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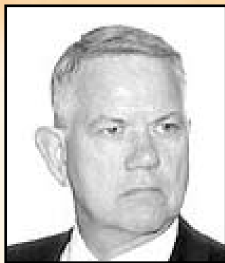
In this issue:



AIRA Celebrates Its Silver Anniversary

Ted Phelps, CIRA/CDBV
Phelps Consulting Group

When milestones are passed, it is in our nature to pause for a moment to review our progress before continuing our journey. AIRA is celebrating its 25th year as the preeminent organization serving the needs of business turnaround, restructuring and bankruptcy practitioners. Its membership comprises accountants, financial advisors, attorneys, workout consultants, trustees and others involved in insolvency and bankruptcy matters. While today's economic climate underscores the importance of our organization, it is important to remember that AIRA has made significant contributions to the practice during the quieter years as well.

This article looks at the history of AIRA primarily as a timeline taken for the most part from the minutes of the Board of Directors meetings held during (and before—more about that later) the 25 year history of the organization, as well as interviews with a few of the early pioneers.

Looking back 25 years from 2009, it is easy to conclude that AIRA began in 1984. Easy, but not exactly right. To get to the real genesis of the organization, you have to look back an additional five years, to mid 1979. In the words of David Mork:

"In mid 1979, I hosted 11 practitioners at the Minneapolis Athletic Club to begin an association of practitioners interested in knowing more about working as accountants in insolvencies under the newly passed legislation, the 1978 Bankruptcy Reform Act." This group became known as the National Association of Accountants in Insolvency, or NAAI. In the earliest set of Board minutes available, September of 1982, the Board set out ambitious goals, including establishment of a national membership of 1,500, development of courses meeting CPE and CLE requirements, an active lobbyist in Washington, and a national reference library of bankruptcy cases and other materials available to the membership. NAAI issued a press release in November of 1982 announcing its formation. See Exhibit 1.

The group met regularly through 1984 and while they had members from around the country and from some of the largest firms, it still was not making it as a national organization. There was a feeling among some of the members that being located in Minneapolis might be keeping them from achieving a national status.

On August 27, 1984, the president of NAAI sent out a notice of a "Summit Meeting" to be held in the Chicago offices of Seidman and Seidman, hosted by Alexander Knopfler. The notice reads in part:

> "If you are prepared to assume one of the roles of leadership and can possibly make this Chicago meeting on August 27, you are urged to do so. It will be a "***turning point***" in the development ***(or abandonment)*** of a meaningful and effective national association of accountants who see the opportunities to serve in this expanding field" (emphasis added).

The August 27th meeting was pivotal and a reading of the agenda and the minutes of that meeting indicate that much was accomplished. In attendance at that meeting were:

Jules I. Bagdan
Oppenheim, Appel, Dixon & Co.-Miami

Homer A. Bonhiver
Sole Practitioner-Minneapolis

David A. Borghesi
Arthur Andersen & Co.-Chicago

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In This Issue

AIRA Journal is published six times a year by the Association of Insolvency and Restructuring Advisors, 221 Stewart Avenue, Suite 207, Medford, OR 97501.

AIRA extends special thanks to these **AIRA Journal** contributors:

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Letter from the President

Grant T. Stein
Alston & Bird LLP

I have just reviewed the schedule for the upcoming AIRA Annual Seminar to be held in Orlando in early June. I was truly impressed by the quality and depth of the programs reflected in the subjects to be presented, and the speakers. The dual program track with the Small Business – Middle Market focus provides an excellent alternative to the large business programs; but whichever way you choose to go, the program and speaker combinations are excellent. The small business track includes programs on Accounting and Reporting, Forensics, Reorganization without New Financing, and Ethics. The standard programs include discussions of Wall Street Developments, the Bailout, TARP, the Automotive Industry, Cross-Border Insolvency Issues, Real Estate Restructuring in the New Political Environment, and Substantive Consolidation. The point is that it is not the "same old thing" by any measure.

The hard part for many will be finding the time to attend the AIRA's Annual Bankruptcy and Restructuring Conference in 2009. The level of activity in the restructuring and insolvency world is unmatched in many ways. In that regard, one of the parallels worth reviewing is the circumstances that existed in the 1930's. One perspective was brought to my attention while doing some research on Supreme Court Justice William O. Douglas in connection with my review of one of the decisions he wrote in 1941, early in his tenure on the Supreme Court. To focus on the why Justice Douglas would have been selected to write the opinion in the seminal bankruptcy case of *Consolidated Rock Products Co. v. Du Bois*, 312 U.S. 510 (1941), it is worth studying Justice Douglas' background as a lawyer and his regulatory career with the Securities and Exchange Commission. To do this, the SEC Historical Organization website is one of the best resources I have found on the internet, and it is worth reviewing. http://www.sechistorical.org/museum/galleries/douglas/index.php. In addition to the description of events at that time, links to original documents are provided for the reader. The links to actual documents provide the ability to drill down and see the evolution of the reforms pursued by Justice Douglas with the SEC as well as his background in the insolvency and bankruptcy arena. An excerpt is reprinted because, unfortunately, it has obvious parallels to the current economic situation.

> *The two previous SEC Chairmen, Joseph P. Kennedy and James L. Landis, had constructed the initial design of the administrative agency with an acute understanding of the pitfalls in making and administering regulatory policy.(1) During Kennedy's tenure, the SEC had consolidated the New Deal legislative victory of the securities act. During Landis's Chairmanship, the administrative machinery was established which the SEC would use to implement the mandate of the 1934 and 1935 Acts. Yet, despite the agency's growth from 1934 to 1939, the SEC remained a work in progress. Douglas's tenure as SEC Chairman would be to use the machinery his predecessors had created to make permanent its institutional authority over the nation's stock markets.*
>
> *The SEC continued its business as the national economy began a downturn in early 1937, but it faced an uncertain future. By October 19, 1937, when the bottom once again fell out of the stock market, the national economy was in full-blown recession. Millions of Americans lost their jobs and thousands of businesses went bankrupt. Opponents of the New Deal, especially the Wall Street old-guard led by Richard Whitney, blamed the SEC for the recession, arguing that its policies restricted the free flow of capital into the markets undermining the economy. Douglas became the voice of regulation on the Commission, giving numerous speeches denying that SEC regulation of the markets had hurt the economy. Despite heavy opposition to continued SEC involvement in regulating the national economy, Douglas continued to advise President Roosevelt on action the government should take to reform the economy.*
>
> *Douglas's SEC moment came when the rest of the New Deal was in fast retreat. Stock prices had fallen by 30% in the two months preceding his election as Chairman. More than six million Americans lost their jobs. Charles Gay, the president of the NYSE, commented on Douglas's appointment, stating it "gratifying" and commended Douglas for "his experience and intimate knowledge of the problems that confront the securities markets," but blamed the SEC for amateurish regulation and interference with the process and flow of capital.(2)*
>
> *Stung by the recession, President Roosevelt suggested a relaxation of margin requirements and the nomination of John W. Hanes, a member of the NYSE, to the SEC. Douglas acceded to Roosevelt's suggestion to appoint a business insider, but got his friend Jerome Frank nominated to the Commission as a counterweight to Hanes.(3) When study of the stock exchanges which had been ordered during Joseph Kennedy's tenure as Chairman was finally published in 1937, Douglas used the opportunity to push for major reforms. The receipt of the Kennedy Stock Exchange investigation report prompted Douglas to prepare for a battle to reform the country's stock exchanges by regulating the activities of the exchanges in the interest of the investing public.*
>
> *Despite the economic downturn, an October 1937 Gallup Poll reported that 62% of all investors and 69% of all voters thought that "Government regulation of the stock exchanges has helped investors."(4) Aware of the value of public support for the role of the SEC in the national economy, Douglas gave numerous public speeches advocating the position of the SEC. He criticized the NYSE for its clubby atmosphere and lack of*

control over insider trading. Putting his SEC experience as a staff member, Commissioner and now as Chairman, into action, Douglas advocated that the Exchange regulate itself, but insisted that it must do so by segregating broker/dealer functions and by establishing strong new reforms for its members.

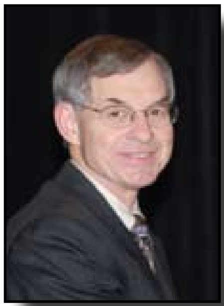
What are the answers to the crisis that faces us at this time? Is it simply a crisis of confidence, or something deeper. Are the New Deal policies re-proposed by the stimulus package going to work, and to what extent, and what else is necessary to restore confidence in our economic system? Will it take a classic maverick with the audacity and intelligence of a William Douglas to accomplish true change, and is that even possible with the atmosphere that has existed for years in Washington that often focuses on a person's human weaknesses and mistakes and not his potential to effectuate positive change. Of course, is it really any different than it ever has been, or are we all just intimately aware of it as a consequence of nearly instantaneous communication?

I look forward to seeing as many of you as possible in June in Orlando.

Grant T. Stein

Grant Stein is a partner in Alston & Bird's Bankruptcy, Reorganization and Workouts Group. His diverse practice includes the representation of debtors, secured and unsecured creditors, creditors' committees, and fiduciaries in complex and difficult out-of-court workouts, debt restructurings, bankruptcy cases, and financial transactions throughout the United States and internationally. He also regularly represents officers, directors, and other parties in bankruptcy litigation of all kinds. His restructuring experience includes manufacturing, real estate, wholesale, retail, distribution companies, health care, communications, technology and intellectual property issues.

Mr. Stein is a Fellow of the American College of Bankruptcy and is identified as a top practitioner in Chambers USA: America's Leading Lawyers for Business, The Best Lawyers in America and Super Lawyers magazine. He serves as a director and president-elect of the Association of Insolvency and Restructuring Advisors (AIRA). He also is a director and president-elect for the Southeastern Bankruptcy Law Institute. He recently served as a Member of the executive committee of Emory University's Board of Visitors. He has written numerous articles on bankruptcy and workout issues and regularly lectures around the country. Mr. Stein served as law clerk to The Honorable W. Homer Drake, the senior judge of the United States Bankruptcy Court for the Northern District of Georgia, following his graduation, with honors, from the University of Georgia School of Law in 1981. He received his B.B.A., with high honors, from Emory University in 1978.



Executive Director's Column

Grant W. Newton, CIRA
AIRA

25th Anniversary—A Critical Conference in the Midst of Adversity

I want to encourage you to attend the 25th annual conference and celebration even though you may have increased work loads and time constraints during this challenging time. The benefits of attending the AIRA Annual Conference are more important than ever: acquire vital knowledge on major current issues; interact with and directly question expert speakers and participants; establish and renew valuable contacts; fulfill CPE and CLE requirements; enjoy a needed break at the opulent Ritz Carlton Grande Lakes or stress-relieving excitement at Orlando's world famous resorts.

Empty Creditors—Are They Contributing to the Crisis?

Generally it is assumed that investors as well as creditors will seek to protect their economic interests through measures to increase returns to entities in which they are invested. If a debtor is unable to make future bond interest payments it would be anticipated that bondholders would prefer out of court restructuring where all or part of their debt would be exchanged for equity rather than forcing the debtor to file chapter 11 and in effect undermining turnaround and cash-loss mitigation efforts. However, in certain recent troubled debt situations defensive strategies by creditors have resulted in actions that run contrary to patterns in the past. Such actions can result in unintended consequences.

A significant example of these consequences occurs where there are "empty creditors,"[1] defined in a recent Wall Street Journal article[2] as creditors that have a right to enforce the agreement between holders and issuers of contractual control but, due to holding credit default swaps, have little or no economic exposure if the debt goes bad. If enough credit default swaps are held bondholders have an incentive to force the debtor into chapter 11 because they will receive a larger return than would be the case in an out of court exchange. A growing number of cases have been identified where empty creditors may have forced chapter 11 filings or other measures which caused debtors to follow a course of action not traditionally expected to be in the best interest of creditors.

One example was described in an April 2009 Washington Post article on the difficulties of amusement park operator Six Flags.[3] Management was determined to turn the company around and avoid a chapter 11 filing, announcing an offer to swap approximately $600 million in debt for around 60 percent of the company's stock, and stating it might resort to chapter 11 if bondholders refused the offer and demanded interest payments. However, bondholders were not necessarily eager to cooperate with management's efforts, notably a Fidelity Investments fund owning more than $100 million in bonds due in 2010. It could have been because Fidelity believed the company might be able to make interest payments, but it is more likely that it felt well insured by the credit default swap potential in chapter 11 as opposed to settlement out of court.

Two other examples were reported in the Financial Times in April 2009, where the empty creditor paradox seemed to be a causative factor in General Growth Properties and paper company Abitibi-Bowater ending up in chapter 11.[4] Although not a bankruptcy case, similar forces were in play when AIG's condition was exacerbated by being forced to pay $7 billion of government loan money to satisfy its obligations to Goldman Sachs. Goldman had ironically reported its exposure to AIG as immaterial, apparently because it felt it had adequately hedged its risk through contracts, credit default swaps and other derivatives.

Of course it is not unusual for various creditors in the same class to have different positions and objectives. This frequently occurs for example in situations where creditors sell their claims and may have a different objective in both amount and nature of recovery than creditors that are the original holders of the debt. However, in chapter 11 proceedings information about the exchange is generally known. Thus, there exists an issue that needs to be addressed with respect to empty creditors: should there be disclosure of the existence and nature of credit derivatives that may result in reduced creditor cooperation when debtors fall on hard times? One possible solution is a real-time information clearinghouse as suggested by Hu and others,[5] where entity specific information about credit derivatives would be disclosed and market participants, including the federal government, would have timely access to critical information about this category of risk.

Comments on the empty creditor issue are invited and will be published in future issues of the *AIRA Journal*.

See you in Orlando. Best regards,

Grant

1 The empty creditor concept is related to research developed by Professors Hu and Black on empty voting, as reported in Hu, Henry T.C. and Black, Bernard S., "Empty Voting and Hidden (Morphable) Ownership: Taxonomy, Implications, and Reforms," *Business Lawyer,* Vol. 61, pp. 1011-1070, 2006. Available at SSRN: http://ssrn.com/abstract=887183.

2 Hu, Henry T.C., "'Empty Creditors' and the Crisis," *The Wall Street Journal*, April 9, 2009. Available at SSRN: http://online.wsj.com/article/SB123933166470307811.html.

3 Rosenfeld, Michael S, "Plagued by Debt Six Flags Faces Its Own Wild Ride: Company Hopes Signs of Turnaround Help It Strike Deals with Bondholders," *The Washington Post*, April 13, 2009. Available at http://www.washingtonpost.com/wp-dyn/content/article/2009/04/12/AR2009041202152.html.

4 Henry Sender, "CDS blamed for role in bankruptcy filings," *Financial Times*, April 17, 2009 00:57.

5 Hu, *supra* note 2.

AIRA Scholar in Residence

Professor Jack F. Williams, CIRA, CDBV
Georgia State University

BANKRUPTCY RETAKES

Section 503(b)(9) Claims

Prior to BAPCPA, Title 11 of the United States Code (the "Bankruptcy Code") provided some level of protection to sellers of goods who delivered those goods to the debtor in the days preceding the filing of the debtor's petition by incorporating state law reclamation rights, as provided by the UCC, into the Bankruptcy Code in the form of Section 546(c). However, the amendments made by BAPCPA via amended Section 546(c) and the inclusion of Section 503(b)(9) dramatically change these rights.

An example may be in order. In *In re Georgetown Steel Company, LLC*,[1] the seller of goods was disputing the status of its reclamation claim regarding twelve supersacks of silicomanganes ("SMI"). There, the court determined that reclamation was a state law right, and thus, to prevail, the seller must prove up not only the timely written notice requirement contained in Section 546(c), but also the elements of the state law right: (1) that the goods sold to the debtor on credit were of a type within the ordinary course of business of both parties; (2) that the debtor was insolvent pursuant to the bankruptcy code at the time of delivery of the goods; and (3) that the goods were still in the possession of the goods or that the goods were not in the hands of a good faith purchaser at the time the demand for reclamation was received.[2] In that case, the seller was unable to prove that the debtor had possession of the goods or that they were not in the hands of a good faith purchaser, thus the seller could not prevail.[3] The replacement of the words "any statutory or common law" with the word "the" in Section 546(c)(1) appears to change the outcome of this case by rendering the possession requirement moot.

What if the seller in *Georgetown Steel* had prevailed? Old Section 546(c)(2) gave the court the ability to deny reclamation (i.e. not require the debtor to return the goods) where the elements of reclamation were shown if the court granted the seller either a lien in property to secure its claim or granted a priority claim for the value of the goods. The elimination of old Section 546(c)(2) in its entirety seems to divest the court of any option: If the seller shows that the goods were sold within 45 days of the commencement of the case to an insolvent debtor, and that a written demand was timely made, the seller appears to have an absolute right to reclaim the goods. How this will work with the definition of Property of the Estate as described by Section 541 of the Bankruptcy Code and the Automatic Stay provided by Section 362 is yet to be seen. The first instances of litigation may well come when the debtor seeks to sell the goods as part of a larger parcel of goods free and clear of liens and interests pursuant to Section 363.

1 318 B.R. 336 (Bankr.S.C. 2004).
2 *Id.*. at 339.
3 *Id*. At 340.

The reality is that in most cases, asset based financing provides a prior perfected lien on most goods such that the right of reclamation is rendered moot. Further, where a lien does not act to moot the reclamation rights, many vendors fail to provide the timely written notice.[4] So why all the concern about goods sold in the days immediately before the filing? The fact that the right to reclaim, and thus potentially put a serious dent in the debtor's ability to operate, is one answer. Another answer is found in New Section 546(c)(2) which refers to Section 503(b)(9) which grants administrative expense status for the:

> the value of any goods received by the debtor within 20 days before the date of commencement of a case under this title in which the goods have been sold to the debtor in the ordinary course of such debtor's business.[5]

This provision, in essence, appears to deem all vendors delivering goods within 20 days of the petition date "critical." Thus, as a result of this provision, it will become increasingly critical that the debtor not order any goods for product lines or stores that will be shutdown at. or immediately after, the filing of the petition which will require additional planning on the part of the debtor and its advisors to avoid unnecessary administrative expenses.

The series of decisions in *In re Plastech Engineered Products, Inc., et al.* provides a wealth of information on how at least one court views the application of section 503(b)(9). The first decision, "*Plastech I*",[6] begins by summarizing the previous decisions on this provision stating that both *In re Global Home Products, LLC*,[7] and *In re Bookbinder's Restaurant, Inc.*,[8] the courts determined that the allowance of a claim under 503(b)(9) does not give an unqualified right to immediate payment. Further, other than as of the effective date of the chapter 11 plan, payment of administrative expenses is left to the discretion of the court. In determining when the payment should be made, the court in *Global Home* determined that it should consider three factors:

1. The prejudice to the debtor of making the payment;

2. The hardship on the administrative expense holder of not making the payment; and

3. The potential detriment to other parties in the case (i.e. how would the cash drain impact the ongoing operations of the debtor).[9]

4 Query, however, whether the increased time to provide that notice, and the absence of the requirement that the seller show that the goods are in the possession of either the debtor or an entity that is not a good faith purchaser, taken with the absolute right to reclaim, will increase the instances of reclamation demands.
5 11 U.S.C. §503(b)(9).
6 394 B.R. 147 (Bankr.E.D. Mich. 2006) decided on September 16, 2008.
7 2006 WL 3791955 (Bankr.D.Del. Dec. 21., 2006)
8 2006 WL 3858020 (Bankr.E.D.Pa. Dec. 28, 2006)
9 *Global Home*, 2006 WL 3791955 at *4.

There, the court denied the motion seeking immediate payment. It would seem that filing a motion seeking such a payment may be a way to cause the court to: (a) direct the payment; (b) direct the debtor to determine if the case is administratively solvent; and/or (c) convert the case to chapter 7.

The court in *Plastech I* then addressed the question at hand, which was the interplay of section 501 which governs the filing of claims; section 502 which governs the allowance of claims; and section 503 administrative expenses. Specifically, the question was whether section 502(d) of the Bankruptcy Code which provides for the disallowance of a claim filed under section 501 of the Bankruptcy Code due to the failure to repay an allegedly preferential transfer under section 547 of the Bankruptcy Code apply to section 503(b)(9) administrative expenses. Noting that no other court had ruled on the matter, the court reviewed decisions on the question of whether section 502(d) applies to section 503(b) in general and noted a split in the circuits. The court found that section 502(d) did not apply to section 503(b)(9) for a variety of reasons, most importantly:

4. The court agreed with the line of cases finding that section 502(d) was not applicable to section 503, rather 502(d) only applied to claims filed under section 501 and allowed under section 502;

5. Requests for administrative expenses, including 503(b)(9) are not filed under section 501 but rather under section 503(a); and

6. Determining that 502(d) did apply to section 503(b)(9) violates statutory rules of construction.[10]

The second decision in the *In re Plastech Engineered Products, Inc., et al.* ("*Plastech II*") case involving section 503(b)(9) is an unpublished decision dated October 7, 2008.[11] This decision determined the question of whether the goods in question had to be received by the debtor, or simply the value of the goods. The court stated: "In the Court's view, the word *received* modifies the word *goods* and not the *value* that must be received by the debtor to trigger § 503(b)(9)."[12] Thus, the goods in question must actually be received by the debtors to give rise to the claim under section 503(b)(9). This line of reasoning is cited heavily in *In re Goodys' Family Clothing, Inc.*[13]

The third decision in this case is dated December 10, 2008 ("*Plastech III*")[14] This decision provided several important points. First, the UCC definition of goods applies to section 503(b)(9) such that there is no claim for services provided.[15] The court cited favorably to *In re Samaritan Alliance,*[16] which provided that electricity is more in the form of a service and does not give rise to a 503(b)(9) expense and *In re Deer*[17] which also consulted the UCC to determine the definition of goods when determining if advertising was a good or a service.[18]

Second, *Plastech III* states that the predominate purpose test used in some instances to determine if a contract was for goods or services is not applicable to section 503(b)(9). Where an entity provides both goods and services, it is entitled to section 503(b)(9) treatment for the goods provided, but not the services in a bifurcated manner, unlike the "winner take all" result of the predominate purpose test.[19]

Finally, *Plastech* III states that the goods need not be reclaimable (i.e. identifiable, still in the hands of the debtor, in their original state, and not subject to a superior lien) to give rise to section 503(b)(9) treatment. The court states: "…there is nothing in § 503(b)(9) that requires a claimant to be also be entitled to a reclamation right under § 546. Section 546 does not limit or control in any way the rights that a claimant has under § 503(b)(9)"[20]

The decision of *In re Brown & Cole Stores, LLC*[21] filed on August 17, 2007 addressed a different set of questions. Specifically, whether the creditor needed to be unsecured to be entitled to section 503(b)(9) treatment and whether the 503(b)(9) expense's prepetition nature possessed the requisite mutuality for setoff purposes with regard to alleged prepetition breach of contract claim against the holder of the section 503(b)(9) expense. There, the court determined that the provision of goods on a wholly secured basis can give rise to a section 503(b)(9) expense. In answer to the debtors contention that this was unfair to other creditors, the court stated: "…if AGI's twenty-day sales claim is fully secured, then payment of it by B&C will free the value of the security for that claim for the benefit of other creditors. If AGI's claim proves to be undersecured or unsecured, then to deny administrative priority would be to ignore the statute, something we cannot do." [22] The court then noted that there was mutuality under the test set forth in *Biggs v. Stovin (In re Luz Int'l, Ltd.)*[23] which states:

7. The debtor owes the creditor a prepetition debt;

8. the creditor owes the debtor a prepetition debt;

9. the debts are mutual.[24]

Since both the potential breach of contract claim and the sale giving rise to the 503(b)(9) expense were prepetition, setoff was available.[25] The court went on to note, however, that the issue was premature because the debtor simply alleged a breach of contract claim and had not filed a contested matter or an adversary proceeding to determine those rights. Until the right to payment from the creditor was established, there was nothing to setoff against.[26]

10 *Plastech I*, 394 B.R. at 161-64.
11 2008 WL 5223014.
12 *Id.* At *2.
13 2009 WL 294384 (Bankr. D. Del. 2009)
14 397 B.R. 828 (Bankr. E.D. Mich. 2008)
15 *Id.* at 835-6.
16 2008 WL 2520107 (Bankr. E.D. Ky. June 20, 2008)
17 No. 06-02460, slip op. at 2 (Bankr. S.D. Miss. June 14, 2007)
18 See Also *In re Goodys' Family Clothing, Inc.*, 2009 WL 294384 (Bankr. D. Del. Feb. 6, 2009)
19 *Plastech III*, 397 B.R. at 837.
20 397 B.R. at 838.
21 375 B.R. 873 (9th Cir. BAP 2007).
22 375 B.R. at 878.
23 219 B.R. 837 (9th Cir. BAP 1998).
24 219 B.R. at 843-44.
25 375 B.R. at 879-80.
26 375 B.R. at 880-881.

Taxation Cases

Forrest Lewis
Plante & Moran PLLC

NEW LAW ALLOWS 5 YEAR DEFERRAL OF COD INCOME FROM REACQUIRING DEBT

The American Recovery and Reinvestment Tax Act of 2009 added Internal Revenue Code subsection 108(i) which provides for a deferral of cancellation of debt ((COD) income resulting from reacquisition of certain of the taxpayer's own debt instruments. The new provision is turning out to be rather broad and user-friendly in its scope. Besides reacquisition of publicly traded bonds, it appears to apply to write offs and compromises of garden variety privately issued notes in a business setting.

Under the new law and at the election of the taxpayer, income from the discharge of indebtedness in connection with the "reacquisition" after December 31, 2008, and before January 1, 2011, of an applicable debt instrument is includible in gross income ratably over the five-tax-year period beginning with:

- The fifth tax year following the tax year in which the reacquisition occurs for a reacquisition occurring in 2009; and

- The fourth tax year following the tax year in which the reacquisition occurs for a reacquisition occurring in 2010

Applicable debt instrument. An applicable debt instrument is any debt instrument issued by: (i) a C corporation, a partnership or an individual in connection with the conduct of a trade or business by that person. A debt instrument for these purposes is broadly defined to include bonds, debentures, notes, certificates, or any other instrument or contractual arrangement constituting indebtedness within the meaning of Code Sec. 1275(a)(1). [While the definition includes privately issued debt instruments in the course of a trade or business, it presumably does not include debts not evidenced by some sort of written note or document, i.e. open account indebtedness does not qualify.—FL]

Reacquisition. Reacquisition for these purposes includes" any acquisition" of an applicable debt instrument by (i) the debtor who is the issuer or a related person. Acquisition for these purposes includes an acquisition of an applicable debt instrument for cash, the exchange of the debt instrument for another debt instrument (including a deemed exchange resulting from a modification of the debt instrument), the exchange of the debt instrument for corporate stock or a partnership interest, the contribution of the debt instrument to capital, and the complete forgiveness of the indebtedness by the holder of the debt instrument. The exchanges resulting from the modification of the debt are extremely common now as many mortgage and loan workouts involve reductions in interest, principal or payment period which constitute the issuance of a new loan for tax purposes. So, a debtor reworking an existing loan with a creditor can defer any deemed cancellation of debt income resulting from concessions on principal or interest, etc. [Presumably a simple compromise of the original principal and pay off of that balance qualifies for the deferral—FL]

Coordination with other exclusions. If a taxpayer elects to defer discharge of indebtedness income, the other exclusions for discharge in Section 108 <u>do not apply</u>: a case under Title 11(bankruptcy), when the taxpayer is insolvent, qualified farm indebtedness, and qualified real property business indebtedness. Those exclusions do not apply to the income from the discharge of indebtedness for the tax year of the election or any subsequent tax year. For example, an insolvent taxpayer may elect to defer income from the discharge of indebtedness rather than excluding the income and reducing tax attributes by a corresponding amount.

Acceleration of deferred items. In the case of the liquidation or sale of substantially all the assets of the taxpayer (including in a title 11 bankruptcy or similar case), the cessation of business by the taxpayer, the death of the taxpayer or similar circumstances, any item of income or deduction which is deferred (and has not previously been taken into account) must be taken into account in the tax year in which the acceleration event occurs.

Conclusion: While the new law does not forgive the tax on the COD income, but merely defers the tax, it gives the adviser another tool to work with. The first consideration will remain whether another Section 108 exclusion is available and what are the consequences of that exclusion considering any required favorable tax attribute reduction. Then, the adviser will want to look at this deferral election. In cases where no other Section 108 exclusion is available, this may be the only possible tax break.

ARRA PROVIDES MORE RELIEF FOR CREDIT CRISIS

The American Recovery and Reinvestment Act of 2009 (P.L. 111-5) enacted into law on February 17, 2009 contained several provisions to help unfreeze credit markets plus administrative provisions on previous "bailout bills" passed by Congress.

- See the accompanying article discussing the new rules on deferral for five years of taxable income from cancellation of debt for businesses.

- In order to create more demand for tax exempt interest bonds, issued primarily by state and local governments, a temporary exception is added to the rule prohibiting financial institutions from deducting tax-exempt interest expenses. The exception applies with respect to tax-exempt bonds issued during 2009 and 2010 to the extent that these investments constitute less than two percent of the average adjusted bases of all the assets of the financial institution.

- The anti-junk bond rules enacted in the 1980s are temporarily suspended for certain instruments. Because "junk bonds" often provided for deferral of interest or balloon interest payments and were risky, the Congress enacted rules deferring the interest deduction for unpaid interest expense by issuers until the interest was paid. Those rules were called the Applicable High Yield Discount Obligation (AHYDO) rules. Now, on certain of those instruments accrued, unpaid interest may be deducted currently. This applies to any AHYDO issued, during the period beginning on September 1, 2008, and ending on December 31, 2009, in exchange for an obligation that is not an AHYDO, so long as the issuer (or obligor) of both the AHYDO and the non-AHYDO are the same.

- As you will recall, the IRS had issued a liberalization of the anti-loss trafficking rules under Sec. 382 for banks in Notice 2008-83. The Notice waived the normal requirement for a acquirer to determine whether there were built-in losses in the company acquired, in this case in a bank's loan loss reserve. If so, there are limits on the deductibility of the built-in losses. Despite the fact that the IRS ruling was similar to actions Congress was taking to shore up financial institutions, certain Congressmen were offended that they were not consulted in advance. That led to feuding between the IRS and some Congressmen. Not surprisingly the Congress had the last word and ARRA repeals the effect of Notice 2008-83 as of January 16, 2009.

- Obviously the executive compensation limits, or lack thereof, for companies receiving the various bailout programs such as Capital Purchase Program and Troubled Asset Relief Program have generated the greatest public interest of all these provisions. Because that area is evolving so fast and being played out on the front page of newspapers, I won't go into that difficult topic here.

WHEN DO CORPORATE INCOME TAXES ACCRUE?

The first decision to make in classifying claims relating to taxes is whether they are prepetition or postpetition claims. For the year in which a corporation files a petition in bankruptcy, whether a claim is pre- or post- has many implications, the most prominent being whether the tax is a second priority administrative claim or an eighth priority tax claim. There are basically two theories on this. The Internal Revenue Service and some courts take the position that income taxes accrue on the last day of the corporation's tax year. At least three federal circuits have disagreed with that saying that taxable income can be apportioned to a prepetition portion of the year and a postpetition portion.

In the view of the Internal Revenue Service, stated in Chief Counsel Advice 200235024, the legislative history of the Bankruptcy Reform Act of 1978 indicates that under Bankruptcy Code Section 507, the taxable income of a corporate year cannot be divided into a pre- and post- period. The tax liability accrues on the last day of the corporation's taxable year. This position is upheld by the Ninth Circuit in Towers v. United States (In re Pacific-Atlantic Trading Co.), 64 F.3d 1292, 1299-1300 (9th Cir. 1995). Thus, if a corporation files a bankruptcy petition during its taxable year, the entire liability accrues on the last day of the tax year and is a postpetition liability. In this view it would be treated as a second priority administrative expense.

Courts in three circuits have held that a corporation's income tax can be divided into a pre- and post- portions. In our example of a corporation that files a petition during its tax year, the tax liability attributable to the prepetition period becomes an eighth priority tax claim and the postpetition portion becomes a second priority administrative claim. The cases referred to are (In re L.J. O'Neill Shoe Co.), 64 F.3d 1146, 1150 (8th Cir.1995), In re O.P.M. Leasing Servs. Inc. (68 B.R. 979; 1987 Bankr. LEXIS 48), In re Hillsborough Holdings Corporation, Debtors. (CA-11).

Without going into all the legal nuances, the differences arise from the interpretation of the phrase "[taxes] not assessed before, but assessable after" in Bankruptcy Code section 507(a)(7) refers only to taxes incurred prepetition. In the IRS view, the phrase applies to taxes which were incurred prepetition and are assessed in the normal course of affairs at the corporation's normal year end, i.e. falling after the petition date. In the second theory, Sec. 507 is talking exclusively about prepetition events which are still liable to be assessed after the petition date. Thus, they split the corporation's tax year into pre- and post-.

So far we have been focusing solely on income taxes, but the same issue has been litigated with regard to federal payroll taxes, i.e. FICA, FUTA and withholding which are normally filed on a quarterly basis. In a 1997 case (In re Bellus, 125 F.3d 821), the court referred to some of the income tax cases and concluded that payroll taxes should be split into pre- and post-. However, they did note that the liability for payroll taxes arise as the wages are paid, making for a cleaner determination of what amounts fall into each period. An interesting aspect of the case which is not fully explained is what happened to the post-petition payroll taxes. Bellus was an individual and debtor in possession of the business. While she did not succeed in escaping all responsibility for the payroll taxes in the quarter in which she filed, the case does not say who, if anyone paid the post-petition portion of the taxes, whether it was the "bankruptcy estate", the trustee or if the whole thing arose after the estate was disbursed and the taxes went upaid.

Conclusion: whether corporate income taxes can be split into pre- and post- or not is still somewhat an open question. The IRS position right now is that corporate income taxes from the straddle year are a postpetition liability and treated solely as an administrative expense claim. Several courts do not follow that position as to income taxes. For other types of taxes such as payroll taxes, treatment as pre- and post- may be more widely accepted.

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Bankruptcy Cases

Baxter Dunaway

Eleventh Circuit

Are the § 303(b) requirements for commencing an involuntary bankruptcy case not subject matter jurisdictional and can be waived?

In an en banc decision, Eleventh Circuit rules that § 303(b) requirements for commencing an involuntary bankruptcy case are not subject matter jurisdictional and can be waived. In re Trusted Net Media Holdings, LLC, 550 F.3d 1035, 50 Bankr.Ct.Dec. 254, Bankr. L. Rep. P 81,366 (11th Cir.(Ga.) Dec 02, 2008).

More than four years after filing of involuntary bankruptcy petition against it, Chapter 7 debtor filed motion to dismiss case for lack of subject matter jurisdiction, arguing that the involuntary petition did not meet the requirements of the section of the Bankruptcy Code governing involuntary cases. The United States Bankruptcy Court denied the motion to dismiss, and debtor appealed. On rehearing en banc, the Court of Appeals held that the Bankruptcy Code's requirements for commencing an involuntary case are not subject matter jurisdictional in nature and therefore can be waived, overruling *In re All Media Properties, Inc.*, 646 F.2d 193 (5th Cir 1981).

Section 303(b) permits the commencement of an involuntary bankruptcy case against a debtor (1) by three or more creditors holding non-contingent, undisputed claims against that debtor, or (2) by a single holder of a non-contingent, undisputed claim if there are fewer than twelve such creditors of the debtor. 11 U.S.C. § 303(b). At the time Morrison filed its involuntary petition against Trusted Net, § 303(b) also required that the petitioning creditors' non-contingent, undisputed claims against the debtor aggregate at least $11,625. *See*11 U.S.C. § 303(b) (2001). Trusted Net argued that § 303(b)'s requirements must be met for the bankruptcy court to have subject matter jurisdiction, and that Morrison's petition violated § 303(b) because: (1) at the time of the involuntary petition, Morrison was not the holder of a non-contingent, undisputed claim, and (2) Morrison's involuntary Chapter 7 petition was not joined by three holders of non-contingent, undisputed claims. The bankruptcy court once again denied the motion to dismiss. It concluded that § 303(b) of the Bankruptcy Code is not jurisdictional and that any argument by debtor that the petitioning creditor was disqualified or that there were more than 12 creditors was waived when debtor allowed the entry of the order for relief.

The circuit courts are split on this question. The courts have framed the question as whether subject matter jurisdiction of an involuntary case is dictated entirely by the provisions of Title 28, § 157, or further embellished upon by § 303(b) of the Code. The Ninth Circuit, many bankruptcy courts, and leading commentators state that the requirements of § 303(b) are not jurisdictional and can be waived. See *Mason v. Integrity Ins. Co. (In re Mason)*, 709 F.2d 1313, 1318-19 (9th Cir.1983). The Second Circuit, on the other hand, and other bankruptcy court decisions hold that § 303(b)'s requirements are subject matter jurisdictional. See *Key Mech. Inc. v. BDC 56 LLC (In re BDC 56 LLC)*, 330 F.3d 111, 118 (2d Cir.2003).

"Only Congress may determine a lower federal court's subject-matter jurisdiction." *Kontrick v. Ryan*, 540 U.S. 443, 452, 124 S.Ct. 906, 914, 157 L.Ed.2d 867 (2004). Therefore, the Supreme Court has instructed that courts should look to whether Congress has included jurisdictional language in the statute in question. If the Legislature clearly states that a threshold limitation on a statute's scope shall count as jurisdictional, then courts and litigants will be duly instructed and will not be left to wrestle with the issue. But when Congress does not rank a statutory limitation on coverage as jurisdictional, courts should treat the restriction as nonjurisdictional. Therefore, the Supreme Court has instructed that courts should look to whether Congress has included jurisdictional language in the statute in question, stating:

> If the Legislature *clearly states* that a threshold limitation on a statute's scope shall count as jurisdictional, then courts and litigants will be duly instructed and will not be left to wrestle with the issue. But when Congress does not rank a statutory limitation on coverage as jurisdictional, courts should treat the restriction as nonjurisdictional in character.

Arbaugh, 546 U.S. at 515-16, 126 S.Ct. at 1245 (emphasis added) (citations and footnote omitted).

Research References: Bankruptcy Service, L. Ed. §§ 13:100, 13:200; Norton Bankr. L. & Prac. 3d § 4:3. Bankruptcy Law Manual 5d §§ 3:13, 3:14, 3:37; Ben Ellison, Eleventh Circuit En Banc: No Provision of Title 11 Is Subject-Matter Jurisdictional, 2009 NO. 2 NRTN-BLA 2 (February 2009).

Fifth Circuit

Does a bankruptcy court have jurisdiction to also enter a money judgment when rendering a judgment in an exception to discharge case?

The Court of Appeals held that Bankruptcy Court, in addition to declaring debt nondischargeable, had the jurisdiction to liquidate the debt and enter judgment against the debtor. In re Morrison, — F.3d —, 2009 WL 103693 (5th Cir.(Tex.) Jan 16, 2009). The judgment of the district court was affirmed.

Morrison was the president and principal shareholder of Morrison Excavation, Inc. On February 6, 2002, Morrison was informed by his CPA, that his company was in serious financial trouble. On February 14, Morrison Excavation submitted a bid for a subcontract with Western Builders. On February 15, the bookkeeper for Morrison Excavation, found an accounting error that overstated the company's accounts receivable, which meant that Morrison Excavation was no longer solvent. On February 22, a general contractor Western Builders, requested a copy of Morrison Excavation's financial statement. The same day, Morrison faxed a copy of a financial statement that still reflected the inflated accounts receivable error to Western Builders. On March 6, Morrison Excavation and Western Builders entered into a contract with Western as the general contractor and Morrison Excavation as it's subcontractor.

Starting on March 28, 2002, Western Builders began making advance payments at the request of Morrison Excavation in order to allow Morrison to pay it's subcontractors and suppliers for the project. Morrison Excavation, however, used some of the money to pay for expenses on other projects and debts. During this time, Morrison also paid off his personal home equity loan from the company account and gave himself a substantial raise. By mid-August, Morrison Excavation abandoned the job. Western Builders paid the outstanding liens and hired a new excavation company to finish the project for more than a half million dollars over the original contract price.

On March 13, 2004, Morrison filed an individual Chapter 7 bankruptcy case. Western Builders commenced an adversary proceeding to determine the nondischargeability of the debt owed to it pursuant to 11 U.S.C. § 523(a)(2)(B), based on a false financial statement of the debtor or an insider of the debtor. The court found that the testimony "strongly suggest[ed] that Morrison most likely knew by February 22, 2002, that the financial statement contained an error-but perhaps did not know the magnitude of the error." The bankruptcy court held that the debt created by the delivery of the false financial statement caused the debt to be excepted from discharge under § 523(a)(2)(B) because the debtor could be held liable for the misrepresentation that benefitted the excavation company. The court concluded that debtor personally committed common-law fraud in order to obtain the subcontract. Therefore the debtor was personally liable for the debt under applicable state common law that holds a corporate agent liable for his misrepresentations made on behalf of the corporation. The bankruptcy court entered judgment and declared the debt excepted from discharge under 11 U.S.C.A. § 523(a)(2)(B). The district court affirmed, as did the Fifth Circuit.

Before reaching the substantive questions Morrison raised, the Fifth Circuit court determined *sua sponte* the legal issue whether the bankruptcy court had the power to render a money judgment for the nondischargeable debt. The court noted that bankruptcy courts exercise jurisdiction, through referral from the district courts, of two types of cases. "Core" proceedings are those that invoke a substantive right provided by title 11 or could arise only in the context of a bankruptcy case. Cases "related to" the bankruptcy case are those whose outcome could have any conceivable effect on the estate being administered in bankruptcy. Tthe question presented was whether a bankruptcy court, in addition to declaring a debt non-dischargeable, has jurisdiction to liquidate the debt and enter a monetary judgement against the debtor.The court cited the circuits that have considered this question found that the bankruptcy courts have the power to enter judgment in exactly this manner. *See Cowen v. Kennedy (In re Kennedy)*, 108 F.3d 1015, 1017-18 (9th Cir.1997); *Longo v. McLaren (In re McLaren)*, 3 F.3d 958, 965-66 (6th Cir.1993); *Abramowitz v. Palmer,* 999 F.2d 1274, 1278-79 (8th Cir.1993); *N.I.S. Corp. v. Hallahan (In re Hallahan)*, 936 F.2d 1496, 1508 (7th Cir.1991); *cf. Porges v. Gruntal & Co. (In re Porges)*, 44 F.3d 159, 163-65 & n. 7 (2d Cir.1995). Circuit courts that have approved the entry of money judgments by bankruptcy courts in nondischargeability cases have paid little attention to the jurisdictional dichotomy of core and related-to jurisdiction and have instead relied principally on tradition and pragmatism. Logically, the litigation necessary to prove nondischargeability also proves the basis for and amount of the debt. There would be no judicial efficiency in requiring the beneficiary of a nondischargeability judgment to pursue a separate lawsuit in state or federal court in order to secure a money judgment against the debtor. Moreover, entry of judgment for the debt is proper because the court actually determined the existence and validity of the debt in a core proceeding.

Research References: Norton Bankr. L. & Prac. 3d §§ 4:85, 57:63; Bankruptcy Law Manual 5d §§ 2A:5, 4:34, 4:52.

Ninth Circuit

Does the Bankruptcy Code permit the debtor to directly pay mortgage payments on debts secured by the home when arrears related to that debt are simultaneously being paid in the plan?

Ninth Circuit held that a Chapter 13 debtor may propose a plan which pays secured creditors postpetition monthly payments outside the plan and that nothing in BAPCPA changes that conclusion. In re Lopez, 550 F.3d 1202 (9th Cir. Dec 24, 2008). The Trustee appealed the Bankruptcy Appellate Panel's decision affirming the Bankruptcy Court's order confirming Rudy Lopez's Chapter 13 plan. The Ninth Circuit adopted as it's own the published opinion of the Bankruptcy Appellate Panel, *In re Lopez,* 372 B.R. 40 (9th Cir. BAP 2007).

The Chapter 13 trustee, challenged the bankruptcy court's order confirming the Chapter 13 plan of the debtor Lopez. Lopez's plan permits him to pay his postpetition payments on notes secured by deeds of trust on his residence ("maintenance payments") directly to his creditors, while simultaneously allowing him to pay his prepetition arrears on those notes via the trustee. The trustee objected to the direct payment provisions; he believes Lopez should pay all amounts to him under the plan, and that he should then disburse those amounts to the creditors. The trustee contended that, despite longstanding practice in this and other circuits and the comments of the leading treatise on Chapter 13, pre-BAPCPA Ninth Circuit precedent does not permit debtors to make direct payments in these circumstances. *See, e.g., Mendoza v. Temple-Inland Mortgage Corp. (In re Mendoza),* 111 F.3d 1264, 1269 (5th Cir.1997); *Wagner v. Armstrong (In re Wagner),* 36 F.3d 723 (8th Cir.1994); *In re Aberegg,* 961 F.2d 1307 (7th Cir.1992); *In re Bettger,* 105 B.R. 607, 609 (Bankr.D.Or.1989); *In re Burkhart,* 94 B.R. 724, 725 (Bankr.N.D.Fla.1988) (Permittting direct payments to creditors). *See* also, 5 Keith M. Lundin, *Chapter 13 Bankruptcy* § 401.1, p. 401-1 (3d ed. 2000 & Supp.2006) ("Direct payment has always been allowed by the Bankruptcy Code in Chapter 13 cases....").

The trustee's principal argument relied on Ninth Circuit precedent holding that direct payments may be impermissible in certain Chapter 12 family-farmer bankruptcies. Specifically, the trustee points to *Fulkrod v. Barmettler (In re Fulkrod),* 126 B.R. 584 (9th Cir.BAP1991) (" *Fulkrod I*"), *aff'd sub. nom. Fulkrod v. Savage (In re Fulkrod),* 973 F.2d 801 (9th Cir.1992) (" *Fulkrod II*") (collectively "Fulkrod") to support his position. The court stated that *In re Fulkrod.* the Ninth Circuit held that a Chapter 12 debtor must make payments to creditors with "impaired" claims through the Chapter 12 trustee. However, the court said that *Fulkrod* did not decide the precise issue in this case, but if it did, the holding on that subject was dicta, and, in any event, this case did not involve impairment, a necessary element of the *Fulkrod* analysis. The court then analyzed the changes enacted by BAPCPA and found they did not change the result.

One question is whether the debtor may act as disbursing agent for payments under the plan. Debtors with otherwise confirmable plans sometimes spend an inordinate amount of effort simply trying to avoid what appears to be a windfall fee to the trustee for handling mortgage payments, and, as often as not, the only objection by the trustee to confirmation of the debtor's plan is over the amount of the fee.

The Bankruptcy Code contemplates that the trustee will act as the disbursing agent in most instances. Section 1322(a)(1) of the Bankruptcy Code provides that: "The plan shall provide for the submission of all or such portion of future earnings or other income of the debtor to the supervision and control of the trustee as is necessary for the execution of the plan." Section 1326(c) provides that "(e)xcept as otherwise provided in the plan or in the order confirming the plan, the trustee shall make payments to creditors under the plan."[1] The Code nonetheless clearly envisions that there will be exceptions. In *In re Foster,* In re Foster, 670 F.2d 478 (5th Cir. 1982), the Fifth Circuit concluded, based upon the foregoing statutory language, that "Chapter 13 permits a debtor to act as disbursing agent, subject to the bankruptcy court's 'feasibility' determination under 11 U.S.C.A. § 1325(a)(6)."In re Foster, 670 F.2d 478, 486 (5th Cir. 1982). In *Foster* the debtors were delinquent on two mortgages on their home. Their plan proposed to pay the arrearage payments to cure the mortgages to the trustee and to pay the current payment directly to the creditor. The court went on to say that:

> [W]e believe that the intent of Congress to enhance the flexibility of debtors in formulating plans under Chapter 13 should be given strong consideration by a bankruptcy court in deciding whether to allow the debtor to serve as disbursing agent for the current mortgage payment, we also believe that the provisions of Chapter 13

make it clear that the designation of the debtor as such a disbursing agent is very much a matter left to the considered discretion of the bankruptcy court. In re Foster, 670 F.2d at 486.

Research References: Bankruptcy Service, L. Ed. §§ 50:538, 50:539; Norton Bankr. L. & Prac. 3d § 149:10; Curing default and maintaining payments on long-term obligations (Code **§** 1322(b)(5) and (e)); Bankruptcy Law Manual 5d § 13:45. Plan payments.

Eight Circuit BAP

Did the addition of 11 U.S.C.A. § 522(o) to the Bankruptcy Code establish any new law regarding the analysis of "intent to hinder, delay or defraud" in the context of pre-bankruptcy homestead exemption planning?

The Eighth Circuit BAP held that rather than establishing a new evidentiary standard for pre-bankruptcy homestead exemption planning, the addition of § 522(*o*) marks out a look-back period of ten years. It also extends what was the law in the Eighth Circuit and made it uniform national law. After rejecting the argument that § 522(*o*) creates a new evidentiary standard, the court stated that § 522(*o*)"merely establishes a 10-year look-back period from which such evidence may be considered".. In re Wilmoth, 397 B.R. 915, 920; Bankr. L. Rep. P 81,373 (8th Cir.BAP (Ark.) Dec 09, 2008).

Finding that Chapter 7 debtors did not act with fraudulent intent when, shortly before their bankruptcy filing, they liquidated their non-exempt construction equipment and used some of the proceeds to pay down their mortgage, thereby increasing their homestead exemption, was supported by evidence that debtors relied on the advice of counsel, that debtors did not liquidate substantially all of their assets, that debtors did not convey the equipment for inadequate consideration, that debtors fully disclosed their payments to their mortgage company on their statement of financial affairs (SOFA), and that debtors were forthcoming with the trustee, and by lack of any extrinsic evidence of intent to hinder, delay, or defraud. 11 U.S.C.A. § 522(*o*).

Seventh Circuit

Can debtors purchase claims in their own cases without risk that the purchased claims will be equitably subordinated?

Corporation formed by debtors to buy claim against their bankruptcy estates that was held by junior mortgagee moved, in debtors' jointly administered Chapter 7 cases, to have its secured claim deemed allowed and for claim to be paid by trustee out of proceeds from sale of real property. Trustee objected. The Bankruptcy Court equitably subordinated corporation's secured claim to that of all unsecured creditors. The Court of Appeals held that creditors were not harmed by corporation's acquisition of secured claim, precluding equitable subordination of that claim. Equitable subordination generally requires the satisfaction of three conditions: (1) the claimant must have engaged in some type of inequitable conduct, (2) the misconduct must have resulted in injury to the debtor's creditors or conferred an unfair advantage on the claimant, and (3) subordination must not be inconsistent with the provisions of the Bankruptcy Code. 11 U.S.C.A. § 510(c). The court held that the debtors' formation of a corporation to purchase a secured claim against their own estates may have amounted to misconduct, but it did not harm the other creditors, who were in the same position whether the original creditor or the debtors' corporation owned the secured claim. In re Kreisler, 546 F.3d 863, 50 Bankr.Ct.Dec. 199, Bankr. L. Rep. P 81,343 (7th Cir.(Ill.) Oct 20, 2008).

Third Circuit

Did state's action in obtaining default judgment against debtor for environmental clean up violate the automatic stay?

In gasoline supplier's bankruptcy proceeding, state filed claim to recover damages for cleanup of contamination by one of debtor's customers. The Bankruptcy Court allowed claim, and debtor appealed. The United States District Court affirmed, and debtor appealed. The Court of Appeals, held that:(1) state's action in obtaining default judgment against debtor did not violate automatic stay, and (2) state court had subject matter jurisdiction to issue default judgment. In re Mystic Tank Lines Corp., 544 F.3d 524, 50 Bankr.Ct.Dec. 190 (3rd Cir.(N.J.) Oct 16, 2008).

State's action in obtaining default judgment in action against gasoline supplier to recover costs it incurred in cleaning up discharged petroleum at site owned by supplier's customer fell within police power exception and was not violation of automatic stay in supplier's bankruptcy case, even though state sought to reduce to judgment its claim for costs it expended for pre-petition site clean-up, where action sought only entry of judgment, not enforcement of judgment. 11 U.S.C.A. § 362(b)(4).

Prof. Dunaway, Section Editor, is also Professor Emeritus at Pepperdine University School of Law.

AIRA's Silver Anniversary *continued from* **p.1**

Thomas L. Dunleavy
Main Hurdman/KMG-Minneapolis

Peter J. Gibbons
Price Waterhouse & Co.-Philadelphia

Manny Katten
Oppenheim, Appel, Dixon & Co.-Chicago

Alex Knopfler
Seidman & Seidman-Chicago

Kenneth J. Malek
Seidman & Seidman-Chicago

David Mork
Mork & Co.-Minneapolis

Michael A. Policano
Frank Zolfo & Co.-New York

Murray H. Schofel
Coopers & Lybrand-Philadelphia

Daniel Scouler
The Clarkson Co. Ltd./Arthur Young & Co.-Canada

Robert S. Seideman
Seideman & Associates-Cleveland

James H. Smith
Coe Laboratories, Inc.

Robert A. Wiener
Sole Practitioner-New York

Other steps taken at the August meeting included:

Formation of a Steering Committee with Alex Knopfler as its Chairman

Scheduling of election of a new Board of Directors, balloting to be by mail and ballot to be prepared by Manny Katten.

Subcommittee appointed by Knopfler, to be headed up by Peter Gibbons of Price Waterhouse to review the criteria for membership in NAAI, qualifications for full and associate member status, enforceable standards of conduct for members, and the member of tabulating member votes.

New Board of Directors to be introduced at the national meeting of the Commercial Law League in November, 1984.

At the October, 1984 meeting of the Steering Committee, the name of the organization was officially changed to the Association of Insolvency Accountants (AIA). Peter Gibbons presented a report on the objectives of the AIA and the Committee reached a consensus that the "major purpose of the AIA should be to define and develop the role of the accountant in insolvency engagements." Full membership was limited to Certified Public Accountants, Licensed Public Accountants, Chartered Accountants, and "Any professional employed by a public accounting firm serving this market and supervised by an accountant as defined above". (One can only imagine the discussions leading up to the inclusion of that last category!) Associate membership included just about everyone else including Analysts, Attorneys, Consultants, Educators, Internal Auditors, Judges, Lenders and loan workout personnel, Liquidators, Receivers, Trustees, and Turnaround Specialists.

At the November 1984 meeting, Homer Bonhiver was appointed the first Executive Director of the AIA. The minutes of that meeting also contain the first printed mention of Grant Newton. He was appointed to the Education Sub-Committee-Development and Review of Accounting and Reporting Standards. Apparently, this was without his knowledge, as there appears an asterisk by his name indicating the following: "subject to request to be made of Mr. Newton by Alex Knopfler". Thus it appears that Grant's first involvement in the organization may have been as a draftee.

The minutes for the January, 1985 Board meeting indicate that the organization had 88 regular and associate memberships. By April of 1985, membership had grown to 105, making AIA eligible for representation on the INSOL International Council.

On April 24, 1985, a letter was sent to the Tax Counsel of the Senate Finance Committee from Alex Knopfler representing the views of AIA on pending tax legislation. It appears that this was the first time that the organization officially commented on pending legislation.

In January of 1986, the organization published its first newsletter which has been in continuous print since its first edition. In May 1987, AIRA arranged for all members to receive the *Distressed Business and Real Estate Newsletter* published by Westlake Publishing Company and edited by Professors Baxter Dunaway and Grant Newton. 2 years later AIRA purchased the Newsletter from Westlake Publishing and it became a part of the *AIA News* (*AIRA News* in 1999); in 2005, the title was changed to *AIRA Journal*. Published quarterly, the latest edition was printed in the latter part of 2008 and is now in its 22nd volume with articles provided by both members of the organization as well as those associated with banking, legal and government arenas.

Key to the accomplishment of its mission, the AIA started the Certified Insolvency and Restructuring Accountant (CIRA) program in 1992, "to recognize those professionals that demonstrate a high level of competency through not only the completion of a course of study and examination but by providing evidence of comprehensive experience." Those successfully completing the course are deemed qualified to:

- Render professional services for debtors, trustees, creditors' committees, individual creditors or equity holders, and other interested parties in Chapter 11 bankruptcy proceedings and out of court workouts
- Apply the provisions in the bankruptcy code relevant to the financial services performed
- Categorize business failures according to underlying causes
- Perform analysis for preferences and fraudulent transfer recovery
- Prepare financial information to be included in Chapter 11 and out of court plans

- Prepare applications for retention and petitions for fee allowance required in bankruptcy proceedings

- Prepare financial statements according to provisions of SOP 90-7 during bankruptcy and on emergence from chapter 11

- File operating reports required by the U.S. Trustee's office

- Identify tax issues that should be addressed in chapter 11 proceedings and out of court workouts

- Determine reorganization and liquidations values for chapter 11 disclosure statements and plans.

- Provide special analysis related to issues that must be addressed in chapter 11 including rejection of executory contracts and leases, feasibility of plans, debt classifications, and substantive consolidation.

In 1999, the Board met in Chicago during the annual conference and decided to rename the organization yet again. In recognition of the diversity of disciplines composing its membership, the name was changed to the Association of Insolvency and Restructuring Advisors and at the same time, the CIRA credential was renamed Certified Insolvency and Restructuring Advisor. The distinctions between full and associate members had already been dropped, thus changing the emphasis of the organization from an accounting association with members from ancillary disciplines to a true association of bankruptcy and insolvency professionals.

At the October, 1999 meeting, the Board voted to endow the Manny Katten Award, which is bestowed annually to the individual chosen by the Board who has demonstrated exceptional leadership, dedication and service to the bankruptcy, insolvency and turnaround fields. The award is funded through donations from Board members and others with a special allocation going to the Emanuel Katten Scholarship at the University of Illinois, Manny's alma mater. He was the Chairman of the first AIA annual conference and a Founding Board Member. Freddie Reiss a former partner of Manny's at Spicer & Oppenheim said that "Manny was a big affable guy who liked everyone and in return was loved by all. He left us way too soon."

In 2004, AIRA launched its second certification program, the Certificate in Distressed Business Valuation (CDBV), a unique valuation certification program designed to train and accredit professionals who value distressed assets, including distressed and/or bankrupt companies.

A professional organization is nothing more (nor less) than its members, and it is impossible to say much about the AIRA without in the same breath mentioning Grant Newton.

Grant Newton, who had recently completed his PhD in Accounting (his thesis was on Bankruptcy Accounting), was introduced to NAAI by David Mork in 1983 when he was asked to participate in an event hosted by the organization. He never left. His varying responsibilities have included Board Member of NAAI, Founding Director of AIA, Vice President, President, and since 1999, Executive Director. Nothing attests to the importance of Grant to the organization more than the move of its headquarters from Philadelphia to Westlake Village, not far from Pepperdine University where he had been a professor since 1984. When Grant cut back on his activities at Pepperdine in 1997 and moved his residence to Oregon, the headquarters relocated to Medford. Grant continues to this day as Executive Director of AIRA and his tireless and selfless efforts benefit all who are associated with the organization.

Much more could be said, but space prevents a thorough treatment of the history of this group which has grown from its early beginning to more than 2,000 members, 1,100 CIRA's and 30 CDBV's. But a few things must be said, because they are important and they distinguish us from others. First, from its founding, AIRA has been an amalgamation of sole practitioners, small firms and large firms. This is and always has been reflected in the composition of its Board of Directors as well as in its overall membership. It has recently been reaffirmed by the addition of the small firm track of seminars at the Annual Conferences.

Second, when the NAAI was founded in 1979, it was in response to a need to assist the profession brought on by new legislation. This was not simply a networking group; it was instead born of a desire to be of service to one's fellow professionals and to the public at large. This mindset is and has been a hallmark of AIRA from its very beginnings to this day. AIRA members are justifiably proud of this heritage of service.

If the last six months are any indication, AIRA's second 25 years is starting with a bang. Because of our founding principles of service and education, our leadership, and our members, we are ready for whatever challenges lie ahead.

Ted Phelps, CIRA, CDBV

The author gratefully acknowledges the assistance of Grant Newton, Freddie Reiss, David Mork, Don Beaven and Mullaney Phelps in the preparation of this article.

Theodore G. Phelps is the President of PCG Consultants, responsible for the firm's Restructuring and Insolvency Services Practice. His experience with financially distressed companies spans nearly 30 years.

Ted's consulting capabilities include corporate turnaround, problem loan workouts, and financial restructurings, both in court (Chapter 11) and out of court. He has acted as an Assignee in general assignments for the benefit of creditors and has a Receiver in a number of cases.

In 1984, Mr. Phelps became an independent turnaround and workout consultant. In 1990, he spent two years with Price Waterhouse as its Director of Corporate Reorganization, West Region. Returning to independent consulting, he expanded his range of services to include litigation services and fraud investigation and prevention. In 2001, he founded Audigators, Inc., an investigative business services firm, merging that practice into PCG in 2004, creating a national consulting services firm.

Ted is a Certified Public Accountant, a Certified Insolvency and Restructuring Advisor (CIRA) a Certified Fraud Examiner (CFE) and a Diplomate of the American Board of Forensic Accounting. He is also a Certified Valuation Analyst (CVA) and holds the Certification in Distressed Business Valuation (CDBV) granted by AIRA.

His affiliations include the Turnaround Managers Association (TMA), the Association of Insolvency and Restructuring Advisors (AIRA), the California Receivers' Forum and the American College of Forensic Examiners. He sits on the Board of Directors for AIRA and for the Receivers' Forum

Mr. Phelps studied engineering at the United States Naval Academy at Annapolis. He completed his education at the University of Southern California with a degree in accounting.

EXHIBIT 1

Page 2 - N.A.A.I. FORMED

Bonhiver noted that in bankruptcies the creditors, debtors, judicial system and legal profession need the kind of investigative, analytical and technical skills which competent accountants can provide.

A regular member of the N.A.A.I. must be a Certified Public Accountant, a Licensed Public Accountant, or a Chartered Public Accountant, and must attend an annual workshop and complete a specific number of hours of continuing education related to investigations, business reorganization and liquidations.

The organization accepts associate members, including attorneys, trustees and receivers. They may participate in all association activities, and have all of the rights of regular members with the exception of the voting right.

Other officers of the association are Connell Saltzman, Minneapolis, and James Keegan, Minneapolis, vice presidents; David Mork, St. Paul, secretary, and Dan Flatz, Minneapolis, treasurer.

For additional information or membership application, write to the N.A.A.I., 90 South 9th Street, Suite 215, Minneapolis, MN 55402, or call (612) 341-2178.

##

EXHIBIT 2

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Sub-Prime Meltdown
The Panel Covers:
- Acronyms of the financial crisis
- Stability of markets
- Are the markets currently stable?
- Impact of subprime crisis on debt prices
- How is the financial crisis impacting companies' ability to restructure?
- Should the auto companies file for bankruptcy?
- How effective are the actions of the Federal Government?

Moderator:
- Bradley Sharp, *Development Specialists*

Speakers:
- Lewis Rosenbloom, *Dewey & LeBoeuf*
- Sandra Laskowski, *Swing Bridge Capital*
- George Blanco, CIRA, *BDO Consulting*

Financing in Today's Market
The Panel Covers:
- Financing in today's markets in a variety of sectors and cover who's lending and what type of lending is occurring
- An update on the current debt markets as well as talk about general financing as it relates to structures, pricing, participants/holds and industries
- Recent financings and participants in DIP/exit financing and how to work with existing lenders
- A speculative discussion on what the future holds based on market intelligence

Moderator:
- Teri Stratton, CIRA, *Macquarie Capital*

Speakers
- Edward Albert, *Fortress Investment*
- Richard Brooks, *Wachovia*
- Edward Siskin, *Crystal Capital*

SOP 90-7: Revision and Applications
The Panel Covers:
- Financial reporting during reorganization
- Financial reports on emerging from chapter 11
- Recent changes to SOP 90-7
- 90-7 and fair value accounting

Moderator:
- Grant Newton, CIRA, *AIRA*

Speakers:
- Nancy O'Neill, CIRA, *Deloitte*
- Steve Darr, CIRA/CDBV, *Mesirow Financial Consulting*
- Mike Sullivan, CIRA, *Huron Consulting Group*

FASB 157: Changes to Market Value Accounting as a Result of the "Credit Crunch"
The Panel Covers:
- FAS 157: Overview on provisions of the statement
- What is so different about accounting and reporting after 157?
- Valuation challenges presented by 157
- Reporting challenges presented by 157 the legal and regulatory quandary: what parties are encountering in litigation and investigations
- Regulatory and legislative response to 157
- Status of actions by IASB, SEC, update on report to Congress
- Discussion of ideas on how 157 should be changed

Moderator:
- Jim Lukenda, CIRA, Huron Consulting Group

Speakers:
- Kenneth J. Evola, *Huron Consulting Group*
- Boris J. Steffen, CDBV, *Bates White, LLC*
- Elizabeth H. Baird, *O'Melveny & Myers LLP*

Reconciling Valuation Approaches in Upside-Down Markets
The Panel Covers:
- Which valuation methodologies are appropriate in abnormal environments?
- Discussion on current market: Is valuation reasonable?
- How to determine appropriate discount rate
- How to deal with a lack of transaction comps
- Are asset values skewed due to impairment/accounting treatments?

Moderators:
- Bernard Pump, CIRA/CDBV, Deloitte
- Paul Shields, CIRA/CDBV, LECG

Speakers:
- David C. Smith, *University of Virginia*
- Michael Henkin, *Jefferies & Company, Inc.*

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The following members have recently changed firms, positions or addresses. Please update your contact lists.
If you would like to report a recent move, please go online to www.aira.org

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ANNOUNCEMENTS

If you would like to post an announcement in the AIRA Journal please email aira@aira.org for more information.

CRG Partners announced today that Sheon Karol has joined the firm as a partner at its headquarters in New York. With more than twenty years of financial services and turnaround experience, Karol is an innovative leader whose collaborative approach will support CRG's efforts to provide its clients with exceptional operational and financial improvement services.

CLUB 10

Firms with 10 or more professionals who have received their CIRA certification or have passed all three examinations:

FTI Consulting Inc	**71**
AlixPartners, LLP	**48**
Alvarez & Marsal LLC	**48**
Deloitte.	**31**
Grant Thornton LLP	**25**
Zolfo Cooper	**24**
Huron Consulting Group LLC	**20**
KPMG LLP	**19**
BDO Seidman LLP	**18**
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Capstone Advisory Group LLC	**17**
Mesirow Financial Consulting LLC	**16**
Navigant Capital Advisors LLC	**15**
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