: "The Constitutional requirement of uniformity is a requirement of geographic uniformity. It is wholly satisfied when existing obligations of a debtor are treated alike by the bankruptcy administration

[600] 329 U.S. 156, 161 (1946). New York law allowed payment of interest on interest, whereas Kentucky law permitted only simple interest. *Id.*
[601] *Id.* at 161.
[602] *Id.* at 162–63.
[603] *Id.* at 166.
[604] *Id.* at 169 (Frankfurter, J., concurring).
[605] *Id.* at 169.

throughout the country regardless of the State in which the bankruptcy court sits."[606]

At least one interpretation of *Vanston* is that state law may not be used to differentiate between property rights of parties in bankruptcy. *Vanston* has never been vacated, but it is certainly qualified by the subsequent case of *Butner v. United States*.[607] Furthermore, bankruptcy courts rarely, if ever, use their equitable powers to supersede state law in bankruptcy.[608]

Butner v. United States confirmed the rule that property rights in bankruptcy are defined by state law. In *Butner*, a business debtor attempting to reorganize entered into an agreement with a secured creditor, Butner, to consolidate various liens against real property in North Carolina.[609] The security agreement did not address rents earned by the property. An agent was appointed by the court to collect rents and apply them to tax, mortgage, and other obligations; when the reorganization proved unsuccessful, the court appointed a trustee to liquidate the assets.[610] Butner was still owed money after the liquidation, and thus the issue was whether a secured creditor was entitled to rents from the collateral.[611] North Carolina law defined a security interest in real property to include rents from the property.[612] Relying on precedent from other jurisdictions, however, the lower courts decided against the creditor, finding that since a bankruptcy court had power to deprive a mortgagee of his state law remedy, property rights were to be determined by federal law.[613]

On appeal, the Supreme Court reversed, finding that while Congress clearly has power under the uniformity clause to define a mortgagee's interest in rents, it "has generally left the determination of property rights in the assets of a bankrupt estate to state law."[614] According to the Court, deference to state law in bankruptcy is a choice made by Congress: "Property interests are created and defined by state law. Unless some federal interest requires a different result,

[606] *Green*, 329 U.S. at 172. (Frankfurter, J., concurring).
[607] 440 U.S. 48 (1979).
[608] *See, e.g.*, Unsecured Creditors' Comm. of Highland Superstores v. Strobeck Real Estate (*In re* Highland Superstores), 154 F.3d 573, 578 (6th Cir. 1998) ("Bankruptcy courts simply do not have free rein to ignore a statute in the exercise of their equitable powers . . . .").
[609] *Butner*, 440 U.S. at 50.
[610] *Id.*
[611] *Id.* at 51.
[612] *Id.*
[613] *Id.* at 52–53.
[614] *Id.* at 54.

there is no reason why such interests should be analyzed differently simply because an interested party is involved in a bankruptcy proceeding."[615]

As *Butner* shows, property rights originate under state law. Bankruptcy can intervene procedurally to modify a creditor's state-law rights, but bankruptcy is not intended to be substantive law that creates property rights. The obvious qualification to *Butner*, however, is that federal bankruptcy law overtly supercedes state law by modifying creditor's rights. State law is clearly the starting point for property rights, but there is no basis to conclude that such rights are inviolate in bankruptcy.

In *Blanchette v. Connecticut General Insurance Corp.* (*The Regional Rail Reorganization Act Cases*), the Court considered whether the Regional Rail Reorganization Act violated the uniformity clause when the Act operated only within a single statutorily defined region.[616] The Court held that it did not because there was no other railroad proceeding taking place outside that region: "The Rail Act operates uniformly upon all bankrupt railroads then operating in the United States and uniformly with respect to all creditors of each of these railroads."[617] The fact that the Act had a purely regional effect did not invalidate it since "the uniformity provision does not deny Congress power to take into account differences that exist between different parts of the country, and to fashion legislation to resolve geographically isolated problems."[618] In this sense, the rule in the *Regional Rail Reorganization Cases* was similar to the rule in *Ptasynski*—congressional exercise of the bankruptcy and taxing powers to address a strictly regional matter is not nonuniform as long as a hypothetical debtor or creditor, wherever located, would be treated equally.

In another case, *Railway Labor Executive Ass'n v. Gibbons*, the Court ruled that select bankruptcy relief violated the uniformity clause.[619] That case dealt with a federal statute, the Rock Island Transition and Employee Assistance Act, which, by its terms, applied to only one regional bankrupt railroad during a time when there were other railroads in reorganization proceedings.[620] The Court stated that the Bankruptcy Clause does not impair the ability of Congress to

[615] *Butner*, 440 U.S. at 55.
[616] 419 U.S. 102 (1974).
[617] *Id.* at 159.
[618] *Id.*
[619] 455 U.S. 457 (1982).
[620] *Id.* at 470.

define classes of debtors and to structure separate relief accordingly.[621] However,

> [a] law can hardly be said to be uniform throughout the country if it applies only to one debtor and can be enforced only by the one bankruptcy court having jurisdiction over the debtor.
>
> . . . .
>
> To survive scrutiny under the Bankruptcy Clause, a law must at least apply uniformly to a defined class of debtors.[622]

Thus, Gibbons reinforces the principle that bankruptcy law may provide for different treatment to separate classes of creditors, but that members within a class must be treated uniformly.

IV. BANKRUPTCY AND CONSTITUTIONAL UNIFORMITY

There are ample reasons to conclude that the Framers intended to prevent the state-by-state patchwork of insolvency regimes that hindered commerce in the early republic—hence, the mandate for "uniform" bankruptcy laws.[623] To the extent that bankruptcy in the United States still resembles a patchwork of insolvency regimes, it is not, in the plain sense of the word, "uniform."

To be sure, Congress is not affirmatively required to enact a national bankruptcy law.[624] The bankruptcy clause provides that Congress has the power to establish uniform bankruptcy laws, not that Congress is required to do so. Therefore, when there is no national bankruptcy law, states may enact their own bankruptcy and insolvency laws.[625] This shows that absolute bankruptcy equality is not a sacrosanct right of citizenship. Bankruptcy discharge on equal footing for every person in every state is not a guaranteed component of life, liberty, or the pursuit of happiness.

The issue raised in this Article is, when Congress chooses to exercise its bankruptcy power, must the laws enacted pursuant thereto be uniform in their application to all classes of debtors and creditors everywhere? Or, can these laws allow for variation in the treatment of the same classes of debtors and creditors based on geography? The answer to the latter question is a hard "no" if one agrees with the apparent conclusion of *Katz*. The answer is a softer "no" if one analo-

[621] *Id.* at 473.
[622] *Id.* at 471–73.
[623] *See supra* notes 535–37 and accompanying text.
[624] Ogden v. Saunders, 25 U.S. 213, 230 n.a (1827) (noting that holding that "it is the exercise of national bankruptcy power, not the mere existence of it," that gives Congress exclusive right to legislate bankruptcy law).
[625] Brown v. Smart, 145 U.S. 454, 457 (1892).

gizes bankruptcy uniformity with the uniformity standards of the taxing and naturalization powers. Neither of these two powers allows for express variation based on state law or other geographic considerations,[626] but both of them tolerate regional differences that may indirectly result from the operation of the laws.[627] In contrast, those who agree with the *Moyses* geographic uniformity doctrine, as further explicated in *Butner*, fully accept disproportionate geographic effects in the operation of national bankruptcy law. For them, bankruptcy should be a procedural forum to administer state law property rights.[628]

The majority in *Katz* seems to suggest that the Framers intended the Bankruptcy Clause to establish personal uniformity in bankruptcy.[629] But the *Katz* "personal uniformity" standard is not convincing. The bankruptcy clause does not state that the *effect* of bankruptcy laws must be uniform, but rather that the *laws* must be uniform. A creditor whose security interest under state law includes rent proceeds may fare better in a bankruptcy case than a creditor in a state where the laws do not specify that rents are a part of the security interest. But allowing claims in bankruptcy to reflect property rights existing under *state* laws at the time the bankruptcy was filed does not violate the requirement for uniformity in *bankruptcy* laws.

The *Moyses* and proceduralist "geographic uniformity" standard is also unsatisfying. First, there are flaws in the legal logic of the case, as discussed above.[630] Second, although it is conceptually uncomplicated, geographic uniformity does not account for the concerns that motivated the Framers to create a unified system of commerce.[631] The rule in *Moyses* would fully honor state laws that discriminate in favor of citizens against non-citizens, or that inordinately benefit business or other interests unique to that state. Third, the lack of uniformity due to differing property rights, procedural variances, and key differences in fundamental precedent results in bankruptcy ad-

[626] *See* Knowlton v. Moore, 178 U.S. 41, 84 (1900) ("[W]herever a subject is taxed anywhere, the same must be taxed everywhere throughout the United States, and at the same rate."); Nemetz v. INS, 647 F.2d 432, 435 (4th Cir. 1981) ("While it is true that Congress has in the past allowed states great latitude with respect to morality, that latitude cannot be granted when the resulting consistencies undermine a uniform rule of naturalization.").

[627] *See* United States v. Ptasynski, 462 U.S. 74, 84 (1983); DeCanas v. Bica, 424 U.S. 351, 357 (1976).

[628] Lipson, *supra* note 545, at 619.

[629] *See supra* notes 589–91 and accompanying text.

[630] *See supra* notes 560–72 and accompanying text.

[631] *See supra* notes 533–38 and accompanying text.

ministration that is inconsistent and haphazard,[632] and which can suffer from the perception that it is unfair.

Finally, to characterize a patchwork system of bankruptcy laws and procedures that allow for such significantly different outcomes for similarly-situated debtors and creditors based primarily on where the case is filed simply stretches the notion of uniformity too far. "Geographic uniformity" under the Bankruptcy Code is not uniform under any reasonable definition of that word.

The aspiration in *Katz* for more robust fidelity to bankruptcy uniformity can be harmonized with the excessive deference to state law displayed in *Moyses* and *Butner*. When a debtor files a bankruptcy petition, the crucial baseline for treatment of creditors is the schedules of assets, liabilities, and other documents filed by the debtor.[633] Bankruptcy is said to create a "snapshot" of the debtor's financial situation as of the moment of filing.[634] Up to that point, the debtor's assets and liabilities—and hence, its relationships with creditors—have been established and governed under non-bankruptcy law. There is no reason to disregard the rights and obligations of the parties as they have been fixed by non-bankruptcy law prior to filing. In fact, to do so would require creating a body of federal common law of property. This "snapshot" is therefore the set of rights held by creditors at the commencement of the bankruptcy, which the debtor must address. This may result in non-uniformity of the rights held by parties in different states when the bankruptcy commences, but it is based on *non-bankruptcy* law and therefore cannot constitute "non-uniform" *bankruptcy* law.

Once the case is filed, however, bankruptcy law comes into effect in that it modifies the rights and obligations of the parties post-filing. Some examples include the automatic stay, rejection of contracts, curing of defaults, modification of loan terms, modification of liens, priorities of distribution of assets to creditors, discharge of the debtor, and other powers.[635] Post-filing, the laws passed by Congress that

[632] Jackson, *supra* note 430, at 907.

[633] 11 U.S.C. § 521(a) (2006).

[634] *See, e.g.*, *In re* Orso, 283 F.3d 686, 691 (5th Cir. 2002) ("[In making decisions,] the court must take a retrospective 'snapshot' of the law and the facts as they stood on the day the petition was filed.").

[635] *See supra* note 583 and accompanying text. Professor Thomas E. Plank cautions against over-expanding the range of issues and problems that are subject to the bankruptcy power. Plank, *supra* note 543, at 561– 564. Plank asserts that bankruptcy as understood by the Framers was meant to apply narrowly to the situations when debtors cannot pay their creditors. *Id.* at 532. Thus, bankruptcy cannot create det-

address the debtor-creditor relationship, distribute assets, provide for discharge, or serve other bankruptcy purposes are under the bankruptcy power and therefore must be uniform. These bankruptcy laws cannot vary in their effect based on geography.

V. CONCLUSION

By distinguishing between laws that establish the debtor-creditor relationship up to the moment of bankruptcy, and laws that effect its modification after the bankruptcy case is filed, we can consider which laws may permissibly vary based on nonbankruptcy law, local procedures, or other geographic factors, and which laws must be uniform in order to satisfy the uniformity criterion.[636] It is clear that exemptions in bankruptcy must be the same, regardless of where the debtor files. Exemptions directly impact what the debtor may retain and what creditors may recover. This is the clearest example of how a state can use its laws to favor its citizens to the detriment of noncitizens.[637] A close second is the difference in state ipso facto laws. Evidence conclusively shows that debtors in states that permit enforcement of ipso facto clauses enter into reaffirmation agreements at a far higher rate than debtors in states that do allow such provisions. There is no reason debtors should be channeled into forgoing discharge of debt because of where they live. This does not mean that states have to change their ipso facto or exemption laws, only that these state laws cannot apply to parties in a bankruptcy case.

riments or benefits for third parties just to have an impact on debtors and creditors in bankruptcy. *Id.* at 545.

[636] Stellwagen v. Clum, 245 U.S. 605, 613 (1918) ("The Federal Constitution . . . gives Congress the power to establish uniform laws on the subject of bankruptcy throughout the United States. . . . While this is true, state laws are thus suspended only to the extent of actual conflict with the system provided by the Bankruptcy Act of Congress." (citing Sturges v. Crowninshield, 17 U.S. 122 (1 How.), 196 (1819))).

[637] In 1973, the National Bankruptcy Review Commission recommended the adoption of uniform federal bankruptcy exemptions. REPORT OF THE COMM'N ON THE BANKR. LAWS OF THE UNITED STATES, H.R. DOC. NO. 93-137, pt. 2, at 125–30 (1973). A number of commentators have considered the dual federal/state exemptions, and most are critical of it. *See* William Houston Brown & Lawrence Ponoroff, *A Second Look at the Proposed Uniform Bankruptcy Exemptions: Tennessee As an Example*, 28 U. MEM. L. REV. 647 (1998) (stating that reasons favoring uniformity in exemptions include predictability, greater public respect, elimination of incentive for forum shopping and federal control over policy issues); William Woodward, *Exemptions, Opting Out, and Bankruptcy Reform*, 43 OHIO STATE L.J. 335 (1983) (noting unfairness to creditors of expansive state exemptions). An opposite view is presented by G. Marcus Cole, *The Federalist Cost of Bankruptcy Exemption Reform*, 74 AM. BANKR. L.J. 227, 251, 273 (2000). Cole asserts that principles of U.S. federalism favor keeping state law exemptions, and that "forum shopping" is not necessarily bad and in fact rarely happens. *Id.* at 236, 272 –273.

Other state laws, such as laws on subordination of debt, are likewise not uniform and should not be incorporated into bankruptcy law.

In place of the state laws now used in bankruptcy, bankruptcy courts can develop a body of federal common law. Doing so would not offend the principle of *Erie Railroad. Co. v. Tompkins*.[638] *Erie* held that courts must apply the law of the forum state in matters not governed by the federal Constitution or acts of Congress.[639] The diversity action in *Erie* is entirely different from a bankruptcy case, which arises under the federal Bankruptcy Code enacted pursuant to the Bankruptcy Clause. Indeed, bankruptcy courts already use federal common law to distinguish between a non-dischargeable domestic support order and other types of dischargeable family debt, which are both created under state law.[640] Because federal common law and state law are both "nonbankruptcy law," the Code sections that mention nonbankruptcy law will not have to be re-written. For example, §510(a) provides that a subordination agreement is enforceable in bankruptcy to the same extent it would be under nonbankruptcy law.[641] At present, state law is used to determine enforceability of a subordination agreement.[642] Federal courts could establish national criteria as to the form, content, and other requirements for enforceability of such agreements. By doing so, creditors with an interest in property subject to a subordinate agreement will be treated the same irrespective of where the bankruptcy case is filed.

Another key cause of nonuniformity in bankruptcy is case law precedent. This is a natural consequence of the federal court system and is not due to a lack of uniform bankruptcy laws. But consideration for uniformity should be an active component of judicial decision-making in bankruptcy. As noted, the lack of uniformity is the most common reason why the Supreme Court accepts certiorari. Lower courts should consider uniformity with equal reverence.

Local rules, forms, standing orders, and trustee procedures that create discernible differences in how bankruptcy applies to parties

[638] 304 U.S. 64 (1938).

[639] *Id.* at 78 ("Except in matters governed by the Federal Constitution or by acts of Congress, the law to be applied in any case is the law of the state.").

[640] *See* Brody v. Brody (*In re* Brody), 3 F.3d 35, 38 (2nd Cir. 1993) ("[T]he label that the parties attach to a payment is not dispositive; the court must look to the substance, and not merely the form, of the payments."); Long v. Calhoun (*In re* Calhoun), 715 F.2d 1103, 1107 (6th Cir. 1983) (holding that a domestic support obligation is a determination made in accordance with federal bankruptcy law, not state law).

[641] 11 U.S.C. § 510(a) (2006).

[642] *See supra* notes 250–57.

undermine uniformity too because they invest local courts and officials with discretion to distinguish among parties in bankruptcy. The Bankruptcy Clause allows laws that distinguish between classes of debtors and creditors, but it does not allow anyone other than Congress to make those laws. At the very minimum, all local Chapter 13 plan forms should be abolished, as should local trustee practices that have unique requirements for establishing things such as property values and charitable contributions. They should be replaced by a single national Chapter 13 form and national guidelines for essential bankruptcy functions. In addition, it is hard to justify so many local Chapter 13 trustee practices and commission rates. Chapter 13 debtors should pay the same trustee commission rate, under the same terms, regardless of where they file. Local standing orders, which are issued without the procedural requirements of local bankruptcy rules but have the same effect of local bankruptcy rules, should also be abolished. These steps will go far in eliminating nonuniform bankruptcy outcomes that are based on geography.