Bankruptcy Court Liaison Committee Newsletter

Fall 2017

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Behind the Bench with Judge Thorne

By Ainat Margalit, Legal Assistance Foundation of Metropolitan Chicago

Deborah Thorne was appointed to a 14 year term as bankruptcy judge in the Eastern Division of the Northern District almost two years ago. I recently had the opportunity to sit down with Judge Thorne for a short interview.

Career before the Bench

Judge Thorne was a teacher for five years before law school and has a Masters in Teaching with a focus on History. She spent two years teaching in North Carolina and then returned to the Midwest and taught for three years in Winnetka. She toyed with pursuing a Ph.D in history but more practical minds prevailed and she went to law school.

Judge Thorne's early law career included an externship with Bankruptcy Judge Eisen and then a position as corporation counsel for the City of Chicago under Mayor Harold Washington. She was hired to represent the City in bankruptcies but the work spilled over from bankruptcy. Much of the work had "interesting political twists." She was involved in the City's first affirmative breach of contract case, abandoning an earlier laissez faire approach.

Judge Thorne went on to 32 years in private practice focusing on corporate bankruptcy.

Additionally, Judge Thorne has volunteered for years with Women Employed, an organization that develops and advocates for policies supporting women in the workplace. She is currently vice-chair of their board.

Why Judge?

Judge Thorne did not aspire to be a judge. Her husband, Judge Esrig of the Circuit Court of Cook County, became a judge and seemed to be really enjoying it, coming home "with a spring in his step." She was then encouraged by others to apply and sees judgeship as an opportunity to give back to our community.

"Bankruptcy is some individual's only opportunity to be in touch with government and the courts and I want them to feel listened to and respected."

Application Process for Judgeship and Baby Judge School

According to Judge Thorne, the application process was quite secretive. She had no idea who the competition was. After she was chosen there was a 90 day FBI approval process and she could not disclose her nomination before that was finished. Her references

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and opposing counsel were contacted by the FBI and they did not know for what purpose.

After selection, Judge Thorne attended Baby Judge School at the Federal Judicial Center. She described the experience as being very collegial. The new judges were nice, engaged people that wanted to help and get to the right answer.

Pipe Dream - Expanding the Help Desk

Judge Thorne is invested in expanding the capacity of the Bankruptcy Help Desk which serves pro se debtors. She is hopeful that the Pro Bono Committee will be able to find a way to expand the help needed by pro se debtors who attempt to navigate chapters 7 and 13 on their own and are frequently baffled by the forms and procedure required.

She dreams of a Help Desk which includes:

- More volunteers in the afternoon to accommodate pro se debtors' schedules
- 3-4 computer terminals to work on filings
- More law firms and law schools involved on a pro bono basis
- Implementing software specifically designed for pro se filings
- Modifying the clinic to have more continuous interaction with volunteer attorneys
- Moving clinics outside of courthouse to accommodate pro se filers in their own neighborhoods.

Pet Peeves with Lawyers Practicing in her Court

Judge Thorne did not previously practice in the area of consumer bankruptcy law. She found it difficult to decipher the traditions and jargon that are entrenched in the consumer practice in the Northern District. Citing authority in motions and briefs "really helps." "Traditions and Jargon can't be relied on. Cite to cases and law!"

Supreme Court to Decide Scope of § 546(e) Safe Harbor

By Nick Dwayne & Brad Berish, Adelman & Gettleman, Ltd.

The United States Supreme Court is set to review the Seventh Circuit's decision in *FTI Consulting, Inc. v. Merit Management Group, LP*, 830 F.3d 690 (7th Cir. 2016) (*FTI Consulting*), and with it, for the first time, address the scope of the safe harbor provision of § 546(e) of the Bankruptcy Code. The review will resolve a split among several Circuit Courts of Appeal, and potentially result in significant reevaluation of bankruptcy avoidance litigation in the context of securities transactions. Currently, under the majority reading of the section, sellers of securities are afforded significant protection from the unwinding of their securities sales when a financial institution is used as an intermediary or escrow agent. The Seventh Circuit's reading in *FTI Consulting* removes that protection.

Code § 546(e) states:

> Notwithstanding sections 544, 545, 547, 548(a)(1)(B), and 548(b) of this title, *the trustee may not avoid a transfer that is* a margin payment, as defined in section 101, 741, or 761 of this title, or settlement payment, as defined in section 101 or 741 of this title, made by or to (or for the benefit of) a commodity broker, forward contract merchant, stockbroker, financial institution, financial participant, or securities clearing agency, or that is a transfer *made by or to (or for the benefit of) a* commodity broker, forward contract merchant, stockbroker, *financial institution*, financial participant, or securities clearing agency, *in connection with a securities contract*, as defined in section 741(7), commodity contract, as defined in section 761(4), or forward contract, that is made before the commencement of the case, except under section 548(a)(1)(A) of this title.

11 U.S.C. § 546(e) (emphases added).

Essentially, section 546(e) protects all transfers made "by or to (or for the benefit of)" a "financial institution . . . in connection with a securities contract" (i.e., the sale of stock) from virtually all of the avoidance powers of a bankruptcy trustee.

While this safe harbor does prohibit constructive fraudulent transfer actions under § 548(a)(1)(B) where less than reasonably equivalent value was received for the transfer and the debtor was insolvent or became insolvent as a result of such transfer, it does not protect transfers under § 548(a)(1)(A) that are made with actual intent to hinder, delay or defraud, and which are typically more difficult to prove.

The interpretive challenge that has befallen the lower courts is the meaning of the words "made by or to (or for the benefit of)." The majority approach—adopted by the Second, Third, Sixth, Eighth and Tenth Circuits—is that the phrase is plain on its face and means that any transfer of property enjoys the protection outlined by § 546(e), if the transferred property, at any point, for any duration or purpose, at least passes through a financial institution. On the other hand, the Eleventh and Seventh Circuits have ruled that there is a "mere conduit" exception to the safe harbor of § 546(e). That is to say that a transfer may

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nonetheless be avoided by the trustee if the ultimate intended beneficiary of the transferred property is not a financial institution and a financial institution never takes a beneficial interest in the property.

FTI Consulting Facts

FTI Consulting, like the other Circuit decisions interpreting § 546(e), resulted from a leveraged buyout gone wrong. Prior to becoming a debtor under chapter 11, Valley View Downs, LP, owned and operated a horseracing track. Both Valley View and one of its competitors, Bedford Downs, desired to expand their businesses from mere racetracks to racetrack-casino hybrids, or "racinos." Rather than compete for the requisite license, the tracks agreed that Valley View would purchase all shares of Bedford for $55 million. Valley View borrowed money from Credit Suisse to finance the transaction and Citizens Bank of Pennsylvania served as the escrow agent. Shortly after the sale took place, Valley View filed a chapter 11 petition.

FTI Consulting, Inc., as trustee of a litigation trust created pursuant to a confirmed plan in Valley View's bankruptcy, brought suit against Merit Management Group LP., which, as a 30% shareholder of Bedford, had received $16.5 million in proceeds from the sale. FTI sought to avoid the transfer from Valley View to Merit under §§ 544, 548(a)(1)(b), and 550. As a defense, Merit argued that the transfer was safe from avoidance pursuant to § 546(e). The parties did not dispute that the transfer qualified as a "payment made 'in connection with a securities contract'" and that Merit was not a "commodity broker, forward contract merchant, stockbroker, financial institution, financial participant, or securities clearing agency." But Merit argued that it was nonetheless protected by § 546(e) on account of the involvement of Citizens Bank (escrow agent) and Credit Suisse (as the lender)—both "financial institutions" through which the sale proceeds had passed. The District Court for the Northern District of Illinois, citing the majority rule, held the transfer was "by or to (or for the benefit of)" Citizens Bank and Credit Suisse, and therefore unavoidable. On appeal, the Seventh Circuit reversed and remanded.

Seventh (and Eleventh) Circuit Reasoning

The Seventh Circuit began, like all six Circuit Courts before it, by analyzing the text of § 546(e). Unlike five of its sister circuits, however, the Seventh Circuit found the meaning of "by or to (or for the benefit of)" to be ambiguous, necessitating an inquiry into the section's purpose and context. The court then looked to other sections of the Code finding that in the context of §§544, 547, 548, and 550, section 546(e)'s safe harbor only applies "where the named entity is a counterparty [to the transfer] as opposed to a conduit or bank for a counterparty." 830 F.3d at 695. The Court reasoned that its interpretation did not detract from the safe harbor's purpose—to protect the securities markets from systemic risk and provide greater confidence to institutions in the securities industry—since neither Valley View nor Merit was "in the securities industry," and the only "financial institutions" involved were merely conduits for the transfer.

With its decision in *FTI Consulting*, the Seventh Circuit joined the Eleventh Circuit, which, in *In re Munford, Inc.*, 98 F.3d 604 (11th Cir. 1996), held that the § 546(e) safe harbor applies only to transfers in which a financial institution (or any of those entities listed in the section) "is a debtor or actual recipient of a transfer, rather than simply a conduit for funds." *Id.* at 696.

The Majority View

The Second, Third, Sixth, Eighth and Tenth Circuit court decisions were all presented with substantially similar factual scenarios involving the sale of stock through an intermediary financial institution. Unlike the Seventh and Eleventh Circuits, however, each of those courts found that the meaning of § 546(e) was clear and unambiguous on its face. As described by one court, "[b]y its terms, § 546(e) protects settlement payments 'made by or to a . . . financial institution,' and does not expressly require that the financial institution obtain a beneficial interest in the funds." *Contemporary Indus. Corp. v. Frost*, 564 F.3d 981, 987 (8th Cir. 2009). As such, the majority view is that the protections of § 546(e) kick in if, at any point, the transferred property targeted for clawback passed through a financial institution.

Proponents of the majority position argue that such a reading is consistent with the purpose of the section: to protect the integrity of securities markets and the expectations of securities buyers and sellers. They also argue that the Seventh Circuit's interpretation of the section is at odds with that purpose, and the purpose of the Code, generally. Finally, they contend that the Seventh Circuit's ruling renders the inclusion of "securities clearing agenc[ies]" meaningless as they are, by definition, intermediaries.

Status Before the Supreme Court

The parties before the Supreme Court have filed their initial briefs on the merits, and the Court took oral argument on November 6, 2017. Interestingly, although Merit argues that a ruling for FTI will prevent upheaval in the financial markets, no amici of note filed a supporting brief. FTI, on the other hand, is supported by *amicus* briefs by law professors Ralph Brubaker, Bruce A. Markell, Charles W. Mooney, Jr., and Mark J. Roe, as well as the National Association of Bankruptcy Trustees.

At least until the Supreme Court renders a decision, practitioners advising clients in connection with stock sales can be expected to recommend using financial intermediaries as a relatively inexpensive form of insurance against the later avoidance of such sales as constructively fraudulent transfers. ■

Frequent Tax Issues in Consumer Bankruptcy

By Michael Kelly, U.S. Department of Justice

This column is part of a series that provides guidance on frequently encountered IRS bankruptcy issues. The views expressed here are mine alone, and not necessarily those of the United States.

IRS Priority Claims—Three-Year Look Back? Not always.

The bankruptcy priority claim statute's subsection on claims of government units (11 U.S.C. § 507(a)(8)) is no one's idea of an easy read, but at least the portion addressing debts owed on recently-due tax years is relatively straightforward. Priority tax claims include claims "for which a return, if required, is last due, including extensions, after three years before the date of the filing of the petition." 11 U.S.C. § 507(a)(8)(A)(i). Seems simple, right? Not always.

There is a common law overlay to § 507(a)(8)(A)(i) that can be a trap for the unwary: equitable tolling. The Supreme Court addressed how equitable tolling impacts the three-year look back for priority tax claims in a Justice Scalia opinion, *Young v. United States*, 535 U.S. 43 (2002). In *Young*, the debtor filed a chapter 7 bankruptcy shortly after the dismissal of a chapter 13 bankruptcy. The IRS had a claim for a which a return was due more than three years before the filing of the chapter 7 bankruptcy but less than three years back if the time during the prior chapter 13 bankruptcy was excluded. The IRS argued that the three-year look back was equitably tolled by the earlier bankruptcy, while the debtor insisted that "three years" was three years.

Before addressing equitable tolling's application, the court explained why Congress limited priority treatment to the three-year period in the first place: to encourage the IRS to protect its rights by acting swiftly to collect its debts. *Id.* at 47. "If the IRS sleeps on its rights, its claim loses priority and the debt becomes dischargeable." *Id*. Not a bad exegesis of legislative intent!

Next, the court turned its focus to whether applying equitable tolling to § 507(a)(8)(A)(i) was appropriate, noting that while equitable tolling typically applies to any statutory time limitation, it does not apply where the tolling would be "inconsistent with the text of the statute." *Id*. at 49. The court found no such inconsistency.

The debtor pointed out that § 507(a)(8)(A)(ii) excludes time during which an offer in compromise is pending from the 240-day period applicable to tax assessments. *Id*. at 53. This, the debtor argued, showed that Congress was capable of implementing tolling into the priority statute when it felt like it, had chosen to do so for § 507(a)(8)(A)(ii), but had opted not to do so for § 507(a)(8)(A)(i)'s three-year look back.

The court batted this down, pointing out that *voluntary* forbearance from pursuing one's rights—which is what happens during an offer in compromise—would never result in equitable tolling. *Id*. Therefore, the exclusion of time while an offer in compromise is pending "*supplements* rather than displaces principles of equitable tolling." *Id*. Or, viewed through another lens, if the purpose of the three-year look back is to encourage swift collection by the IRS, equitable tolling is appropriate for periods when the IRS is prevented from collecting, as it is when the automatic stay is in place during prior bankruptcies.

So, when considering whether your client's tax debt will be priority or not, it is wise to inquire into your client's past forays into bankruptcy.

IRS Requesting Tax Returns *Before* Tax Day?

Each year, I receive a certain amount of correspondence concerning debtors who file bankruptcy cases after January 1 but before tax day (April 15 or thereabouts) and are surprised to see IRS proofs of claim characterizing the previous year's tax debt as unassessed because no return has been filed. Since "no return" on a recent tax year generally prevents plan confirmation in a chapter 13, the tone of this correspondence can be somewhat irate. I submit that there are sound legal and practical reasons for this IRS practice.

First, the legal reasons. As is widely known, there is a statutory provision that imposes a bankruptcy-specific deadline for tax return filing: 11 U.S.C. § 1308(a). That section requires that debtors must file a tax return before the first date on which a § 341(a) meeting is scheduled "if the debtor was required to file a tax return under applicable nonbankruptcy law."

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Critics of the IRS's first quarter claim filing strategy point to that phrase as evidence that the IRS is jumping the gun. Under nonbankruptcy law, the return would not be due until April, so the rule about filing returns before the § 341(a) meeting does not apply in those cases, or so the argument goes. The IRS's view is that the phrase says nothing that would limit § 1308(a)'s application to returns whose date has not yet come due but rather is drafted broadly to encompass any return that would be required to be filed at all (i.e., a return for a debtor whose income exceed the minimum threshold for filing).

A close read of § 1308(b)(1) supports the IRS's interpretation of the statute. Section 1308(b)(1) provides the trustee leeway to hold a 341 meeting open to allow a debtor time to file an unfiled return. Then, the statute goes on to limit that discretion by imposing time limits on how long the trustee can hold the meeting open. The limit is 120 days for debtors with returns past due as of the petition filing (i.e., debtors with unfiled returns who file bankruptcy after April 15). 11 U.S.C. § 1308(b)(1)(A). But there is a more generous time period for debtors with returns that were not past due as of the petition (i.e., debtors with unfiled returns who file before April 15). 11 U.S.C. § 1308(b)(1)(B). If 1308(a) did not accelerate the due date for returns for bankruptcies filed before April 15, then 1308(b)(1)(B)'s inclusion would be nonsensical. A Wisconsin bankruptcy court relied on § 1308(b)(1)(B)'s inclusion to reach just this conclusion. *In re French*, 354 B.R. 258 (E.D. Wisc. 2006).

Therefore, the bankruptcy code accelerates the due date for tax returns for cases filed before April 15. But why? I am merely an attorney, not a Congressman, so I can't answer definitively. But I suspect it comes down to plan feasibility. Recent tax years are afforded priority status and must be paid at 100% over the life of a chapter 13 plan. 11 U.S.C. § 1322(a)(2). Having accurate information about the tax claim due on a recent tax year is, therefore, critical information for all parties to have in order to evaluate whether the proposed plan is going to work given the debtor's income and expenses. Given this, it may make sense to urge your clients to have their tax return in hand when filing bankruptcies in the first few months of the year.

That brings this installment to an end. If you have IRS bankruptcy questions that you'd like to see addressed in this column, please don't hesitate to send them my way at michael.kelly@usdoj.gov.

New Federal Rules of Bankruptcy Procedure to Impact the Consumer Bankruptcy Bar

By Rachael Stokas, Codilis & Associates, P.C.

New Federal Bankruptcy Rules will go into effect December 1, 2017. The rule changes will significantly impact consumer bankruptcy proceedings throughout the United States. The changes will impact all parties both on a national and local level. The rules changes focus on proof of claim filing deadlines and notice provisions. The Rules will also introduce the national model plan in Chapter 13 Bankruptcy cases. The rules being amended are Bankruptcy Rules, 2002, 3002, 3007, 3012, 3015, 4003, 5009, 7001, 9009, and a newly added rule 3015.1. These rules in their entirety can be found on the internet at http://www.uscourts.gov/rules-policies/pending-rules-and-forms-amendments and the new national form plan can be located at http://www.uscourts.gov/sites/default/files/b_113_and_cn_0.pdf. The Bankruptcy Court's website also has a link under "forms" which will take you to the U.S. Courts website.

Listed below are some of the most significant changes that will be implemented under the new rules.

1. Bankruptcy Rule 3015(c), provides that all practitioners filing Chapter 13 plans must use the Official Form plan unless the jurisdiction has adopted a local plan that is compliant with the newly added Rule 3015.1.
2. Practitioners in the Northern District of Illinois will be required to use the Official Form.
3. The new Rule 3015.1 allows a bankruptcy district to "opt out" of the use of the Official Form but requires the Local Form plan to comply with key components of the new format set forth in the new rule. The Central and Southern Districts of Illinois have opted to use a Local Form Plan.
4. Rule 3002, with respect to claims filed in bankruptcy cases, has also been changed impacting secured and unsecured claims filed in Chapter 7, Chapter 12, and Chapter 13 cases.
5. The claims bar date set in the above Chapters for secured and unsecured claims has been shortened to 70 days after the case has been filed or a conversion order has been entered. Creditors must file claims within the 70 day period in order to receive any distribution under the plan.
6. Additionally, secured creditors, although required to file the claim with the required attachments under 3001(c)(2)(C), will have additional time to supplement the claims if necessary with their security documents and will be allowed 50 additional days to file those documents.
7. Rules 3007, 3012, 4003, 5009, and 7001 clarify service methods and objection deadlines relating to objections to claims, determinations of security and priority claims, exemptions, declarations of satisfying liens and proceedings to determine the validity of liens.

As the rule changes are just around the corner, the bankruptcy bar in the Northern District as well as other jurisdictions should become familiar with the changes. Bankruptcy court websites are useful tools to keep up with any local rule changes or administrative procedures that may happen. Additionally, the Bankruptcy Liaison Committee can also be a resource if you have questions or concerns you would like to relay to the bench bar. Knowledge provides the best resource in adapting to change.

Chicago CARE (Credit Abuse Resistance Education) Program

By Shara Cornell, U.S. Bankruptcy Court

The Chicago CARE (Credit Abuse Resistance Education) program continues to serve Chicagoland, making financial literacy presentations to local schools and community organizations. This past year has been busy for Chicago CARE. Most recently, Bill Barrett of Barack Ferrazzano hosted a CARE training program for new volunteers. CARE would also like to thank Karen Goodman and the Taft team for hosting the CARE Fall 2017 Cocktail Social. As of the third week of October, 2017, Chicago CARE had been asked to give presentations at 11 different venues between the end of October and the end of the year, with an expected audience count of well over 1000 students and young adults.

This past year, CARE volunteers reached over 4028 people in 155 presentations at 38 different venues. This is an almost 20% increase since the previous school year. Our presenters included 77 volunteers, counting at least 38 volunteers that presented more than once. Of our 38 venues, 14 were new to CARE. CARE has been working hard to expand the geographic scope of our presentations to include more suburban schools, in addition to our work in the Chicago Public School system. This explosive growth is due to our wonderful and committed volunteer base.

In other great news, CARE's pilot program for online calendaring to make volunteering easier has been a huge success. To register to volunteer, please visit the Chicago CARE web site (www.CAREChicago.org) and click the Volgistics link.

We look forward to a busy and productive fall semester in the short term and to even greater successes in the long term. Join us and show us that you CARE! As always, you can find us at www.CAREchicago.org.

The Fan Deck, The Hippest Party in Town: Bankruptcy Liaison Committee's White Sox Outing

By Rachael Stokas, Codilis & Associates, P.C.

Sean Williams, David Holtkamp, Blair Zanzig, John Hiltz, Megan Preusker and James Sowka

Richard Fogel, Judge Pamela Hollis and Rachael Stokas

The Fan Deck at Guaranteed Rate Field was back by popular demand. The Bankruptcy Liaison Committee once again chose this premier spot to host its annual baseball outing on September 7, 2017. The Fan Deck provided attendees with a relaxed and casual atmosphere for mixing and mingling with fellow colleagues. There was also prime seating for those who wished to watch the baseball game.

Members again were able to partake in unlimited food and beverage service before and during the game. The food consisted of traditional ball park favorites such as hot dogs, hamburgers, chicken, potato chips and popcorn.

Attendees this year included judges, trustees, corporate and consumer attorneys.

Although the White Sox didn't walk away with a win, good times were had by all.

Bravo to the committee for putting on another fabulous event with special thanks to Brad Berish for all of his organizing efforts.

The outing was the HIPPEST PARTY IN TOWN.

Annual Bench-Bar Holiday Party

Come and enjoy cocktails and appetizers with your colleagues from the Northern District of Illinois Bankruptcy Court Liaison Committee, hosted at the offices of Kirkland & Ellis.

Thursday, December 7, 2017

5:30 – 8:30 p.m.

Kirkland & Ellis

300 North LaSalle

Chicago, IL

Please RSVP by December 2 to attend the event.

If you have any questions, please contact Janet Sandridge at janet.sandridge@kirkland.com.

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Judge Janet S. Baer

Judge Timothy A. Barnes

Judge Donald R. Cassling

Judge Jacqueline P. Cox

Judge Carol A. Doyle

Judge A. Benjamin Goldgar

Judge LaShonda A. Hunt

Judge Thomas M. Lynch

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Practitioners and interested parties wishing to anonymously share any ideas or concerns with the Liaison Committee may send an email to bankruptcyliaisoncommittee@gmail.com or directly contact any of its members using the contact information available on the Bankruptcy Court's website at the following link https://www.ilnb.uscourts.gov/bankruptcy-court-liaison-committee.