THE TOP TEN CASES THAT EVERY BANKRUPTCY PRACTITIONER SHOULD KNOW (PLUS CERTAIN ADDITIONAL HONORABLE MENTIONS)

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The era of "modern" bankruptcy practice in the United States began with the Bankruptcy Act of 1898. In the 111-plus years since the enactment of the Bankruptcy Act and in the 31 years since the enactment of the current Bankruptcy Code, there have been countless cases that have set the foundations for how bankruptcy law is practiced today. This body of case law cannot be covered comprehensively via a discussion of the 10 "most important" cases. In addition, it is not clear how one significant concept of bankruptcy law can be said to be more important than another significant concept. It therefore stands to reason that this discussion of the top 10 cases that all practitioners of bankruptcy law should know will omit cases that some practitioners think are of vital importance. This is unavoidable, even though the authors snuck in a few extra cases under the heading of "Honorable Mentions." With those caveats made, the cases discussed in this article are those that many bankruptcy practitioners can recite by case name, largely because they established a bedrock principle of bankruptcy law. The cases are presented in chronological order, not in order of perceived importance.

1. *Stoll v. Gottlieb*, 305 U.S. 165 (1938)

Ten Fifteen North Clark Building Corporation (the debtor) filed a petition for reorganization under the Bankruptcy Act. The debtor proposed a plan of reorganization whereby stock in the reorganized company (Olympic Hotel Building Corporation) would be issued to bondholders and the bonds would be canceled. The plan also provided for a cancellation of personal guaranties of the bonds issued by J.O. Stoll and S.A. Crowe Jr. The cancellation of the guaranties was in consideration "for the transfer of all the assets of said Debtor … to the

Olympic Hotel Building Corporation and the surrender of the said Common Stock of the Debtor." *Id.* at 168–69.

One of the debtor's creditors was William Gottlieb, who received notice of the confirmation hearing and did not appear. At the confirmation hearing, the plan was confirmed over the objection of creditors in the same class as Gottlieb. Gottlieb subsequently filed a state court action against Stoll and Crowe, seeking to enforce the guaranties. Gottlieb also filed a petition in the bankruptcy court seeking to vacate the confirmation order on the ground that the bankruptcy court lacked jurisdiction to cancel the guaranties. The bankruptcy court denied the petition and Gottlieb did not appeal that order.

The state court granted a judgment in favor of Stoll and Crowe, and the Supreme Court of Illinois reversed the decision, finding in favor of Gottlieb. Stoll and Crowe appealed to the U.S. Supreme Court, which expressed no opinion on whether the bankruptcy court had jurisdiction. *See id.* at 171 n.8. The U.S. Supreme Court reversed the decision of the Supreme Court of Illinois, however, on the ground that the bankruptcy court's order on Gottlieb's petition to vacate confirmation settled the issue of jurisdiction and that Gottlieb's state court action was precluded under the principle of res judicata. The Court noted that "[i]t is just as important that there should be a place to end as that there should be a place to begin litigation," and that res judicata would decide the issue "whether or not power to deal with the particular subject matter was strictly or quasi-jurisdictional." *Id.* at 172, 177.

Important Principle

A confirmed plan may finally resolve an issue, even if the bankruptcy court may not have had the jurisdiction to decide the issue. This matter has been addressed by cases under the Bankruptcy Code as well. *See, e.g., Republic Supply Co. v. Shoaf*, 815 F.2d 1046 (5th Cir. 1987) (holding that res judicata barred a party's suit to enforce a guaranty when the confirmed plan released the guarantor).

2. *Case v. Los Angeles Lumber Prods.*, 308 U.S. 106 (1939)

The debtor was a holding company that owned all the shares of certain subsidiaries. The debtor's principal asset was the stock of the Los Angeles Shipbuilding and Drydock Corporation (the subsidiary), which was solvent. The debtor was insolvent and its principal liability consisted of obligations owed to bondholders. The debtor's debt to the bondholders was secured by various assets. In 1930, the debtor and its creditors negotiated a "voluntary reorganization," under which the debtor was able to operate for several more years, but then filed bankruptcy in 1938. The plan of reorganization submitted by the debtor provided that a new corporation would be formed and would acquire the subsidiary's assets. Certain stockholders would receive stock in the new corporation without needing to make any new contributions.

The debtor's plan was accepted by more than 90 percent of the bondholders, as well as the holders of stock. However, holders of $18,500 worth of bonds (the petitioners) objected to the plan, on the grounds that it gave old stockholders 23 percent of the assets and voting power in the new company, even though the stockholders did not make "any fresh contribution by way of subscription or agreement." *Id.* at 112. The debtor argued that this was permitted because, among other things, the stockholders added value through their familiarity with the debtor and because, if the bondholders were to foreclose, the bondholders would receive "substantially less than the present appraised value of the assets." *Id.* at 113.

The bankruptcy court confirmed the plan over the petitioners' objection, and the court of appeals affirmed the decision. The U.S. Supreme Court reversed, on the grounds that the plan was not "fair and equitable," because it violated the "rule of full or absolute priority." *Id.* at 117. The Court first noted that the fact that the plan had overwhelming support from creditors was not significant: "The court is not merely a ministerial register of the vote of the several classes of security holders. All those interested in the estate are entitled to the court's protection. Accordingly, the fact that the vast majority of the security holders have approved the plan is not the test of whether the plan is a fair and equitable one." *Id.* at 114. The Court cited previous Supreme Court case law providing the "fixed principle" that "the stockholder's interest in the property is subordinate to the rights of creditors; first of secured and then of unsecured creditors." *Id.* at 120 (quoting *Louisville Trust Co. v. Louisville, N.A. & C. Ry. Co.*, 174 U.S. 674, 684 (1899)).

As to the facts of this case, the Supreme Court noted that, if the debtor's assets were turned over to the bondholders, the bondholders would realize less than 25 percent of their claims. "Yet in spite of this fact [the bondholders] will be required under the plan to surrender to the stockholders 23 percent of the value of the enterprise." *Id.* at 122. As to the assertion that the stockholders' continued presence added value, the Court stated that this argument was based on "hopes or possibilities" and had "no place in the asset column of the balance sheet of the new company." *Id.* at 122–23. Finally, as to the argument that the bondholders would receive very little if they were to foreclose, the Court held that this fact had no bearing on whether the plan was fair and equitable.

Important Principle

This case provides the foundations for the absolute priority rule. The statutory basis for the rule was § 77B of the Bankruptcy Act, which required a plan to be "fair and equitable." The Court used this language as a basis for applying the absolute priority rule, which was a concept that had been in existence since at least 1899. *See Louisville Trust Co. v. Louisville, N.A. & C. Ry. Co.*, 174 U.S. (1899). In applying the rule, the Court made it clear that intangible benefits allegedly provided by old stockholders do not qualify as added value for the purpose of confirming a plan. The Court, in dicta, noted that stockholders could participate in a plan and receive new equity if they contributed new capital. This principle has become known as the "new value corollary." Note that the *Los Angeles Lumber Products* case was decided under the Bankruptcy Act, which allowed any creditor to invoke the rule. Under the Bankruptcy Code, there must be a dissenting *class* of creditors to invoke the rule. *See* 11 U.S.C. § 1129(b). The Supreme Court addressed the issue of the absolute priority rule and cram down under the Bankruptcy Code in *Bank of America Nat'l Trust & Savs. Ass'n v. 203 N. LaSalle Street P'ship*, 526 U.S. 434 (1999), in which the Court noted that some lower courts applied the new value corollary, but the Court did not accept or reject the corollary. Instead, in *203 N. LaSalle*, the Court held that a plan violates § 1129(b) if it provides that *only* old equity holders are given the opportunity to purchase new equity. The Court did not specify the method but made it clear that the old equity holders must pay market rate for the new equity and that the best way to ensure such market valuation is to expose the interests to the market—that is, to allow competing parties the chance to purchase the equity.

3. *Katchen v. Landy*, 382 U.S. 323 (1966)

The debtor made payment on two notes to a bank. On one of the notes, an officer of the debtor (the petitioner) was an accommodation maker. The debtor filed for bankruptcy and the petitioner filed two claims: one for certain rent payments due to the petitioner by the debtor, and one for a payment on one of the notes made by petitioner from his personal funds. The trustee sued the petitioner, asserting that the note payments were avoidable as preferences (the petitioner, as an accommodation maker, was a beneficiary of the note payment). The bankruptcy court ruled in favor of the trustee and held that the petitioner's claims would be allowed only when and if the petitioner paid back the payment related to the note for which he was an accommodation maker. The district court and the court of appeals affirmed the decision. On appeal to the U.S. Supreme Court, the petitioner argued that the bankruptcy court had denied him the right to a jury trial in the preference suit. The Court held that

> although petitioner might be entitled to a jury trial on the issue of preference if he presented no claim in the bankruptcy proceeding and awaited a federal plenary action by the trustee … when the same issue arises as part of the process of allowance and disallowance of claims, it is triable in equity. The Bankruptcy Act, passed pursuant to the power given to Congress by Art. I, § 8, of the Constitution to establish uniform laws on the subject of bankruptcy, converts the creditor's legal claim into an equitable claim to a pro rata share in the *res*. *Id*. at 401.

Important Principle

Filing a proof of claim in a bankruptcy case subjects the claimant to the jurisdiction of the bankruptcy court and waives the claimant's right to a jury trial. In other words, it converts a legal claim into an equitable claim. Subsequent Supreme Court case law has upheld this principle under the Bankruptcy Code. *See Granfinanciera v. Nordberg*, 492 U.S. 33 (1989) (fraudulent transfer defendants that did not file claims are entitled to a jury trial); *Langenkamp v. Culp*, 498 U.S. 42 (1990) (preference defendants that filed a claim waived their jury trial rights because, by filing the claim, they brought themselves within the equitable jurisdiction of the bankruptcy court).

4. *Butner v. United States*, 440 U.S. 48 (1979)

In 1973, Golden Enterprises, Inc. (the debtor) filed bankruptcy under the Bankruptcy Act. The bankruptcy judge confirmed a plan and, as a result of these proceedings, Butner (the petitioner) acquired a second mortgage on certain properties to secure his debt of $360,000. The bankruptcy court later granted the debtor's motion to appoint an agent to collect rents on the properties and apply them as directed by the bankruptcy court. Approximately nine months later, the debtor was "adjudicated a bankrupt," which resulted in the appointment of a trustee (similar to a modern-day conversion to Chapter 7 bankruptcy). The trustee was appointed to collect and retain the rents in a fund. Another nine months later, the court approved the sale of the properties to the petitioner, who paid for them by reducing the balance of his debt from $360,000 to $186,000.

The petitioner then filed a motion, claiming a security interest in the amounts that had accumulated in the fund, arguing that such amounts should be applied to the remaining balance of the petitioner's indebtedness. The bankruptcy court denied the motion, holding that the $186,000 owed was a general unsecured claim. The district court reversed the decision on the grounds that, under North Carolina law,

> a mortgagor is deemed the owner of the land subject to the mortgage and is entitled to rents and profits, even after default, so long as he retains possession. But the court viewed the appointment of an agent to collect rents during the [period prior to being adjudicated a bankrupt] as tantamount to the appointment of a receiver. This appointment, the court concluded, satisfied the state-law requirement of a change in possession giving the mortgagee [that is, the petitioner] an interest in the rents; no further action after the adjudication in bankruptcy was required to secure or preserve this interest. *Id*. at 51.

The court of appeals reversed the district court's ruling and interpreted North Carolina law as providing that the petitioner's failure to request the sequestration of rents during the bankruptcy case meant that the petitioner had not perfected its security interest in the rents. The Supreme Court affirmed this decision, specifically noting that it "did not grant certiorari to decide whether the Court of Appeals correctly applied North Carolina law." *Id*. Rather, the sole issue before the Supreme Court was whether state law should govern the issue. The Court noted that the laws of some states, referred to as "title states," provide that a mortgagee is automatically entitled to possession of the property and to a secured interest in the rents. In other states, the mortgagee's right to rents depends on the mortgagee's taking actual or constructive possession of the property. The Court noted that "[b]ecause the applicable law varies from State to State, the results in federal bankruptcy proceedings will also vary under the approach taken by most Circuits [which follow the applicable state law]." *Id*. at 53. The Court noted, however, that a minority of circuits "adopted a federal rule of equity that affords the mortgagee a secured interest in the rents even if state law would not recognize any such interest until after foreclosure." *Id.* The Court rejected this approach and adopted the majority view that "[p]roperty interests are created and defined by state law." *Id.* at 55.

Important Principle

In bankruptcy, a creditor's property interests are defined by state law, unless the Bankruptcy Code provides otherwise. It should be noted that the Supreme Court did not address the underlying substantive issue involving the assignment of rents. The Court did note, however, that the issue is likely to be decided differently based on whether the relevant state is a "title state" or a "lien state." Texas is a "lien state," meaning that, even though secured parties have a lien on property, the secured party is not deemed an owner of the property. For a very recent decision discussing the assignment of rents, *see In re Four Bucks LLC*, No. 09-42629, 2009 WL 1857432 (Bankr. N.D. Tex. June 29, 2009) (holding that an assignment of rents was an "absolute assignment," and therefore the rents were the property of the secured lender).

5. *Northern Pipeline Const. Co. v. Marathon Pipe Line Co.*, 458 U.S. 50 (1982)

Northern Pipeline Construction Co. (the debtor) filed a petition under Chapter 11 of the Bankruptcy Code in January 1980. In March 1980, the debtor filed a breach of contract suit in the bankruptcy court against Marathon Pipe Line Co., which sought dismissal of the suit on the grounds that the Bankruptcy Code "unconstitutionally conferred Art. III judicial power upon judges who lacked life tenure and protection of salary diminution." *Id.* at 56–57. The bankruptcy court denied the motion to dismiss, and the district court reversed this decision and granted the motion on the grounds that "the delegation of authority in 28 U.S.C. § 1471 to the Bankruptcy Judges to try cases which are otherwise relegated under the Constitution to Article III judges" was unconstitutional. *Id.* at 57. On appeal to the U.S. Supreme Court, a plurality of the Court held that, to the extent that the Bankruptcy Code granted bankruptcy judges the authority to try the type of case brought by the debtor, the code was unconstitutional.

The Supreme Court's decision was based on the Court's view that the grant of authority to non-Article III courts had the potential to threaten the independence of the federal judiciary. The opinion was written by Justice Brennan, with Justices Marshall, Blackmun, and Stevens joining. Justices Rehnquist and O'Connor concurred in the judgment. Justices Burger and White both wrote dissenting opinions. Justice Brennan's opinion noted each of the arguments raised by the debtor and by the United States in support of the constitutionality of the power granted to bankruptcy judges.

The debtor first analogized the grant of authority to specific situations in which Congress had non-Article III tribunals: (1) territorial courts including territories that were not states and the District of Columbia; (2) proceedings established by Congress and the President to administer courts-martial; and (3) proceedings involving "public rights," defined as matters arising between government departments. As an example of a public right, the Court noted that Congress may establish procedures to collect debts due to the government from one of its customs agents. The Court held that the power granted to bankruptcy judges was different than each of these exceptions. Specifically, the Court stated that each of those situations involved "exceptional powers bestowed upon Congress by the Constitution or by historical consensus. … We discern no such exceptional grant of power applicable in the cases before us." *Id.* at 70–71. As to the issue of "public rights," the Court noted that the restructuring of debtor-creditor relations may qualify as a public right, but that the issue before the Court was the debtor's right to recover contract damages, which was a private right.

The debtor also argued that Congress had the power to create Article I specialized courts, but the Court disagreed on the grounds that, if Congress had the power to create courts for each specialized area of the law, then Congress could conceivably "supplant" the Article III system with a system of such specialized courts. Finally, the debtor argued that the Bankruptcy Code was constitutional because the bankruptcy court was an "adjunct" to the district court. The Court acknowledged that Congress could vest authority in magistrates and special masters but held that these situations involve the adjudication of rights created by Congress. Bankruptcy, in contrast, is vested in federal law by the Constitution. In their concurring opinion, Justices Rehnquist and O'Connor noted that the decision was limited to the situation before the Court—that is, an action claiming a breach of contract that was pending in a bankruptcy court. The justices implicitly noted that the Bankruptcy Code may be constitutional in other situations.

Important Principle

Bankruptcy courts, as they exist today, are structured according to amendments made by Congress in response to the *Marathon* decision. These amendments were made in the Bankruptcy Amendments and Federal Judgeship Act of 1984. Bankruptcy judges are now considered "units" of the district court, rather than adjuncts. In addition, bankruptcy judges are appointed to their terms by courts of appeals, rather than appointed by the President with the advice and consent of the Senate, which was the case under the Bankruptcy Code as originally enacted. Moreover, Congress vested subject matter jurisdiction in the district courts. *See* 28 U.S.C. § 1334. The district courts may refer matters to bankruptcy courts. 28 U.S.C. § 157(a)–(c). Bankruptcy judges may issue final judgments in core bankruptcy matters. Final judgments may also be entered in noncore matters (that is, matters related to the bankruptcy case), but only when the parties consent to the jurisdiction of the bankruptcy court. For a discussion of what constitutes "related to" jurisdiction, *see Celotex Corp. v. Edwards*, 514 U.S. 300, 308 (1995) (adopting the standard set forth by the Third Circuit in *Pacor Inc. v. Higgins*, 743 F.2d 984 (3d Cir. 1984), which applies the test of "whether the outcome of that proceeding could conceivably have any effect on the estate being administered in bankruptcy. …").

6. *United Sav. Bank Ass'n v. Timbers of Inwood Forest Assocs.*, 484 U.S. 365 (1988)

Timbers of Inwood Forest Associates Ltd. (the debtor) owned an apartment complex in Houston, Texas, and borrowed $4.1 million from United Savings Bank Association of Texas secured by the apartment complex. The debtor filed for bankruptcy and the bank moved for relief from the automatic stay on the grounds that it was not adequately protected. The parties agreed that the value of the apartment complex was lower than the amount of the loan. The apartment complex was increasing in value, but only "very slightly." The debtor offered to pay the bank all of the post-petition rents from the complex, minus operating expenses.

The bank refused the offer, arguing that it was entitled to security in the amount that the bank would realize on the value of the funds that would be paid to the bank if it were permitted to foreclose and sell the complex. In other words, the bank argued that to protect its "interest in property," as set forth in § 362(d)(1), "the secured party [must be] reimbursed for the use of the proceeds he is deprived of during the term of the stay." *Id.* at 371 (summarizing the bank's argument). The bankruptcy court agreed, holding that the debtor was required to pay the bank 12 percent of the estimated value realizable by the bank on foreclosure.

The Fifth Circuit reversed the decision, and the Supreme Court affirmed the Fifth Circuit's ruling on the grounds that the bank's use of the term "interest in property" was inconsistent with the manner in which the term is used throughout the Bankruptcy Code. In addition, the Court held that the bank was not entitled to its opportunity cost amount on the grounds of delay because § 362(d)(2) provides a method for lifting the stay if there is no reasonable possibility of a successful reorganization.

Important Principle

The concept of "adequate protection" will not be interpreted broadly to provide an undersecured creditor with the amount the creditor could have realized on the funds if the undersecured creditor were permitted to foreclose on the security and put the funds to a more profitable use.

7. *Kane v. Johns-Manville Corp.*, 843 F.2d 636 (2d Cir. 1988)

Johns-Manville Corporation (the debtor), an asbestos manufacturer, filed for Chapter 11 bankruptcy in 1982. During the pendency of the bankruptcy case, the bankruptcy court approved the debtor's plan, which the district court later affirmed. Lawrence Kane, on behalf of himself and a group of other personal injury claimants—persons with asbestos-related diseases who had filed pre-petition personal injury suits against Johns-Manville—appealed the confirmation order. Under the terms of the plan, as a condition precedent to confirmation, the bankruptcy court would issue an injunction channeling all asbestos-related personal injury claims to a trust. The injunction provided that asbestos claimants could proceed only against the trust to satisfy their claims. The claims of future claimants, those persons who had been exposed to Johns-Manville's asbestos prior to the petition date but had not yet shown any sign of asbestos-related injury, were also channeled into the trust. Thus, under the plan, future claimants were treated identically as the claimants were by virtue of the injunction. On appeal, the court of appeals did not directly address whether future claimants had "claims" as defined in the Bankruptcy Code. However, the court affirmed that the future claimants were "parties in interest" entitled to participate in the case and to seek distributions from the trust.

The court of appeals also addressed whether Kane had standing to bring an appeal. The court held that Kane was sufficiently harmed by confirmation of the plan to challenge it on appeal, but that his appeal must be limited to only those contentions that assert a deprivation of his own rights, not the rights of third parties. The court also affirmed the special voting procedures set forth in the plan. Finally, the court upheld the plan as well as the concept of the injunction on the grounds that the plan was in the best interest of creditors and that the Bankruptcy Code was sufficiently flexible to accommodate the arrangement.

Important Principle

The *Johns-Manville* case demonstrates one successful way in which a plan may deal with both future and present asbestos claimants through the use of a trust. Although the Second Circuit's decision focused mainly on the issues of standing, whether the voting procedures were adequate, and whether the plan met various requirements of the Bankruptcy Code, the trust process devised in *Johns-Manville* was so successful that it led Congress to add § 524(g) to the Bankruptcy Code in 1994—a provision that relates to companies filing for bankruptcy because of asbestos liabilities, and the *Johns-Manville* case was used as a template. In addition, although the court of appeals in *Johns-Manville* did not decide the issue, the court touched on the issue of when a claim arises for the purposes of participation and disposition in a bankruptcy case. Various tests have been developed to determine when a claim arises for this purpose. These tests include Right to Payment (*In re Frenville Co.*, 744 F.2d 332 (3d Cir. 1984)); Fair Contemplation (*In re Crystal Oil Co.*, 158 F.3d 291 (5th Cir. 1998)); Underlying Act (*In re Chateaugay Corp.*, 944 F.2d 997 (2d Cir. 1991)); and Debtor-Creditor Relationship (*In re Johns-Manville Corp.*, 57 B.R. 680 (Bankr. S.D.N.Y. 1986)).

8. *Assocs. Commercial Corp. v. Rash*, 520 U.S. 953 (1997)

Elray Rash purchased a tractor truck for use in his freight-hauling business. To purchase the truck, Rash obtained a loan, secured by the truck as collateral. The seller of the truck assigned the loan to Associates Commercial Corporation (ACC). Rash and his wife (the debtors) filed for Chapter 13 bankruptcy. At the time of the filing, the balance owed to ACC on the loan was $41,171. The debtors sought to confirm a cram down plan, whereby ACC would be paid the present value of the collateral over the life of the plan. The dispute at issue in the case was how to value the truck for this purpose. ACC argued that "the proper valuation was the price [the debtors] would have to pay to purchase a like vehicle, an amount ACC's expert estimated to be $41,000." *Id.* at 957. The debtors argued that "the proper valuation was the net amount ACC would realize upon foreclosure and sale of the collateral, an amount their expert estimated to be $31,875." *Id.*

The bankruptcy court agreed with the debtors, and the Fifth Circuit affirmed the decision. On appeal, the U.S. Supreme Court reversed the ruling. Analyzing § 506(a) of the Bankruptcy Code—which provides that, in determining a creditor's secured status, the "value [of the collateral] shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property, …" the Court held that the debtors "elected to use the collateral to generate an income stream. That actual use, rather than a foreclosure sale that will not take place, is the proper guide under a prescription that hinged to the property's 'disposition or use.'" *Id.* at 963. The Court specifically left it to the bankruptcy courts, as the triers of fact, to identify "the best way of ascertaining replacement value on the basis of the evidence presented." *Id.* at 964 n.6.

Important Principle

When determining the value of retained collateral for the purposes of a Chapter 13 cram down plan, the relevant value is replacement value rather than the value that would be realized at foreclosure. While *Rash* is a Chapter 13 case, this principle, derived from the second sentence of § 506(a), has generally been applied to Chapter 11 cases.

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

Catapult Entertainment Inc. (the debtor), a creator of online video games, entered into two license agreements with Stephen Perlman whereby Perlman licensed certain patents to the debtors. Approximately two years after entering into the agreement, the debtor filed for Chapter 11 bankruptcy. Shortly before filing its bankruptcy petition, the debtor entered into a merger agreement with Mpath Interactive Inc. The agreement contemplated the filing of a bankruptcy petition followed by a "reverse triangular merger" involving the debtor, Mpath, and MPCAT Acquisition Corporation (a wholly owned subsidiary of Mpath that was created for the purpose of the merger). By the merger, MPCAT would merge into the debtor, leaving the debtor as the surviving entity, and the debtor would then become a wholly owned subsidiary of Mpath. As part of the merger, the debtor sought to assume (but not assign) the license agreements it had with Perlman, which provided that the licenses could not be assigned without Perlman's consent. Under federal patent law, the requirement to obtain Perlman's consent would be upheld.

The bankruptcy court approved the debtor's plan, including the assumption of the license agreements, over Perlman's objection, and the district court affirmed the decision. On appeal, the Ninth Circuit reversed the district court, holding that the language of § 365(c) prohibits a debtor from assuming a contract that is nonassignable under applicable nonbankruptcy law, even if the debtor has no intention of assigning the contract. The court noted that other courts had adopted an "actual test," which analyzed whether the debtor actually sought to assign the contract. The court rejected this test and adopted the "hypothetical test," which "bars a debtor in possession from *assuming* an executory contract without the nondebtor's consent where applicable law precludes *assignment* of the contract to a third party." *Id.* at 750. The court specifically refuted arguments made against the hypothetical test, including arguments that the interpretation of § 365(c)(1) conflicts with other provisions of the Bankruptcy Code or that the test is inconsistent with legislative history.

Important Principle

The *Catapult* case represents one side of a split among circuit courts that is sometimes referred to as the *Catapult* debate. The Ninth and Third Circuits (*In re W. Elecs. Inc.*, 852 F.2d 79 (3d Cir. 1988)) have adopted the hypothetical test, thus prohibiting debtors from assuming contracts that are nonassignable under applicable nonbankruptcy law. The Fifth Circuit (*In re Mirant Corp.*, 440 F.3d 238 (5th Cir. 2006)) and most likely courts within the Second Circuit (*In re Ontario Locomotive & Indus. Ry. Supplies Inc.* 126 B.R. 146 (W.D.N.Y. 1991)) have adopted the actual test. The test that a court applies has the potential to radically change the outcome of a bankruptcy case because it may determine whether a debtor whose business depends on its rights to continue using an intellectual property license can "afford" to file for Chapter 11 bankruptcy.

10. *Till v. SCS Credit Corp.*, 541 U.S. 465 (2004)

Lee and Amy Till (the debtors) purchased a used truck by obtaining a loan, secured by the truck, from Instant Auto Finance. The loan, which was assigned to SCS Credit Corp., had a finance charge of 21 percent per year for 136 weeks. Approximately one year after purchasing the truck, the debtors filed for Chapter 13 bankruptcy. At the time the bankruptcy was filed, the balance on the note to SCS was $4,894.89. The parties agreed that the truck was worth $4,000. The debtors sought to confirm a cram down plan whereby they would pay interest on the secured portion of SCS's claim at a rate of 9.5 percent per year. This rate was calculated under the "prime-plus" or "formula rate" method, which takes the prime rate and adjusts it upward based on such factors as the circumstances of the estate, the nature of the security, and the duration and feasibility of the reorganization plan. SCS argued that the rate should be 21 percent, calculated using the "presumptive contract rate" method, which uses the contract rate and makes adjustments as necessary under the circumstances of the case.

The bankruptcy court approved the interest rate as calculated using the formula rate method proposed by the debtors. The district court reversed the decision, holding that SCS's presumptive contract rate was correct. The Seventh Circuit reversed the district court, holding that the correct method to use was yet another method: the "coerced" or "forced loan" method, which analyzed the rate that the lender would charge a similarly situated borrower that had not filed for bankruptcy. This rate would be the presumptive rate, which then could be adjusted based on the evidence presented by either the debtor or the lender. A dissent that was filed in the Seventh Circuit case identified a fourth method: the "cost of funds" approach, which analyzes what it would cost the creditor to obtain the cash equivalent of the collateral from an alternative source.

On appeal, the U.S. Supreme Court reversed the Seventh Circuit, holding that the formula rate was the correct method to use in this case. The Court focused on the requirement under § 1325(a)(5)(B) that the payments equal the present value of the property to be distributed under the plan. The Court held that the other three methods improperly focused on the contract and/or on making the lender whole: "These considerations lead us to reject the coerced loan, presumptive contract rate, and cost of fund approaches. Each of these approaches is complicated, imposes significant evidentiary costs, and aims to make each individual creditor whole rather than to ensure the debtor's payments have the required present value." *Id.* at 477.

The Court did not dictate exactly how the proper rate should be calculated, but provided some guidance. "Together with the cram down provision, this requirement obligates the court to select a rate high enough to compensate the creditor for its risk but not so high as to doom the plan. If the court determines the likelihood of default is so high as to necessitate an 'eye-popping' interest rate … the plan probably should not be confirmed." *Id.* at 480–81. The Court also noted that its decision was based in part on the fact that there is no market for cram down loans in Chapter 13 cases and contrasted the situation at hand with Chapter 11 cases, where there is a market for debtor-in-possession loans. *See id.* at 476 n.14. The Court therefore suggested that, "when picking a cram down rate in a Chapter 11 case, it might make sense to ask what rate an efficient market would produce." *Id.*

Important Principle

The cram down interest rate in Chapter 13 cases will be determined using the formula rate approach. The Supreme Court specifically rejected approaches that considered the contract rate and what interest rate the market would provide to a similarly situated borrower. As to whether the logic will be applied in a Chapter 11 bankruptcy case, the Court indicated that the debtor in possession financing market available in Chapter 11 bankruptcies (and not available in Chapter 13 cases) may make it appropriate to consider the market rate for a loan similar to the one sought by the debtor via a cram down plan. The majority viewpoint appears to be that the logic of the *Till* case is applicable in Chapter 11 bankruptcies. *See, e.g., In re Prussia Assocs.*, 322 B.R. 572, 587 (Bankr. E.D. Pa. 2005) (noting that *Till* is not controlling in a Chapter 11 case, but it is "instructive"); *see also In re Mirant Corp.,* 334 B.R. 800, 821 (Bankr. N.D. Tex. 2005) (noting in a Chapter 11 case that "*Till* is clearly relevant to a determination of value …").

Honorable Mentions

- ***Dean v. Davis,* 242 U.S. 438 (1917):** The decision in this case held that a preferential transfer of a mortgage can also meet the elements of a fraudulent transfer.
- ***Moore v. Bay,* 284 U.S. 4 (1931):** The ruling held that a transfer that is avoidable by some actual unsecured creditors is avoidable for the benefit of all unsecured creditors. This case was a predecessor to 11 U.S.C. § 544(b).
- ***Mullane v. Cent. Hanover Bank & Trust,* 339 U.S. 306 (1950):** The Court established the constitutional requirements of notice.
- ***Segal v. Rochelle,* 382 U.S. 375 (1966):** This decision provided the basis for a broad interpretation of property of the estate, including contingent property rights.
- ***Nat'l Labor Relations Bd. v. Bildisco & Bildisco,* 465 U.S. 513 (1984):** This case dealt with the rejection of collective bargaining agreements and prompted Congress to enact 11 U.S.C. § 1113.
- ***Commodity Futures Trading Comm'n v. Weintraub,* 471 U.S. 343 (1985):** According to the ruling, a Chapter 7 trustee can waive the debtor's attorney/client privilege. Although the case involved a Chapter 7 trustee, the broad language used by the Court—and the citation to § 1106(a)(1)—indicates that the ruling likely would apply to a Chapter 11 trustee.
- ***Dondi Props. Corp. v. Commerce Sav. & Loan Ass'n,* 122 F.R.D. 284 (N.D. Tex. 1988):** The ruling adopted professionalism and courtesy standards of practice for attorneys.
- ***Levitt v. DePrizio Constr. Co.,* 874 F.2d 1186 (7th Cir. 1989):** According to the ruling, noninsiders can be held liable for a preferential transfer if the transfer benefited an insider—a doctrine that Congress overruled in § 550(c) in 1994 and more clearly in § 547(i) in 2005.
- ***BFP v. Resolution Trust Corp.,* 511 U.S. 531 (1994):** The Supreme Court held that property sold at a foreclosure that was conducted in accordance with state law is not subject to fraudulent transfer attack for lack of reasonably equivalent value. *See also Rubin v. Manufacturers Hanover Trust Co.*, 661 F.2d 979 (2d Cir. 1981) (discussing the issue of fraudulent transfer liability and reasonably equivalent value in the context of a leveraged buyout). **TFL**

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