AIRA | Association of Insolvency & Restructuring Advisors

Journal

News from the Association of Insolvency & Restructuring Advisors

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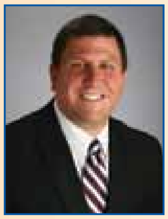

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IN THIS ISSUE

Obituary: Credit Bidding Under § 363(k)?

On March 15, 2010, the U.S. Court of Appeals for the Third Circuit issued a ruling that effectively neutralized once perceived rights of lenders to "credit bid" their interests in collateral. Credit bidding protects against undervaluation or bargain sales of encumbered assets.

Scope

Only a limited number of bankruptcy plans and asset sales involve lenders credit bidding their debt. Indeed, most traditional commercial lending institutions have no desire to take control of their collateral. Other debt holders which may have an interest in owning the underlying assets typically operate in the "Shadow Banking" industry, where institutions such as distressed private equity funds or hedge fund managers may employ "loan-to-own" or other strategies as part of their core operations.

In those bankruptcy cases that involve (or attract) lenders wishing to take control of their collateral, the court's ruling effectively encourages more debtors in possession to shy away from §363 sales of encumbered assets and to be more inclined to sell these assets through plans of reorganization that are more conducive to members of existing management, possibly at the expense of creditors. Such deals could include retaining existing management in exchange for the sale of encumbered collateral at below fair market value. At a minimum, the Appellate Court's ruling forces secured lenders to reconsider long assumed rights of collateral protection and provides years of fodder for attorneys and consultants alike in the journals of American Bankruptcy Law and this publication.

Background

Philadelphia Newspapers, LLC (the "Debtors") own and operate the Philadelphia Inquirer, Daily News, and philly.com publications. The Debtors acquired these assets in 2006 for $515 million, of which $295 million was financed through a consortium of lenders (collectively, the "Lenders") who were owed approximately $318 million at the petition date. The loans were secured by first priority liens in substantially all of the Debtors real and personal property.

The Debtors were in covenant default as of December 31, 2007, and payment default in September 2008, and filed for bankruptcy on February 22, 2009. As debtors in possession, management exercised the Debtors' exclusive right to file a plan of reorganization, which provided for a sale of substantially all of the Debtors' assets at a public auction free and clear of all liens and encumbrances. The Debtors also entered into an asset purchase agreement with a "Stalking Horse" bidder. This agreement was expected to generate approximately $37 million in cash for the Lenders plus transfer ownership of the Debtors' Philadelphia headquarters building, valued at $30 million, to the Lenders. The plan allowed for the Debtors to enjoy a two-year rent free lease at the facility.

The reorganization plan required that any qualified bidder at auction fund its purchase with cash, which effectively prevented the Lenders from "credit bidding." The Lenders objected to the Debtors' motion for approval of the plan and bid procedures. The U.S. Bankruptcy Court for the Eastern District of Pennsylvania ruled in favor of the Lenders and then approved a revised set of bid procedures without the ban on credit bidding.

The lower court's ruling was appealed to the District Court, which reversed the Bankruptcy Court's ruling and held that the Bankruptcy Code (the "Code") provides no legal entitlement for secured lenders to credit bid at an auction pursuant to a plan of reorganization. The Third Circuit Court of Appeals affirmed the District Court's ruling.

Without the ability to credit bid, the Lenders were forced to make a cash bid at the auction to gain control over their collateral. The Lenders' total bid was valued at $135 million, comprised of $105 million in cash and the Debtors' headquarters building valued at $30 million.

The Code § 1129

Confirmation of a plan of reorganization is governed by U.S.C. §1129. When each class of claims or interests has not accepted the plan, §1129(b) allows for the court to confirm a plan,

***Credit Bidding** continues on p. 16*

CONTENTS

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

Executive Director's Column

Grant Newton, CIRA
AIRA Executive Director

AIRA's 26 Annual Conference in San Diego was one of AIRA's best conferences based on comments received from participants. The presentations from five keynote speakers were all highly informative and challenging.

Senator William H. Frist, MD (twelve years in the U.S. Senate) discussed the impact of the new government healthcare law at the Awards Banquet. Before seeking public office, he distinguished himself as a leader in heart-lung transplant surgery and other areas of the medical field during about 20 years of practice and teaching (he earned his Medical Degree with honors from Harvard Medical School). In his presentation, he described his experiences as an on-site medical volunteer in the recent disaster in Haiti and other medical mission locations around the world. He signed copies of his recently released book, A Heart to Serve: The Passion to Bring Health, Hope and Healing, for conference attendees. DVDs of Dr. Frist's presentation are now available (after resolving technical difficulties in the master copy) as a self-study unit for one CPE credit. A complimentary copy of his book will be included with the first eight courses ordered.

Professor Jack Williams, CIRA, CDBV (AIRA Scholar in Residence and Professor of Law, Georgia State University) presented "Financing Undercapitalized Firms in Emerging Markets" at Wednesday's Luncheon Program at the conference. In addition to detailing sources of financing for undercapitalized firms, Professor Williams provided fascinating information on security costs in selected countries, noting that security costs consumes 15 percent of revenues in Afghanistan.

Fred Crawford (Chief Executive Officer, AlixPartners) in opening the conference discussed how financial advisory firms must adjust the new norm and the role professional organizations such as AIRA should facilitate the adjustment that must take place in a changing environment.

Roger Grabowski (Managing Director, Duff & Phelps, LLC and co-author with Shannon Pratt) of three books to be published by Wiley in 2010) discussed the state of the markets and the continuing impact on distress and provided suggestions to deal with illiquidity in a market with limited activity and little transparency.

Valerie A. Ramey, Ph.D, Professor, Department of Economics University of California, San Diego, was the Friday luncheon speaker providing basic lesion dealing with impact on the economy of government spending and tax rate adjustments. Professor Ramey's research suggests that there is a multiplier of between .6 and 1.2 for government spending depending on the sample. She noted that multipliers of less than one resulted even when interest rates were near the zero lower bound. Dr. Ramey also noted that generally research shows a larger multiplier for tax changes. Some researchers suggest a multiplier of up to three times while others suggest a multiple or around 1.1.

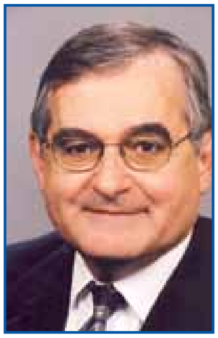
CIRA Program Update

Registrations for the Certified Insolvency and Restructuring Advisor (CIRA) sessions continued to increase during the first 6 months of 2010, to a level of 417 registrants. During the last four months of this year, CIRA course locations include Boston, New York, California, Florida and Chicago. The 2011 CIRA Course Schedule, consisting of 19 different offerings, has been posted on the website and registration is available for any of these courses.

AIRA Presidential Change

At the June Conference, Grant Stein completed his two-year term as President. It was a pleasure working with him during his tenure as President. Grant Stein was the first attorney (and non-financial advisor/accountant) to serve as AIRA's president. Grant will continue for the next two years as AIRA's Chairman of the Board; he served on AIRA's board and as an officer for 11 years before he began his term as president. We are grateful to Grant for his many contributions to AIRA across the years.

The role of AIRA President has now been assumed by Steve Darr, both a CIRA and CDBV. Steve has been a highly active member of AIRA since joining in 1994, and has served on AIRA's Board for 16 years. Other responsibilities have included serving as an officer for 13 years and representing AIRA on the INSOL Board. Steve also served on AIRA's committee to develop recommendations to the FASB for revisions to Accounting Codification section 852 (previously SOP 90-7). I look forward to working with Steve during the next two years. ■



Letter from the President

Stephen Darr, CIRA, CDBV, CPA
Mesirow Financial Consulting LLC

The first thing I want to do in my inaugural President's Letter is to thank everyone for their support in choosing me as President of this fine organization. I hope that I will do as good a job as my predecessors.

As I pondered this new challenge in my life (and writing this letter), I started to think about why I became a member of AIRA and why I have remained active. There are many reasons, but chief among them are:

The People – Our membership includes experts in just about everything relating to bankruptcy accounting, bankruptcy tax and restructuring services. Whatever problem you may face in serving your clients, help and advice is only one or two phone calls away from a member who can help. In spite of the fact that many of us are direct competitors, members always seem willing to assist in any way they can. In addition, through the Association, most members have developed close friendships with other professionals that may not otherwise have occurred.

No discussion of the people of AIRA would be complete without mentioning the staff of the Association. Currently they are: Bryan Anderson (Director of Information Technology), Elysia Harland (Controller), Dann Hauser (Director of Marketing), Terry Jones (Director of CIRA/CDBV Programs), Michele Michael (Administrative Assistant), and Valda Newton (Executive Assistant). Each one is always willing to help cheerfully and as quickly as possible; we all owe them our thanks.

Industry Recognition – The CIRA designation, established in 1992, is widely recognized by the Courts, lenders, investors, attorneys and others in the industry as the preeminent certification for insolvency and restructuring advisors, indicating specialized knowledge and experience in assisting distressed and insolvent businesses and their stakeholders. Similarly, the CDBV certificate is rapidly earning respect as a designation of professional expertise in valuation of distressed assets and distressed and or bankrupt companies.

Thought Leadership – AIRA provides valuable input on proposed legislation, accounting pronouncements, bankruptcy rules and other important issues affecting our work and our clients. AIRA is a recognized thought leader with substantial authority and influence in shaping the bankruptcy environment.

Learning Environment – The list of conferences, classes, webinars and seminars that AIRA sponsors is too long to mention in this letter. However, the theme that runs throughout the list is an outstanding commitment to quality, demonstrated by programs that are always interesting, relevant and first-rate in content. In addition, AIRA's written communications, such as this Journal, are always timely and extremely interesting.

Bright Future – At one time, the second "A" in AIRA stood for "Accountants" but a few years ago it was changed to "Advisors," acknowledging that membership had broadened to include a wider range of disciplines. Now our membership comprises attorneys, bankers, investment advisors and other "non-accountant" types, and the Association continues to attract more professionals in these and other areas. As our membership becomes more diverse, knowledge sharing, marketing and networking, as well as opportunities for personal and professional growth, will increase.

I cannot conclude without mentioning our Executive Director, Grant Newton, who has shaped and guided the Association from its inception. We cannot thank him enough for all that he has done for AIRA.

At the beginning of this letter, I stated that I hope to do as well as my predecessors I ask each of you help me to do so, by either staying or becoming active in the AIRA. ■

Steve Darr is a Senior Managing Director of Mesirow Financial Consulting's Boston office, providing financial consulting services to businesses experiencing significant financial and operating difficulties, typically with deteriorating relationships with creditors and suppliers. Mr. Darr has served DIPs, secured and unsecured creditors, bondholders and others, and as interim management in various industries.

AIRA's Scholar in Residence

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

BANKRUPTCY RETAKES PONZI SCHEMES: PART II

In the first column on Ponzi schemes, I discussed the original scheme that birthed the name Ponzi. In this column, I consider some of the characteristics of a Ponzi scheme (a discussion designed to be illustrative and not exhaustive).

The characteristics of a Ponzi scheme are somewhat open to debate but in essence it involves using newer investments or indebtedness to pay returns on older investments or indebtedness. One court has broken the Ponzi cycle into four steps:

(1) deposits made from investors;

(2) the Ponzi operator conducts no legitimate business as represented to investors;

(3) the purported business of the Ponzi operator produces no profits or earnings, rather the source of funds is the new investments by investors; and

(4) payments to investors are made from other investor's invested funds.

Other factors involved in this determination include (but are not limited to) the misappropriation of funds, unreasonably high or unreasonably steady promised returns, insolvency, and a limited investor pool. Although unreasonably high and/or unreasonably steady returns are often an attribute of a Ponzi scheme, the returns may be reasonable and nonetheless lead a court to find that a Ponzi scheme exists.

Ponzi schemes are almost always pyramid schemes in which the "product" being sold is a return on investment. Often exploiting investors' networks, Ponzi schemes tend to affect communities (social, business, religious, or otherwise) and are a form of affinity fraud. Funds used by the operator for personal expenses will often dwarf the amount used to perpetuate the scheme.

A Ponzi scheme can start with a legitimate business but is often fraudulent from the outset. Additionally, a Ponzi scheme could be conducted within an ongoing otherwise legitimate business. Often, this legitimate business is "a money-losing front a sham to entice investors with façade of legitimacy."

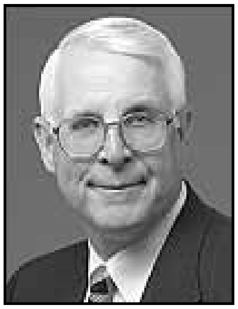
What fuels the fire of Ponzi schemes? Many commentators and investigators have suggested that greed among investors blinds them to obvious and not-so-obvious indicia of fraud. This investor greed is driven by word of profits and high returns, dissatisfaction with current returns, and the money they see their friends making. In my research, I have determined that greed is an important attribute that sustains the growth of a mature Ponzi scheme; that attribute, however, does not explain the Ponzi scheme in its embryonic stages.

In my research, I have found that one attribute more than any other explains how Ponzi schemes get started and are fueled in their early start-up phases when they are most vulnerable to detection. It turns out that this attribute is not a vice, like greed; it is a virtue: the virtue of trust. Investors invest in what they perceive as an excellent opportunity because they trust the Ponzi schemer and his investors. Just how does this work?

Think of a Ponzi scheme as an inverted pyramid. At the very point of inception one would find the fraudster and his accomplices. Occasionally, these accomplices are willing ones, like the co-conspirators in the Bayou Funds bankruptcy cases. More often, these accomplices are more accomplices in fact than in law, turning a blind eye to the development and maturation of the fraud. Some accomplices in fact are ignorant of the fraud or isolated from the fraudulent activity in such a way that they reasonably cannot detect the fraud. The next level up the inverted pyramid, the level closest to the fraudster, usually houses the fraudster's close friends, family, fraternity brothers, fellow church members or military buddies. It is this relationship that marks the Ponzi scheme as a form of affinity fraud. The key to success is not how convincing the fraudster is (although his ability to pull off the fraud is a necessary ingredient); rather, the key is the ability of the first followers (friends, family, etc.) to convince the second level investors to join in the venture. Without the first followers, the fraudster is a lone wolf with a wild-haired scheme to make money that is sure to fail or worse. With the first followers, it becomes a movement! It is the first followers that transform a fraud into a Ponzi scheme. These first followers do so often unwittingly and would be very disturbed to learn that the fraudster preyed upon them and used them as a means to perpetrate the fraud. Thus, without actually knowing how instrumental they are to a Ponzi scheme's success, the first followers then turn to the next level of investors, and so on. Permeating each level of the Ponzi scheme is trust, and the appearance of trustworthiness; the pyramid collapses without it.

What makes the Ponzi scheme so pernicious, even when compared to other frauds, is that it must nurture and then abuse trust. What we often fail to appreciate, however, is that the fraudster need only maintain trust with the first investor level, close contacts already predisposed to trust him, in order to plant the hook. He then uses his close contacts to seek out other investors that are their close contacts (and may not even know the fraudster), trading off of their trust with others. In studying hundreds of deceptions, I have learned that the most successful deceptions are conducted by people without knowledge that they are acting in a deceptive manner. To be sure, the puppeteer orchestrating the fraud is intimately aware, but he is pulling strings attached to people that are actually unaware of the fraud. It is as true for Ponzi schemes today as it has been for military and espionage deception campaigns throughout history.

(The next column will walk us through the bankruptcy implications of a Ponzi scheme.) ■



Bankruptcy Taxes

Forrest Lewis
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ECONOMIC SUBSTANCE: HOW FAR WILL IRS GO WITH 7701(o)?

After a long battle, the "economic substance doctrine" of tax law was codified in Internal Revenue Code Section 7701(o) as part of the Healthcare and Education Reconciliation Act of 2010. The IRS has developed the economic substance doctrine through a series of court cases over many years attacking the tax results of transactions which the IRS thought had no economic purpose or at least contained one or more steps which had no economic purpose apart from tax savings. Supposedly the enactment of Sec. 7701(o) does not change the economic substance doctrine but simply codifies it and says it must be considered where it is "relevant." If economic substance is determined to be relevant and the transaction lacks economic substance, the form of the transaction can be disregarded or recharacterized to one unfavorable to the taxpayer. The new provision is effective for transactions entered into after March 30, 2010.

Safe Harbors

There are several safe harbors; the primary one found in Sec. 7701(o)(1) is:

1. The transaction must change (improve) the taxpayer's economic position in a meaningful way (apart from the Federal tax effects).
2. The taxpayer has a substantial purpose apart from tax savings for entering into the transaction.

Other safe harbors are:

Transactions which carry out a Congressional plan or purpose

- The only current example is found in a specific footnote in the Joint Committee report which identifies low income housing credits as blessed by Congressional intent
- Long standing practices that will supposedly not be affected, such as
- The choice between capitalizing a business with debt or equity
- A U.S. person's choice between using a domestic or foreign corporation to make a foreign investment
- Using a corporate organization or reorganization under Subchapter C
- Using a related-party in a transaction, as long as the dealing is at arms-length as required by IRC 482

However, under the new law, state tax savings deriving from the federal tax treatment of the transaction can no longer be relied on to lend economic substance to a transaction. This overturns a long standing common law safe harbor.

Penalties

Congress put strong teeth into the new provision by amending Section 6662 on understatement and negligence penalties to provide a 40% penalty for undisclosed transactions lacking economic substance. There is even a 20% penalty for disclosed transactions which are held to lack economic substance. Thus, in an IRS audit where an undisclosed position in a transaction is held to lack economic substance, any increase in tax assessed can result in a further increase of 40% of that tax increase. As to the form to be used when taxpayers want to disclose, one Treasury Department official said they may use the Uncertain Tax Positions form to replace Form 8275 for this purpose.

Ominously, the same Treasury official pointed out that new penalty section 6662(b)(6) allows imposition of a penalty on "[a]ny disallowance of claimed tax benefits by reason of a transaction lacking economic substance (within the meaning of section 7701(o)) or failing to meet the requirements of any similar rule of law." This could extend the 40% penalty regime to include doctrines such as "substance over form" and "sham transaction."

Conclusion

Tax practitioners will be watching tensely to see where the IRS goes with this. On the one hand, the IRS could limit use of this new provision to a few large cases under the control of the National Office as they have in the past. On the other hand, it could be a tool put into the hands of all examining agents and mark a major turning point in U.S. tax practice. ■

Thanks to Grant Newton and Dennis Bean for their assistance with this article.

FEDERAL TAX REGULATORY UPDATE

1. IRS proposes liberalization of debt modification rules

IRS has proposed regulations which would liberalize the definition of a "significant modification" of a debt instrument. When a debtor issues a new instrument to replace an existing debt instrument, the regulations under IRC Section 1001 may treat it as a "significant modification" which can lead to treatment as a taxable exchange of the old debt instrument for the new one. An exchange of a debt instrument for an equity instrument can have drastic effects such as disallowing all future "interest" deductions. As learned in the 2008 financial meltdown, sometimes the financial condition of the issuer can deteriorate so much and the prospect of repayment is so doubtful that some may regard the new instrument as more likely to be equity than debt. The proposed amendment to Reg. 1001-3 makes it less likely that the new instrument will be regarded as equity solely because of a deterioration in the issuer's financial situation. [Notice of Proposed Rule Making REG-106750-10]

2.Treasury Allows Federal Tax Refund to be Offset by Nontax Debt Without 10-Year Limit

Previously the Treasury Department could only intercept federal tax refunds to offset nontax debts a taxpayer owed to

Taxes continues from p. 5

the United State for a 10 year period. Pursuant to a change in federal law, the Treasury Department issued a final rule on December 24, 2009 authorizing the offset of federal tax refunds against nontax debt the taxpayer owes the federal government regardless of the period of time the debt has been outstanding. [amending 31 CFR part 285.2, authorized by Pub. Law No. 110-234]

3.IRS simplifies testing date valuations under Section 382 on net operating losses

The current federal tax regime to combat trafficking in net operating losses, IRC Section 382 and the regulations there under, applies if the ownership of a loss corporation measured by relative value shifts by more than 50 percentage points during a three-year testing period (an "ownership change"). The rule can apply to acquisitions of stock for stock or for cash or debt. If there is a more than a 50 percentage point change, net operating loss carryforwards are only deductible on an "amortization system". The general annual limit is the IRS interest rate multiplied times the amount paid for the company [or net fair market value in the case of a taxfree reorganization.] If the company value is relatively low, this can easily result in spreading out the net operating loss deductions over 15 or more years. Sometimes the ownership change is obvious, as when one public company acquires all of the stock of another public company, but an ownership change also can occur through the accumulation of multiple stock acquisitions and dispositions; therefore, the corporation with substantial NOLs must monitor ownership changes under very complex rules.

One of the many computational issues that IRS has avoided to this point is how to account for value shifts over time—this arises most commonly when there are multiple classes of stock. On June 11, 2010, the IRS issued Notice 2010-50, which substantially lessens the dangers of accidentally having an ownership change due to value changes. The Notice sets out alternative methods that can be used to measure ownership changes. The most important points for corporations with losses are:

- Absent some acquisition or disposition of shares, an ownership change cannot occur simply by virtue of a stock value shift among the classes.
- When any acquisition or disposition of shares occurs and it is appropriate to test for an ownership change, it is not necessary to value the corporation and each class of stock, which can be a burden for non-publicly traded corporations.
- The IRS permits some latitude among the various methods employed in practice but IRS wants a corporation to select one method which is reasonable and employ it consistently. ■

Thanks to Grant Newton and Dennis Bean for their assistance with this article and to Gerald Thomas for his insights.

IRS WANTS ALL BANKRUPTCY FEDERALTAX REFUNDS FILED WITH CIO

The IRS has issued Revenue Procedure 2010-27 which a trustee or a debtor in possession of a bankruptcy estate must follow to properly request a tax refund and which says it is an expedited procedure, meaning a faster refund. The procedure is apparently effective immediately and applies to all cases commenced under the Bankruptcy Code with the exception of chapter 9 municipal debt adjustment cases and chapter 15 ancillary and cross-border cases.

Generally, if a credit or refund of an overpayment of tax was not claimed on a return previously filed by the debtor, the trustee may do so by filing the appropriate amended return or form.

For income tax refunds of individuals: in the case of an overpayment of income taxes for a tax year for which a Form 1040 or 1040A has been filed by an individual debtor, the trustee must request a credit or refund on Form 1040X, Amended U.S. Individual Income Tax Return.

For income tax refunds of corporations: If a Form 1120 has been filed by a corporate debtor, the trustee must make a claim for credit or refund on Form 1120X, Amended U.S. Corporation Income Tax Return.

For income tax refunds where debtor has filed a form other than Form 1040, 1040A, or 1120: the trustee must request a credit or refund on the appropriate amended income tax return. The procedure does not apply to the trustee's filing of an application for a tentative carryback or refund adjustment under Code Sec. 6411 (usually using Form 1045 or 1139).

For taxes other than income tax, such as federal excise tax: if the debtor has filed a return, a claim for credit or refund must be made on Form 843, Claim for Refund and Request for Abatement. An exact copy of the return that is the subject of the claim should also be submitted, together with a statement of the name and location of the office where the return was filed.

If the debtor has claimed a credit or refund of an overpayment of tax on a properly filed return or form, the trustee may rely on such claim. With respect to an overpayment of taxes of the bankruptcy estate incurred during the administration of the bankruptcy case, a properly executed tax return will, at the election of the trustee, constitute a claim for credit or refund of the overpayment.

Instead of being mailed to the normal IRS Service Center, a form or return filed under this procedure must be mailed to:

Centralized Insolvency Operation
Post Office Box 21126
Philadelphia, PA 19114

It must be marked "Request for Prompt Refund" and accompanied by a written statement explaining that the request is being submitted pursuant to section 505(a) of the Bankruptcy Code. The IRS will examine such a form or return on an expedited basis, and will complete the examination and notify the trustee of its decision within 120 days from the date of the filing of the claim. ■

Thanks to Grant Newton and Dennis Bean for their assistance with this article.

Forrest Lewis, CPA is a tax practitioner based in East Lansing, Michigan

Bankruptcy Cases

Baxter Dunaway

Supreme Court

Is a broad interpretation of the law, 18 U.S.C.A. § 1346, which makes it a crime "to deprive another of the intangible right of honest services," unconstitutionally vague?

On June 24, 2010, the Supreme Court decided a series of cases concerning "honest services" fraud under 18 U.S.C. §§ 1341, 1343, and 1346. See Skilling v. United States, No. 08-1394, 2010 WL 2518587 (U.S. June 24, 2010); Weyhrauch v. United States, No. 08-1196, 2010 WL 2518696 (U.S. June 24, 2010) (per curiam); Black v. United States, No. 08-876, 2010 WL 2518593 (U.S. June 24, 2010). The key issue in these cases is the constitutionality of the "honest services" fraud statutes under 18 U.S.C. §§ 1341, 1343, and 1346, and the holding on that specific issue is in Skilling v. United States. Many lower court judges and scholars have called the "honest services" law hopelessly vague, saying it could apply to conduct as routine as calling in sick to go to a baseball game. The vagueness of the law, these critics said, gives potential defendants insufficient notice of what is a crime and prosecutors too much discretion in deciding whom to charge. The justices were unanimous in calling a broad interpretation of the law, 18 U.S.C.A. §1346, which makes it a crime ''to deprive another of the intangible right of honest services," unconstitutionally vague. However, the Justices held that §1346 should be construed rather than invalidated. Justice Ruth Bader Ginsburg, who wrote the majority decisions in both the Skilling and Black cases, said the law must be limited to the offenses of bribes and kickbacks. She was joined by Chief Justice John G. Roberts Jr. and Justices John Paul Stevens, Stephen G. Breyer, Samuel A. Alito Jr. and Sonia Sotomayor. Mr. Skilling's lawyers have argued that a decision in his favor should void his entire conviction, which was based on several theories. This is, Justice Ginsburg wrote, ''an open question" to be resolved by the lower courts.

Syllabus of Skilling v. United States

Founded in 1985, Enron Corporation grew from its headquarters in Houston, Texas, into the seventh highest-revenue-grossing company in America. Petitioner Jeffrey Skilling, a longtime Enron officer, was Enron's chief executive officer from February until August 2001, when he resigned. Less than four months later, Enron crashed into bankruptcy, and its stock plummeted in value. After an investigation uncovered an elaborate conspiracy to prop up Enron's stock prices by overstating the company's financial well-being, the Government prosecuted dozens of Enron employees who participated in the scheme. In time, the Government worked its way up the chain of command, indicting Skilling and two other top Enron executives. These three defendants, the indictment charged, engaged in a scheme to deceive investors about Enron's true financial performance by manipulating its publicly reported financial results and making false and misleading statements. Count 1 of the indictment charged Skilling with, inter alia, conspiracy to commit "honest-services" wire fraud, 18 U.S.C. §§ 371, 1343, 1346, by depriving Enron and its shareholders of the intangible right of his honest services. Skilling was also charged with over 25 substantive counts of securities fraud, wire fraud, making false representations to Enron's auditors, and insider trading.

In November 2004, Skilling moved for a change of venue, contending that hostility toward him in Houston, coupled with extensive pretrial publicity, had poisoned potential jurors. He submitted hundreds of news reports detailing Enron's downfall, as well as affidavits from experts he engaged portraying community attitudes in Houston in comparison to other potential venues. The District Court denied the motion, concluding that pretrial publicity did not warrant a presumption that Skilling would be unable to obtain a fair trial in Houston. Despite incidents of intemperate commentary, the court observed, media coverage, on the whole, had been objective and unemotional, and the facts of the case were neither heinous nor sensational. Moreover, the court asserted, effective voir dire would detect juror bias.

In the months before the trial, the court asked the parties for questions it might use to screen prospective jurors. Rejecting the Government's sparer inquiries in favor of Skilling's more probing and specific questions, the court converted Skilling's submission, with slight modifications, into a 77-question, 14-page document. The questionnaire asked prospective jurors about their sources of news and exposure to Enron-related publicity, beliefs concerning Enron and what caused its collapse, opinions regarding the defendants and their possible guilt or innocence, and relationships to the company and to anyone affected by its demise. The court then mailed the questionnaire to 400 prospective jurors and received responses from nearly all of them. It granted hardship exemptions to about 90 individuals, and the parties, with the court's approval, further winnowed the pool by excusing another 119 for cause, hardship, or physical disability. The parties agreed to exclude, in particular, every prospective juror who said that a preexisting opinion about Enron or the defendants would prevent her from being impartial.

In December 2005, three weeks before the trial date, one of Skilling's co-defendants, Richard Causey, pleaded guilty. Skilling renewed his change-of-venue motion, arguing that the juror questionnaires revealed pervasive bias and that news accounts of Causey's guilty plea further tainted the jury pool. The court again declined to move the trial, ruling that the questionnaires and voir dire provided safeguards adequate to ensure an impartial jury. The court also denied Skilling's request for attorney-led voir dire on the ground that potential jurors were more forthcoming with judges than with lawyers. But the court promised to give counsel an opportunity to ask follow-up questions, agreed that venire members should be examined individually about pretrial publicity, and allotted the defendants jointly two extra peremptory challenges.

Bankruptcy *continues from p. 7*

Voir dire began in January 2006. After questioning the venire as a group, the court examined prospective jurors individually, asking each about her exposure to Enron-related news, the content of any stories that stood out in her mind, and any questionnaire answers that raised a red flag signaling possible bias. The court then permitted each side to pose follow-up questions and ruled on the parties' challenges for cause. Ultimately, the court qualified 38 prospective jurors, a number sufficient, allowing for peremptory challenges, to empanel 12 jurors and 4 alternates. After a 4-month trial, the jury found Skilling guilty of 19 counts, including the honest-services-fraud conspiracy charge, and not guilty of 9 insider-trading counts.

On appeal, Skilling raised two arguments relevant here. First, he contended that pretrial publicity and community prejudice prevented him from obtaining a fair trial. Second, he alleged that the jury improperly convicted him of conspiracy to commit honest-services wire fraud. As to the former, the Fifth Circuit initially determined that the volume and negative tone of media coverage generated by Enron's collapse created a presumption of juror prejudice. Stating, however, that the presumption is rebuttable, the court examined the voir dire, found it "proper and thorough," and held that the District Court had empaneled an impartial jury. The Court of Appeals also rejected Skilling's claim that his conduct did not indicate any conspiracy to commit honest-services fraud. It did not address Skilling's argument that the honest-services statute, if not interpreted to exclude his actions, should be invalidated as unconstitutionally vague.

Held :

1. Pretrial publicity and community prejudice did not prevent Skilling from obtaining a fair trial. He did not establish that a presumption of juror prejudice arose or that actual bias infected the jury that tried him. Pp. — - —.

[The text of the Syllabus regarding the fair trial is deleted. For this text, see Skilling v. U.S., — S.Ct. —, 2010 WL 2518587 (U.S. Jun 24, 2010) (NO. 08-1394)]

2. Section 1346, which proscribes fraudulent deprivations of "the intangible right of honest services," is properly confined to cover only bribery and kickback schemes. Because Skilling's alleged misconduct entailed no bribe or kickback, it does not fall within the Court's confinement of § 1346's proscription. Pp. — - —.

(a) To place Skilling's claim that § 1346 is unconstitutionally vague in context, the Court reviews the origin and subsequent application of the honest-services doctrine. Pp. — - —.

(1) In a series of decisions beginning in the 1940s, the Courts of Appeals, one after another, interpreted the mail-fraud statute's prohibition of "any scheme or artifice to defraud" to include deprivations not only of money or property, but also of intangible rights. See, e.g., Shushan v. United States, 117 F.2d 110, which stimulated the development of the "honest-services" doctrine. Unlike traditional fraud, in which the victim's loss of money or property supplied the defendant's gain, with one the mirror image of the other, the honest-services doctrine targeted corruption that lacked similar symmetry. While the offender profited, the betrayed party suffered no deprivation of money or property; instead, a third party, who had not been deceived, provided the enrichment. Even if the scheme occasioned a money or property gain for the betrayed party, courts reasoned, actionable harm lay in the denial of that party's right to the offender's "honest services." Most often these cases involved bribery of public officials, but over time, the courts increasingly recognized that the doctrine applied to a private employee who breached his allegiance to his employer, often by accepting bribes or kickbacks. By 1982, all Courts of Appeals had embraced the honest-services theory of fraud. Pp. — - —.

(2) In 1987, this Court halted the development of the intangible-rights doctrine in McNally v. United States, 483 U.S. 350, 360, 107 S.Ct. 2875, 97 L.Ed.2d 292, which held that the mail-fraud statute was "limited in scope to the protection of property rights." "If Congress desires to go further," the Court stated, "it must speak more clearly." Ibid. P. —.

(3) Congress responded the next year by enacting § 1346, which provides: "For the purposes of th[e] chapter [of the U.S.Code that prohibits, inter alia, mail fraud, § 1341, and wire fraud, § 1343], the term 'scheme or artifice to defraud' includes a scheme or artifice to deprive another of the intangible right of honest services." Pp — - —.

(b) Section 1346, properly confined to core cases, is not unconstitutionally vague. Pp. — - —.

(1) To satisfy due process, "a penal statute [must] define the criminal offense [1] with sufficient definiteness that ordinary people can understand what conduct is prohibited and [2] in a manner that does not encourage arbitrary and discriminatory enforcement." Kolender v. Lawson, 461 U.S. 352, 357, 103 S.Ct. 1855, 75 L.Ed.2d 903. The void-for-vagueness doctrine embraces these requirements. Skilling contends that § 1346 meets neither of the two due-process essentials. But this Court must, if possible, construe, not condemn, Congress' enactments. See, e.g., Civil Service Comm'n v. Letter Carriers, 413 U.S. 548, 571, 93 S.Ct. 2880, 37 L.Ed.2d 796. Alert to § 1346' s potential breadth, the Courts of Appeals have divided on how best to interpret the statute. Uniformly, however, they have declined to throw out the statute as irremediably vague. This Court agrees that § 1346 should be construed rather than invalidated. P. — - —.

(2) The Court looks to the doctrine developed in pre- McNally cases in an endeavor to ascertain the meaning of the phrase "the intangible right of honest services." There is no doubt that Congress intended § 1346 to refer to and incorporate the honest-services doctrine recognized in Courts of Appeals' decisions before McNally derailed the intangible-rights theory of fraud. Congress, it bears emphasis, enacted § 1346 on the heels of McNally and drafted the statute using that

decision's terminology. See 483 U.S., at 355, 362, 107 S.Ct. 2875. Pp. — - —.

(3) To preserve what Congress certainly intended § 1346 to cover, the Court pares the pre- McNally body of precedent down to its core: In the main, the pre- McNally cases involved fraudulent schemes to deprive another of honest services through bribes or kickbacks supplied by a third party who had not been deceived. In parsing the various pre- McNally decisions, the Court acknowledges that Skilling's vagueness challenge has force, for honest-services decisions were not models of clarity or consistency. It has long been the Court's practice, however, before striking a federal statute as impermissibly vague, to consider whether the prescription is amenable to a limiting construction. See, e.g., Hooper v. California, 155 U.S. 648, 657, 15 S.Ct. 207, 39 L.Ed. 297. Arguing against any limiting construction, Skilling contends that it is impossible to identify a salvageable honest-services core because the pre- McNally cases are inconsistent and hopelessly unclear. This Court rejected an argument of the same tenor in Letter Carriers, 413 U.S., at 571-572, 93 S.Ct. 2880. Although some applications of the pre- McNally honest-services doctrine occasioned disagreement among the Courts of Appeals, these decisions do not cloud the fact that the vast majority of cases involved offenders who, in violation of a fiduciary duty, participated in bribery or kickback schemes. Indeed, McNally itself presented a paradigmatic kickback fact pattern. 483 U.S., at 352-353, 360, 107 S.Ct. 2875. In view of this history, there is no doubt that Congress intended § 1346 to reach at least bribes and kickbacks. Because reading the statute to proscribe a wider range of offensive conduct would raise vagueness concerns, the Court holds that § 1346 criminalizes only the bribe-and-kickback core of the pre- McNally case law. Pp. — - —.

(4) The Government urges the Court to go further by reading § 1346 to proscribe another category of conduct: undisclosed self-dealing by a public official or private employee. Neither of the Government's arguments in support of this position withstands close inspection. Contrary to the first, McNally itself did not center on nondisclosure of a conflicting financial interest, but rather involved a classic kickback scheme. See 483 U.S., at 352-353, 360, 107 S.Ct. 2875. Reading § 1346 to proscribe bribes and kickbacks-and nothing more-satisfies Congress' undoubted aim to reverse McNally on its facts. Nor is the Court persuaded by the Government's argument that the pre- McNally conflict-of-interest cases constitute core applications of the honest-services doctrine. Although the Courts of Appeals upheld honest-services convictions for some conflict-of-interest schemes, they reached no consensus on which schemes qualified. Given the relative infrequency of those prosecutions and the intercircuit inconsistencies they produced, the Court concludes that a reasonable limiting construction of § 1346 must exclude this amorphous category of cases. Further dispelling doubt on this point is the principle that "ambiguity concerning the ambit of criminal statutes should be resolved in favor of lenity." Cleveland v. United States, 531 U.S. 12, 25, 121 S.Ct. 365, 148 L.Ed.2d 221. The Court therefore resists the Government's less constrained construction of § 1346 absent Congress' clear instruction otherwise. "If Congress desires to go further," the Court reiterates, "it must speak more clearly than it has." McNally, 483 U.S., at 360, 107 S.Ct. 2875. Pp. — - —.

(5) Interpreted to encompass only bribery and kickback schemes, § 1346 is not unconstitutionally vague. A prohibition on fraudulently depriving another of one's honest services by accepting bribes or kickbacks presents neither a fair-notice nor an arbitrary-prosecution problem. See Kolender, 461 U.S., at 357, 103 S.Ct. 1855. As to fair notice, it has always been clear that bribes and kickbacks constitute honest-services fraud, Williams v. United States, 341 U.S. 97, 101, 71 S.Ct. 576, 95 L.Ed. 774, and the statute's mens rea requirement further blunts any notice concern, see, e.g., Screws v. United States, 325 U.S. 91, 101-104, 65 S.Ct. 1031, 89 L.Ed. 1495. As to arbitrary prosecutions, the Court perceives no significant risk that the honest-services statute, as here interpreted, will be stretched out of shape. Its prohibition on bribes and kickbacks draws content not only from the pre- McNally case law, but also from federal statutes proscribing and defining similar crimes. Pp. — - —.

(c) Skilling did not violate § 1346, as the Court interprets the statute. The Government charged Skilling with conspiring to defraud Enron's shareholders by misrepresenting the company's fiscal health to his own profit, but the Government never alleged that he solicited or accepted side payments from a third party in exchange for making these misrepresentations. Because the indictment alleged three objects of the conspiracy-honest-services wire fraud, money-or-property wire fraud, and securities fraud-Skilling's conviction is flawed. See Yates v. United States, 354 U.S. 298, 77 S.Ct. 1064, 1 L.Ed.2d 1356. This determination, however, does not necessarily require reversal of the conspiracy conviction, for errors of the Yates variety are subject to harmless-error analysis. The Court leaves the parties' dispute about whether the error here was harmless for resolution on remand, along with the question whether reversal on the conspiracy count would touch any of Skilling's other convictions. Pp. — - —.

554 F.3d 529, affirmed in part, vacated in part, and remanded.

GINSBURG, J., delivered the opinion of the Court, Part I of which was joined by ROBERTS, C.J., and STEVENS, SCALIA, KENNEDY, THOMAS, and ALITO, JJ., Part II of which was joined by ROBERTS, C.J., and SCALIA, KENNEDY, and THOMAS, JJ., and Part III of which was joined by ROBERTS, C. J., and STEVENS, BREYER, ALITO, and SOTOMAYOR, JJ. SCALIA, J., filed an opinion concurring in part and concurring in the judgment, in which THOMAS, J., joined, and KENNEDY, J., joined except as to Part III. ALITO, J., filed an opinion concurring in part and concurring in the judgment. SOTOMAYOR, J., filed an opinion concurring in part and dissenting in part, in which STEVENS and BREYER, JJ., joined.

Bankruptcy *continues from p. 9*

Supreme Court
Is Sarbanes-Oxley unconstitutional?

The Supreme Court ordered a technical change to the Sarbanes-Oxley accounting rules but left the broader law intact. A government body that oversees accounting firms is structured in a way that's unconstitutional, the Supreme Court said. Under the 5-4 ruling, the Public Company Accounting Oversight Board can continue to operate with only minor changes. Had the court ruled more broadly, it could have invalidated the accounting panel or even Sarbanes-Oxley. Free Enterprise Fund v. Public Co. Accounting Oversight Bd., — S.Ct. —, 2010 WL 2555191 (U.S.Dist.Col. Jun 28, 2010) (NO. 08-861).

Syllabus of Free Enterprise Fund v. Public Co. Accounting Oversight Bd.

Respondent, the Public Company Accounting Oversight Board, was created as part of a series of accounting reforms in the Sarbanes-Oxley Act of 2002. The Board is composed of five members appointed by the Securities and Exchange Commission. It was modeled on private self-regulatory organizations in the securities industry-such as the New York Stock Exchange-that investigate and discipline their own members subject to Commission oversight. Unlike these organizations, the Board is a Government-created entity with expansive powers to govern an entire industry. Every accounting firm that audits public companies under the securities laws must register with the Board, pay it an annual fee, and comply with its rules and oversight. The Board may inspect registered firms, initiate formal investigations, and issue severe sanctions in its disciplinary proceedings. The parties agree that the Board is "part of the Government" for constitutional purposes, Lebron v. National Railroad Passenger Corporation, 513 U.S. 374, 397, 115 S.Ct. 961, 130 L.Ed.2d 902, and that its members are " 'Officers of the United States' " who "exercis[e] significant authority pursuant to the laws of the United States," Buckley v. Valeo, 424 U.S. 1, 125-126, 96 S.Ct. 612, 46 L.Ed.2d 659. While the SEC has oversight of the Board, it cannot remove Board members at will, but only "for good cause shown," "in accordance with" specified procedures. §§ 7211(e)(6), 7217(d)(3). The parties also agree that the Commissioners, in turn, cannot themselves be removed by the President except for " 'inefficiency, neglect of duty, or malfeasance in office.' " Humphrey's Executor v. United States, 295 U.S. 602, 620, 55 S.Ct. 869, 79 L.Ed. 1611.

The Board inspected petitioner accounting firm, released a report critical of its auditing procedures, and began a formal investigation. The firm and petitioner Free Enterprise Fund, a nonprofit organization of which the firm is a member, sued the Board and its members, seeking, inter alia, a declaratory judgment that the Board is unconstitutional and an injunction preventing the Board from exercising its powers. Petitioners argued that the Sarbanes-Oxley Act contravened the separation of powers by conferring executive power on Board members without subjecting them to Presidential control. The basis for petitioners' challenge was that Board members were insulated from Presidential control by two layers of tenure protection: Board members could only be removed by the Commission for good cause, and the Commissioners could in turn only be removed by the President for good cause. Petitioners also challenged the Board's appointment as violating the Appointments Clause, which requires officers to be appointed by the President with the Senate's advice and consent, or-in the case of "inferior Officers"-by "the President alone, ... the Courts of Law, or ... the Heads of Departments," Art. II, § 2, cl. 2. The United States intervened to defend the statute. The District Court found it had jurisdiction and granted summary judgment to respondents. The Court of Appeals affirmed. It first agreed that the District Court had jurisdiction. It then ruled that the dual restraints on Board members' removal are permissible, and that Board members are inferior officers whose appointment is consistent with the Appointments Clause.

Held:

1. The District Court had jurisdiction over these claims. The Commission may review any Board rule or sanction, and an aggrieved party may challenge the Commission's "final order" or "rule" in a court of appeals under 15 U.S.C. § 78y. The Government reads § 78y as an exclusive route to review, but the text does not expressly or implicitly limit the jurisdiction that other statutes confer on district courts. It is presumed that Congress does not intend to limit jurisdiction if "a finding of preclusion could foreclose all meaningful judicial review"; if the suit is " 'wholly "collateral" ' to a statute's review provisions"; and if the claims are "outside the agency's expertise." Thunder Basin Coal Co. v. Reich, 510 U.S. 200, 212-213, 114 S.Ct. 771, 127 L.Ed.2d 29.

These considerations point against any limitation on review here. Section 78y provides only for review of Commission action, and petitioners' challenge is "collateral" to any Commission orders or rules from which review might be sought. The Government advises petitioners to raise their claims by appealing a Board sanction, but petitioners have not been sanctioned, and it is no "meaningful" avenue of relief, Thunder Basin, supra, at 212, to require a plaintiff to incur a sanction in order to test a law's validity, MedImmune, Inc. v. Genentech, Inc., 549 U.S. 118, 129, 127 S.Ct. 764, 166 L.Ed.2d 604. Petitioners' constitutional claims are also outside the Commission's competence and expertise, and the statutory questions involved do not require technical considerations of agency policy. Pp. — - —.

2. The dual for-cause limitations on the removal of Board members contravene the Constitution's separation of powers. Pp. — - —.

(a) The Constitution provides that "[t]he executive Power shall be vested in a President of the United States of America." Art. II, § 1, cl. 1. Since 1789, the Constitution has been understood to empower the President to keep executive officers accountable-by removing them from office, if necessary. See generally Myers v. United States, 272 U.S. 52, 47 S.Ct. 21, 71 L.Ed. 160. This Court has determined that this authority is not without limit. In Humphrey's Executor, supra, this Court held that Congress can, under certain circumstances, create independent agencies run by principal officers appointed by the President, whom the President may not remove at will but only for good cause. And in United States v. Perkins, 116 U.S. 483, 21 Ct.Cl. 499, 6 S.Ct. 449, 29 L.Ed. 700, and Morrison v. Olson, 487 U.S. 654, 108 S.Ct. 2597, 101 L.Ed.2d 569, the Court sustained similar restrictions on the power of principal executive officers-themselves responsible to the President-to remove their own inferiors. However, this Court has not addressed the consequences of more than one level of good-cause tenure. Pp. — - —.

(b) Where this Court has upheld limited restrictions on the President's removal power, only one level of protected tenure separated the President from an officer exercising executive power. The President-or a subordinate he could remove at will-decided whether the officer's conduct merited removal under the good-cause standard. Here, the Act not only protects Board members from removal except for good cause, but withdraws from the President any decision on whether that good cause exists. That decision is vested in other tenured officers-the Commissioners-who are not subject to the President's direct control. Because the Commission cannot remove a Board member at will, the President cannot hold the Commission fully accountable for the Board's conduct. He can only review the Commissioner's determination of whether the Act's rigorous good-cause standard is met. And if the President disagrees with that determination, he is powerless to intervene-unless the determination is so unreasonable as to constitute " 'inefficiency, neglect of duty, or malfeasance in office.' " Humphrey's Executor, supra, at 620.

This arrangement contradicts Article II's vesting of the executive power in the President. Without the ability to oversee the Board, or to attribute the Board's failings to those whom he can oversee, the President is no longer the judge of the Board's conduct. He can neither ensure that the laws are faithfully executed, nor be held responsible for a Board member's breach of faith. If this dispersion of responsibility were allowed to stand, Congress could multiply it further by adding still more layers of good-cause tenure. Such diffusion of power carries with it a diffusion of accountability; without a clear and effective chain of command, the public cannot determine where the blame for a pernicious measure should fall. The Act's restrictions are therefore incompatible with the Constitution's separation of powers. Pp. — - —.

(c) The " 'fact that a given law or procedure is efficient, convenient, and useful in facilitating functions of government, standing alone, will not save it if it is contrary to the Constitution." Bowsher v. Synar, 478 U.S. 714, 736, 106 S.Ct. 3181, 92 L.Ed.2d 583. The Act's multilevel tenure protections provide a blueprint for the extensive expansion of legislative power. Congress controls the salary, duties, and existence of executive offices, and only Presidential oversight can counter its influence. The Framers created a structure in which "[a] dependence on the people" would be the "primary controul on the government," and that dependence is maintained by giving each branch "the necessary constitutional means and personal motives to resist encroachments of the others." The Federalist No. 51, p. 349. A key "constitutional means" vested in the President was "the power of appointing, overseeing, and controlling those who execute the laws." 1 Annals of Congress 463. While a government of "opposite and rival interests" may sometimes inhibit the smooth functioning of administration, The Federalist No. 51, at 349, "[t]he Framers recognized that, in the long term, structural protections against abuse of power were critical to preserving liberty." Bowsher, supra, at 730. Pp. — - —.

(d) The Government errs in arguing that, even if some constraints on the removal of inferior executive officers might violate the Constitution, the restrictions here do not. There is no construction of the Commission's good-cause removal power that is broad enough to avoid invalidation. Nor is the Commission's broad power over Board functions the equivalent of a power to remove Board members. Altering the Board's budget or powers is not a meaningful way to control an inferior officer; the Commission cannot supervise individual Board members if it must destroy the Board in order to fix it. Moreover, the Commission's power over the Board is hardly plenary, as the Board may take significant enforcement actions largely independently of the Commission. Enacting new SEC rules through the required notice and comment procedures would be a poor means of micromanaging the Board, and without certain findings, the Act forbids any general rule requiring SEC preapproval of Board actions. Finally, the Sarbanes-Oxley Act is highly unusual in committing substantial executive authority to officers protected by two layers of good-cause removal. Pp. — - —.

3. The unconstitutional tenure provisions are severable from the remainder of the statute. Because "[t] he unconstitutionality of a part of an Act does not necessarily defeat or affect the validity of its remaining provisions," Champlin Refining Co. v. Corporation Comm'n of Okla., 286 U.S. 210, 234, 52 S.Ct. 559, 76 L.Ed. 1062, the "normal rule" is "that partial ... invalidation is the required course," Brockett v. Spokane Arcades, Inc., 472 U.S. 491, 504, 105 S.Ct. 2794, 86 L.Ed.2d 394. The Board's existence does not violate the separation of powers, but the substantive removal restrictions imposed by §§ 7211(e)(6) and 7217(d)(3) do. Concluding that the removal restrictions here are invalid leaves the Board removable by the Commission at will. With the tenure restrictions excised, the Act remains " 'fully operative as a law,' " New York v. United States, 505 U.S. 144, 186, 112 S.Ct. 2408, 120 L.Ed.2d 120, and nothing in the Act's text or historical context makes it "evident" that Congress would have preferred no Board at all to a Board whose members are removable at will, Alaska Airlines, Inc. v. Brock, 480 U.S. 678, 684, 107 S.Ct. 1476, 94 L.Ed.2d 661. The consequence is that the Board may continue to function as before, but its members may be removed at will by the Commission. Pp. — - —.

Bankruptcy *continues from p. 11*

4. The Board's appointment is consistent with the Appointments Clause. Pp. — - —.

(a) The Board members are inferior officers whose appointment Congress may permissibly vest in a "Hea[d] of Departmen[t]." Inferior officers "are officers whose work is directed and supervised at some level" by superiors appointed by the President with the Senate's consent. Edmond v. United States, 520 U.S. 651, 662-663, 117 S.Ct. 1573, 137 L.Ed.2d 917. Because the good-cause restrictions discussed above are unconstitutional and void, the Commission possesses the power to remove Board members at will, in addition to its other oversight authority. Board members are therefore directed and supervised by the Commission. Pp. — - —.

(b) The Commission is a "Departmen[t]" under the Appointments Clause. Freytag v. Commissioner, 501 U.S. 868, 887, n. 4, 111 S.Ct. 2631, 115 L.Ed.2d 764, specifically reserved the question whether a "principal agenc[y], such as" the SEC, is a "Departmen[t]." The Court now adopts the reasoning of the concurring Justices in Freytag, who would have concluded that the SEC is such a "Departmen[t]" because it is a freestanding component of the Executive Branch not subordinate to or contained within any other such component. This reading is consistent with the common, near-contemporary definition of a "department"; with the early practice of Congress, see § 3, 1 Stat. 234; and with this Court's cases, which have never invalidated an appointment made by the head of such an establishment. Pp. — - —.

(c) The several Commissioners, and not the Chairman, are the Commission's "Hea[d]." The Commission's powers are generally vested in the Commissioners jointly, not the Chairman alone. The Commissioners do not report to the Chairman, who exercises administrative functions subject to the full Commission's policies. There is no reason why a multimember body may not be the "Hea[d]" of a "Departmen[t]" that it governs. The Appointments Clause necessarily contemplates collective appointments by the "Courts of Law," Art. II, § 2, cl. 2, and each House of Congress appoints its officers collectively, see, e.g., Art. I, § 2, cl. 5. Practice has also sanctioned the appointment of inferior officers by multimember agencies. Pp. — - —.

537 F.3d 667, affirmed in part, reversed in part, and remanded.

ROBERTS, C.J., delivered the opinion of the Court, in which SCALIA, KENNEDY, THOMAS, and ALITO, JJ., joined. BREYER, J., filed a dissenting opinion, in which STEVENS, GINSBURG, and SOTOMAYOR, JJ., joined.

Supreme Court

What is the proper rule to apply when a debtor claims an ambiguous exemption in bankruptcy?

The Supreme Court had to resolve a dispute over what was covered by an exemption that the debtor had claimed—and which the trustee had ratified by failing to object within 30 days.

Justice Thomas wrote for a 6-3 Court "that Schwab [trustee] was not required to object to Reilly's [debtor] claimed exemptions in her business equipment in order to preserve the estate's right to retain any value in the equipment beyond the value of the exempt interest." To hold otherwise "threatens to convert a fresh start into a free pass," Schwab v. Reilly, — S.Ct. —, 2010 WL 2400094, 78 USLW 4598, 10 Cal. Daily Op. Serv. 7580, 2010 Daily Journal D.A.R. 9047 (U.S. Jun 17, 2010) (NO. 08-538).

Justice Thomas, held that when the Bankruptcy Code defines the property a debtor is authorized to exempt as an interest, the value of which may not exceed a certain dollar amount, in a particular type of asset, and the debtor's schedule of exempt property accurately describes the asset and declares the "value of [the] claimed exemption" in that asset to be an amount within the limits that the Code prescribes, an interested party is entitled to rely upon that value as evidence of the claim's validity and need not object to the exemption in order to preserve the estate's ability to recover value in the asset beyond the dollar value the debtor expressly declared exempt, abrogating In re Green, 31 F.3d 1098, and In re Anderson, 377 B.R. 865.

Syllabus Schwab v. Reilly

Respondent Reilly filed for Chapter 7 bankruptcy when her catering business failed. She supported her petition with, inter alia, Schedule B, on which debtors must list their assets, and Schedule C, on which they must list the property they wish to reclaim as exempt. Her Schedule B assets included cooking and other kitchen equipment, to which she assigned an estimated market value of $10,718. On Schedule C, she claimed two exempt interests in this "business equipment": a "tool[s] of the trade" exemption for the statutory-maximum "$1,850 in value," 11 U.S.C. § 522(d)(6); and $8,868 under the statutory provisions allowing miscellaneous, or "wildcard," exemptions up to $10,225 in value. The claimed exemptions' total value ($10,718) equaled Reilly's estimate of the equipment's market value. Property claimed as exempt will be excluded from the bankruptcy estate "[u]nless a party in interest" objects, § 522(l), within a certain 30-day period, see Fed. Rule Bkrtcy. Proc. 4003(b). Absent an objection, the property will be excluded from the estate even if the exemption's value exceeds what the Code permits. See, e.g., § 522(l); Taylor v. Freeland & Kronz, 503 U.S. 638, 642-643, 112 S.Ct. 1644, 118 L.Ed.2d 280.

Although an appraisal revealed that the equipment's total market value could be as much as $17,200, petitioner Schwab, the bankruptcy estate's trustee, did not object to the claimed exemptions because the dollar value Reilly assigned to each fell within the limits of §§ 522(d)(5) and (6). Schwab moved the Bankruptcy Court for permission to auction the equipment so Reilly could receive the $10,718 she claimed exempt and the estate could distribute the remaining value to her creditors. Reilly countered that by equating on Schedule C the total value of her claimed exemptions in the equipment with the equipment's estimated market value, she had put Schwab and her creditors on notice that she intended to exempt the equipment's full value, even if it turned out to be more than the amounts she declared and that the Code allowed. She asserted that the estate had forfeited its claim to any portion of that value because Schwab had not objected within the Rule 4003(b) period, and that she would dismiss her petition rather than sell her equipment.

The Bankruptcy Court denied Schwab's motion and Reilly's conditional motion to dismiss. The District Court denied Schwab relief, rejecting his argument that neither the Code nor Rule 4003(b) requires a trustee to object to a claimed exemption where the amount the debtor declares as the exemption's value is within the limits the Code prescribes. Affirming, the Third Circuit agreed that Reilly's Schedule C entries indicated her intent to exempt the equipment's full value. Relying on Taylor, it held that Schwab's failure to object entitled Reilly to exempt the full value of her equipment, even though that value exceeded the amounts that Reilly declared and the Code permitted.

Held:

Because Reilly gave "the value of [her] claimed exemption[s]" on Schedule C dollar amounts within the range the Code allows for what it defines as the "property claimed as exempt," Schwab was not required to object to the exemptions in order to preserve the estate's right to retain any value in the equipment beyond the value of the exempt interest. Pp. — - —.

(a) Reilly's complicated view of the trustee's statutory obligation, and her reading of Schedule C, does not accord with the Code. Pp. — - —.

(1) The parties agree that this case is governed by § 522(l), which states that a Chapter 7 debtor must "file a list of property that the debtor claims as exempt under subsection (b) of this section," and that "[u]nless a party in interest objects, the property claimed as exempt on such list is exempt." Reilly asserts that the "property claimed as exempt" refers to all of the information on Schedule C, including the estimated market value of each asset. Schwab and amicus United States counter that because the Code defines such property as an interest, not to exceed a certain dollar amount, in a particular asset, not as the asset itself, the value of the property claimed exempt should be judged on the dollar value the debtor assigns the interest, not on the value the debtor assigns the asset. Pp. — - —.

(2) Schwab and the United States are correct. The portion of § 522(l) that resolves this case is not, as Reilly asserts, the provision stating that the "property claimed as exempt on [Schedule C] is exempt" unless an interested party objects. Rather, it is the portion that defines the objection's target, namely, the "list of property that the debtor claims as exempt under subsection (b)." Section 522(b) does not define the "property claimed as exempt" by reference to the estimated market value. It refers only to property defined in § 522(d), which in turn lists 12 categories of property that a debtor may claim as exempt. Most of these categories and all the ones applicable here define "property" as the debtor's "interest"-up to a specified dollar amount-in the assets described in the category, not as the assets themselves. Schwab had no duty to object to the property Reilly claimed as exempt because its stated value was within the limits the Code allows. Reilly's contrary view does not withstand scrutiny because it defines the target of a trustee's objection based on Schedule C's language and dictionary definitions of "property" at odds with the Code's definition. The Third Circuit failed to account for the Code's definition and for provisions that permit debtors to exempt certain property in kind or in full regardless of value. See, e.g., § 522(d)(9). Schwab was entitled to evaluate the claimed exemptions' propriety based on three Schedule C entries: the description of the business equipment in which Reilly claimed the exempt interests; the Code provisions governing the claimed exemptions; and the amounts Reilly listed in the column titled "value of claimed exemption." This conclusion does not render Reilly's market value estimate superfluous. It simply confines that estimate to its proper role: aiding the trustee in administering the estate by helping him identify assets that may have value beyond the amount the debtor claims as exempt, or whose full value may not be available for exemption. This interpretation is consistent with the historical treatment of bankruptcy exemptions. Pp. — - —.

(b) Taylor does not dictate a contrary conclusion. While both Taylor and this case concern the consequences of a trustee's failure to object to a claimed exemption within Rule 4003's time period, Taylor establishes and applies the straightforward proposition that an interested party must object to a claimed exemption if the amount the debtor lists as the "value claimed exempt" is not within statutory limits. In Taylor, the value listed in Schedule C ("$ unknown") was not plainly within those limits, but here, the values ($8,868 and $1,850) are within Code limits and thus do not raise the warning flag present in Taylor. Departing from Taylor would not only ignore the presumption that parties act lawfully and with knowledge of the law; it would also require the Court to expand the statutory definition of "property claimed as exempt" and the universe of information an interested party must consider in evaluating an exemption's validity. Even if the Code allowed such expansions, they would be ill advised. Basing the definition of "property claimed exempt," and thus an interested party's obligation to object under § 522(l), on inferences that party must draw from preprinted bankruptcy schedules that evolve over time, rather than on the facial validity of the value the debtor assigns the "property claimed as exempt" as defined by the Code, would undermine the predictability the statute is designed to provide. Pp. — - —.

(c) Reilly's argument threatens to convert the Code's goal of giving debtors a fresh start into a free pass. By permitting a debtor "to withdraw from the estate certain interests in property, ... up to certain values," Rousey v. Jacoway, 544 U.S. 320, 325, 125 S.Ct. 1561, 161 L.Ed.2d 563, Congress balanced the difficult choices that exemption limits impose on debtors with the economic harm that exemptions visit on creditors. This Court should not alter that balance by requiring trustees to object to claimed exemptions based on

Bankruptcy *continues from p. 13*

form entries beyond those governing an exemption's validity under the Code. In rejecting Reilly's approach, the Court does not create incentives for trustees and creditors to sleep on their rights. The decision reached here encourages a debtor wishing to exempt an asset's full market value or the asset itself to declare the value of the claimed exemption in a way that makes its scope clear. Such declarations will encourage the trustee to object promptly and preserve for the estate any value in the asset beyond relevant statutory limits. If the trustee fails to object, or his objection is overruled, the debtor will be entitled to exclude the asset's full value. If the objection is sustained, the debtor will be required either to forfeit the portion of the exemption exceeding the statutory allowance or to revise other exemptions or arrangements with creditors to permit the exemption. See Rule 1009(a). Either result will facilitate the expeditious and final disposition of assets, and thus enable the debtor and creditors to achieve a fresh start free of Reilly's finality and clouded-title concerns. Pp. —- —.

534 F.3d 173, reversed and remanded.

THOMAS, J., delivered the opinion of the Court, in which STEVENS, SCALIA, KENNEDY, ALITO, and SOTOMAYOR, JJ., joined. GINSBURG, J., filed a dissenting opinion, in which ROBERTS, C.J., and BREYER, J., joined.

Supreme Court

What is the definition of "projected disposable income" in chapter 13 of the Bankruptcy Code?

The Supreme Court affirmed the Tenth Circuit's holding that a court should apply a forward-looking test rather than a mechanical test in determining a debtor's projected disposable income, holding that "when a bankruptcy court calculates a debtor's projected disposable income, the court may account for changes in the debtor's income or expenses that are known or virtually certain at the time of confirmation." Hamilton v. Lanning, — S.Ct. —, 2010 WL 2243704, 78 USLW 4518, 10 Cal. Daily Op. Serv. 6973, 2010 Daily Journal D.A.R. 8299, 22 Fla. L. Weekly Fed. S 427 (U.S. Jun 07, 2010) (NO. 08-998)

Syllabus Hamilton v. Lanning

Debtors filing for protection under Chapter 13 of the Bankruptcy Code must agree to a court-approved plan under which they pay creditors out of their future income. If the bankruptcy trustee or an unsecured creditor objects, a bankruptcy court may not approve the plan unless it provides for the full repayment of unsecured claims or "provides that all of the debtor's projected disposable income to be received" over the plan's duration "will be applied to make payments" in accordance with plan terms. 11 U.S.C. § 1325(b)(1). Before enactment of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA), the Code loosely defined "disposable income." Though it did not define "projected disposable income," most bankruptcy courts calculated it using a mechanical approach, multiplying monthly income by the number of months in the plan and then determining the "disposable" portion of the result. In exceptional cases, those courts also took into account foreseeable changes in a debtor's income or expenses. BAPCPA defines "disposable income" as "current monthly income received by the debtor" less "amounts reasonably necessary to be expended" for, e.g., the debtor's maintenance and support. § 1325(b)(2)(A)(i). "Current monthly income," in turn, is calculated by averaging the debtor's monthly income during a 6-month look-back period preceding the petition's filing. See § 101(10A)(A)(i). If a debtor's income is below the median for his or her State, "amounts reasonably necessary" include the full amount needed for "maintenance or support," see § 1325(b)(2)(A)(i), but if the debtor's income exceeds the state median, only certain specified expenses are included, see §§ 707(b)(2), 1325(b)(3)(A).

A one-time buyout from respondent's former employer caused her current monthly income for the six months preceding her Chapter 13 petition to exceed her State's median income. However, based on the income from her new job, which was below the state median, and her expenses, she reported a monthly disposable income of $149.03. She thus filed a plan that would have required her to pay $144 per month for 36 months. Petitioner, the Chapter 13 trustee, objected to confirmation of the plan because the proposed payment amount was less than the full amount of the claims against respondent, and because she had not committed all of her "projected disposable income" to repaying creditors. Petitioner claimed that the mechanical approach was the proper way to calculate projected disposable income, and that using that approach, respondent should pay $756 per month for 60 months. Her actual income was insufficient to make such payments.

The Bankruptcy Court endorsed a $144 payment over a 60-month period, concluding that "projected" requires courts to consider the debtor's actual income. The Tenth Circuit Bankruptcy Appellate Panel affirmed, as did the Tenth Circuit, which held that a court calculating "projected disposable income" should begin with the "presumption" that the figure yielded by the mechanical approach is correct, but that this figure may be rebutted by evidence of a substantial change in the debtor's circumstances.

Held:

When a bankruptcy court calculates a debtor's projected disposable income, the court may account for changes in the debtor's income or expenses that are known or virtually certain at the time of confirmation. Pp. —- —.

(a) Respondent has the better interpretation of "projected disposable income." First, such a forward-looking approach is supported by the ordinary meaning of "projected." See Asgrow Seed Co. v. Winterboer, 513 U.S. 179, 187, 115 S.Ct. 788, 130 L.Ed.2d 682. In ordinary usage future occurrences are not "projected" based on the assumption that the past will necessarily repeat itself. While a projection takes past events into account, adjustments are often made based on other factors that may affect the outcome. Second, "projected" appears in many federal statutes, yet Congress rarely uses it to mean simple multiplication. See, e.g., 7 U.S.C. § 1301(b)(8)(B). By contrast, as the Bankruptcy Code shows, Congress can make its mandate of simple multiplication unambiguous-commonly using the term "multiplied." See, e.g., 11 U.S.C. § 1325(b)(3). Third, under pre-BAPCPA case law, the general rule was that courts would multiply a debtor's current monthly income by the number of months in the commitment period as the first step in determining projected disposable income, but would also have discretion to account for known or virtually certain changes in the debtor's income. This is significant, since the Court "will not read the Bankruptcy Code to erode past bankruptcy practice absent a clear indication that Congress intended such a departure," Travelers Casualty & Surety Co. of America v. Pacific Gas & Elec. Co., 549 U.S. 443, 454, 127 S.Ct. 1199, 167 L.Ed.2d 178, and Congress did not amend the term "projected disposable income" in 2005. Pp. —-—.

(b) The mechanical approach also clashes with § 1325's terms. First, § 1325(b)(1)(B)'s reference to projected disposable income "to be received in the applicable commitment period" strongly favors the forward-looking approach. Because respondent would have far less than $756 per month in disposable income during the plan period, petitioner's projection does not accurately reflect disposable income "to be received." In such circumstances, the mechanical approach effectively reads that phrase out of the statute. Second, § 1325(b)(1)'s direction to courts to determine projected disposable income "as of the effective date of the plan,"-i.e., the confirmation date-is more consistent with the view that they are to consider postfiling information about a debtor's financial situation. Had Congress intended for projected disposable income to be no more than a multiple of disposable income, it could have specified the plan's filing date as the effective date. Third, § 1325(b)(1)(B)'s requirement that projected disposable income "will be applied to make payments" is rendered a hollow command if, as of the plan's effective date, the debtor lacks the means to pay creditors in the calculated monthly amounts. Pp. —-—.

(c) The arguments supporting the mechanical approach are unpersuasive. The claim that the Code's detailed and precise "disposable income" definition would have no purpose without the mechanical approach overlooks the important role that this statutory formula plays under the forward-looking approach, which begins with a disposable income calculation. The Tenth Circuit's rebuttable "presumption" analysis simply heeds the ordinary meaning of "projected." This Court rejects petitioner's argument that only the mechanical approach is consistent with § 1129(a)(15)(B), which refers to "projected disposable income of the debtor (as defined in section 1325(b)(2))." And the Court declines to infer from the fact that § 1325(b)(3) incorporates § 707-which allows courts to consider "special circumstances," but only with respect to calculating expenses-that Congress intended to eliminate, sub silentio, the discretion that courts previously exercised to account for known or virtually certain changes. Pp. —-—.

(d) Petitioner's proposed strategies for avoiding or mitigating the harsh results that the mechanical approach may produce for debtors-a debtor could delay filing a petition so as to place any extraordinary income outside the 6-month period; a debtor with unusually high income during that period could seek leave to delay filing a schedule of current income and ask the bankruptcy court to select a 6-month period more representative of the debtor's future disposable income; a debtor could dismiss the petition and refile at a later, more favorable date; and respondent might have been able to obtain relief by filing under Chapter 7 or converting her Chapter 13 petition to one under Chapter 7-are all flawed. Pp. —-—.

545 F.3d 1269, affirmed.

ALITO, J., delivered the opinion of the Court, in which ROBERTS, C.J., and STEVENS, KENNEDY, THOMAS, GINSBURG, BREYER, and SOTOMAYOR, JJ., joined. SCALIA, J., filed a dissenting opinion. ■

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

Credit Bidding continues from p. 1

inter alia, when the plan is "fair and equitable." A plan is fair and equitable under the Code if it meets one of three provisions under §1129(b) (2) (A), with respect to a class of secured claims, if the plan provides:

(i)(I) that the holders of such claims retain the liens securing such claims, whether the property subject to such liens is retained by the debtor or transferred to another entity, to the extent of the allowed amount of such claims; and (II) that each holder of a claim of such class receive on account of such claim deferred cash payments totaling at least the allowed amount of such claim, of a value, as of the effective date of the plan, of at least the value of such holder's interest in the estate's interest in such property;

(ii) for the sale, subject to §363(k) of this title, of any property that is subject to the liens securing such claims, free and clear of such liens, with such liens to attach to the proceeds of such sale, and the treatment of such liens on proceeds under clause (i) or (iii) of this subparagraphs; or

(iii) for the realization by such holders of the indubitable equivalent of such claims.

The Code § 363(k)

The right to credit bid is incorporated by reference to §363(k) in §1129(b) (2) (A) (ii) of the plan confirmation process:

§ 363(k) states, …unless the court for cause orders otherwise the holder of such claim may bid at such sale, and, if the holder of such claim purchases such property, such holder may offset such claim against the purchase price of such property.

The above section is informally referred to as "credit bidding."

Case Law Court Ruling

As the dissenting opinion highlights, although few in the first 30 years of the existing Bankruptcy Code have interpreted the Code's language in the same manner, the District and Appellate Courts are not alone in their ruling. The Fifth Circuit in Pacific Lumber, 584 F.3d 229 reached the same conclusion.

The Lenders appeal offered three principal arguments in support of their right to credit bid. First, they contended that the plain language of §1129(b) (2) (A) requires that all sales of assets free and clear of liens must proceed under subsection (ii) (which generally includes the right to credit bid). Second, they argued that subsection (iii) calling for the indubitable equivalent of a lender's secured interest is ambiguous. Finally, they argued that denying secured lenders a right to credit bid is inconsistent with other provisions of the Code. The appellate court addressed and dismissed each argument in turn.

The Appellate Court concluded that the disjunctive use of the word "or" between subparagraphs (ii) and (iii) of §1129(b) (2) (A) operates to provide the debtor alternatives and need not satisfy more than one of these subparagraphs. The court explained that the plain language of that section operates to provide alternatives, allowing the debtor to proceed under subsection (i), (ii), or (iii) and need not satisfy more than one subsection. The court also noted that the Code provides no explicit right to credit bid under subsection (iii).

The Appellate Court interpreted indubitable equivalent as "the unquestionable value of lender's secured interest in the collateral" and concluded that the term is not ambiguous. The court affirmed the District Court's conclusion that it is the plan of reorganization, and not the auction itself, that must generate the indubitable equivalent. Therefore, the Lenders retain the right to argue at confirmation that restriction on credit bidding failed to generate fair market value at auction, but the court could not predict, at this juncture as a matter of law, whether the auction would or would not generate the indubitable equivalent.

Finally, the court also rejected the Lenders' argument that the overall intent of the Code requires that secured creditors retain the ability to credit bid. Beyond what the Appellate Court determined to be the plain language of the Code, Judge Fisher highlighted that other sections of the Code have always balanced the interests of secured creditors with the interests of the reorganized entity. Judge Fisher, writing for the majority, pointed to §363(k) itself that allows a court "for cause" to deny a lender the ability to credit bid.

The Dissent

In a strongly worded 47-page dissent, Judge Ambro labeled certain rulings of the majority as "Pickwickian," considered certain of the court's thought tracks "twisted," and called into question the "perfect" valuations derived from judicial valuations and market auctions. A former bankruptcy attorney, Judge Ambro described the Debtors' plan as a thinly veiled way for insiders to retain control of an insolvent company minus the debt burden the insiders incurred in the first place. He stated that the majority's ruling paves the way for such additional insider transactions in the future.

Judge Ambro also shot down the notion that credit bidding can "chill" an auction process, analogizing credit bidding to competition from a well capitalized buyer. Judge Ambro indicated that neither a well capitalized buyer nor a lender willing to credit bid would be willing to bid beyond their own reservation price just because they have the means and resources to do so.

As justification for his dissent, Judge Ambro essentially agreed with each of the points argued by the Lenders. He disagreed with the majority's position that a plan proponent can simply choose which of the three disjunctive specifications of §1129(b) (2) (A) to satisfy. Rather, Judge Ambro's alternative reading is that the plan's proposed treatment of the secured claim determines which of the three alternative specifications of the requirement must be satisfied.

Such interpretation treats the three alternatives not as mere examples, but as three distinct categories that prescribe a specific treatment depending on the plan proponent's treatment of the collateral (i.e. (i) a sale retaining liens, (ii) a sale free and clear of liens, and (iii) other plans to provide the indubitable equivalent not covered by (i) or (ii) such as abandonment of property or providing substitute collateral). Judge Ambro's ruling took the position that Congress would not expend the ink and energy detailing the procedures in clause (ii) that specifically deal with plan sales free of liens only to have the general clause (iii) that could sidestep entirely those very procedures.

Future Implications

For entities wishing to take control of underlying debt collateral, the Third Circuit's Court of Appeals decision is likely to have significant implications to the bankruptcy confirmation process on a number of levels, particularly as the Third Circuit includes the Delaware Court where many of the larger cases file. The creativity of debtors, lenders, investors, counsel and their advisors may ultimately decide the impact of this matter. In bankruptcy cases that involve or attract debt holders interested in taking control of their collateral, nearer term impacts that may be seen as a result of the ruling (until either overturned or confirmed by the Supreme Court) include:

- preference by debtors in possession for plan sales in lieu of §363 sales to avoid credit bidding rights of lenders
- increased risk of insider deals that may not produce maximum value for creditors
- increased importance of coordination between lenders in syndicated loans to accumulate sufficient cash to enable cash bidding for collateral proposed to be sold pursuant to proposed plans of reorganization
- less "loan-to-own" investment strategies by hedge funds and other distress debt investors
- higher interest rates or less origination by lenders who can no longer credit bid their collateral to protect against undervaluation in a plan sale (particularly in syndicated loans)

One point that could neutralize the ruling entirely, but has yet to be tested, is the court's stated right of lenders to argue at confirmation that restriction on credit bidding failed to generate fair market value at auction, thereby preventing them from receiving the indubitable equivalent of their claim.

It would seem that simply providing the lender with the physical collateral itself (as credit bidding facilitates) would provide the "exact equivalent" at what might be considered a higher level of certainty than the indubitable equivalent, defined by the Appellate Court as "the unquestionable value of lender's secured interest in the collateral."

A lender, who believes the value of its collateral is greater than the value generated at auction, could object at plan confirmation and provide evidence to support its belief, such as expert opinion and/or judicial valuation.

Summary

Debate surrounding lenders' rights to credit bid is likely to continue, increasing the possibility that the matter will someday be brought to the Supreme Court. Unless the ruling is overturned, in situations that involve (or would otherwise attract) debt holders with the desire and capacity to take control of the underlying collateral, we can expect to see fewer §363 sales, more plan sales, reduced participation by distressed debt investors, and more insider "management friendly" transactions effected through plans of reorganization. ■

Mr. Deren has over 12 years of experience performing financial advisory services which include consulting creditors' committees in bankruptcies, lenders in workout situations, companies and creditors in liquidations, and both buyers and sellers in mergers and acquisition transactions. He has extensive experience in advising clients on improving profitability and cash flow through identifying and implementing process improvements, analyzing and right sizing costs, identifying and assisting in the process of selling unused or inefficient assets, and analyzing profitability by customer and product line. Mr. Deren also has considerable experience in building and analyzing cash flow, valuation and liquidation models.

Mr. Deren has also assisted troubled companies and their creditors in identifying and implementing alternative solutions through out-of-court restructurings or Chapter 11 and Chapter 7 proceedings. His industry experience includes construction, real estate, manufacturing, retail, healthcare, professional services, technology, media, telecommunications, distribution and financial services.

Mr. Deren's experience includes:
- *Developed methodologies and financial toolkits to assist clients in addressing business issues and implementing strategic initiatives including improving product line profitability, reducing costs, and improving working capital and cash flow.*
- *Developed detailed financial and operational models, financial projections, and cost benefit models to assist with planning, evaluating and presenting business strategy to bank groups, credit committees, and members of management.*
- *Designed benchmarking toolkits to assist companies in understanding key financial and operational performance trends as compared to industry competitors.*
- *Advised unsecured creditors' committees in bankruptcies,*
- *Led several due diligence teams in a both buy and sell side transactions, including the purchase of a $1B plus construction management company, $800M retail outlet chain and $1B plus real estate company. Due diligence services included analyzing projections, quality of earnings, product line profitability, working capital requirements, capital expenditures, and free cash flow.*

Brad Hayes has extensive experience providing advisory services in the areas of financial and operational restructuring, due diligence, merger and acquisition investment banking, and financial statement audit. He is currently a Vice President with Mesirow Financial Consulting's Corporate Recovery practice. Prior to joining Mesirow Financial Consulting, Mr. Hayes was a Manager at KPMG in the Transaction Services advisory practice where he focused on providing due diligence and merger and acquisition advisory services to both strategic and financial buyers and sellers. Prior to that, Mr. Hayes was a member of the Technology Audit Practice at KPMG. Mr. Hayes is member of the Association of Insolvency and Restructuring Advisors, American Bankruptcy Institute, and Turnaround Management Association. He graduated from Indiana University with a Bachelors of Science degree in Accounting and Finance and from the Kellogg School of Management at Northwestern University with a Masters in Business Administration. Mr. Hayes is a Certified Public Accountant (Illinois).

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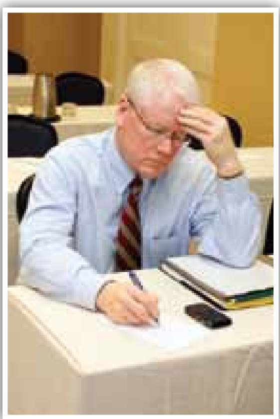










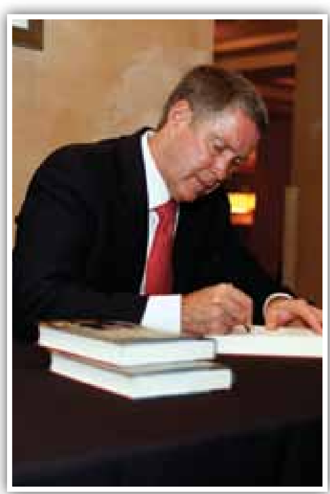













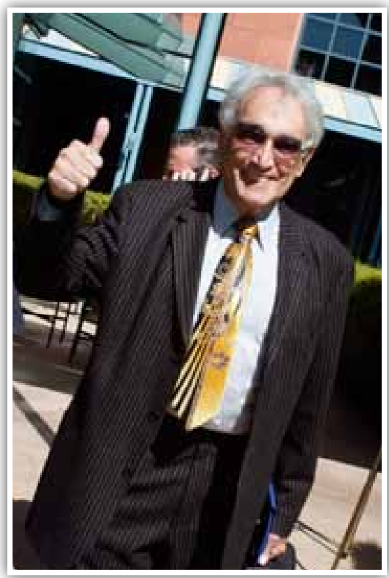


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CIRA Award Winners

Each year the AIRA presents the Zolfo Cooper/Randy Waits Awards to honor individuals earning the highest total scores on the three CIRA exams. Medals are presented to the winners at AIRA's Annual Conference. Below are the 2010 Zolfo Cooper/Randy Waits Award recipients.

Gold Medal Winner: Kyle A. Sturgeon, CIRA (Alvarez & Marsal, Atlanta GA)

Kyle received a Bachelor of Arts degree from the University of Virginia in 2004. He joined Alvarez & Marsal in 2006; before that, he was a senior consultant with Navigant Consulting. Kyle has been a member of AIRA since 2008. Kyle lives in Atlanta with his wife, Karyn and their daughter, Fiona; favorite pastimes include running, playing golf and rooting for the Atlanta Braves. Family vacations are split between the Outer Banks of North Carolina and the lakes of northern Michigan.

Silver Medal Winner: Andrew Gersh (KPMG, Mountain View CA)

Andy received a Bachelor of Accountancy degree from the University of Glasgow in 1992. He is a Scottish Chartered Accountant, as well as a CPA licensed in Massachusetts and California. Andy has been with KPMG since 1992, in both the U.K. and the U.S. Since 1994, he has been located in KPMG's Mountain View, California, office. An AIRA member since 2009, Andy is married with three beautiful children. He enjoys family vacations, skiing, swimming and running.

Bronze Medal Winner: Mark D. Allen, CIRA (Lighthouse Management Group, Inc., Irvine CA)

Mark received an AB degree in Economics and Business from Lafayette College in 1989 and a MBA in Finance from Indiana University in 1994. He has been a Turnaround Consultant with Lighthouse Management Group, Inc. since 2001. Mark became a member of AIRA in 2007. Mark (in his words) has a lovely wife and 3 wonderful children. At the awards ceremony, he stated he is grateful they have put up with his traveling to fix troubled companies for so many years.

Bronze Medal Winner: Brian C. Maloney, CIRA (BDO Consulting, New York NY)

Brian received a BS degree in Finance from the University of Maryland in 2005, and started with BDO the same year. He spent 2008-2009 working in BDO's insolvency practice in Melbourne, Australia, through their "secondment" program. Brian joined the AIRA in 2008. In April, Brian proposed to long-time girlfriend, Caitlin Burke (she said Yes). His hobbies include motorcycle riding, beer brewing and spending time outdoors. His favorite spectator sport is baseball (a Yankee fan, much to the chagrin of his Mets-fan fiancé. Oops!).

Distinguished Performance Award Winners

After determination of the Zolfo Cooper/Randy Waits Award winners, Distinguished Performance Awards are presented to individuals achieving the next highest exceptional scores, only a few points short of a medal. Recipients of these awards for 2010 are:

William Homony, CIRA (Miller Coffey Tate LLP, Philadelphia) *Bachelor's degree from University of Pittsburgh, 2000*

Gabriel Koch, CIRA (AlixPartners, Dallas) *MBA, Finance/Strategy, University of Texas at Austin, 2006; Bachelor of Arts in History/Political Science, Trinity University, 1995*

Robert Molina (FTI Consulting, Dallas) *BSE, Electrical Engineering degree from University of Michigan, 1997; MBA from University of Texas, 2006*

Heather Rudy, CIRA (Huron Consulting Group, New York) BA in Finance/Accounting from the University of Michigan, 2004

Kitty Sahin (The Watermill Group, Needham MA) MBA, Wharton University of Pennsylvania, 1997; BA from Yale University, 1992

Iain Slimmon (Alvarez & Marsal, Atlanta) Bachelor of Commerce, University of Toronto, 1976

Robert Remian, CIRA
Receives Manny Katten Award

Co-chairman of AIRA's first annual conference in Chicago, Manny Katten was a founding director and continued as an active leader of AIRA until his untimely death. In 1999, the Board passed a resolution to endow the Manny Katten Award, presented annually to an individual demonstrating exceptional leadership, dedication and service to the bankruptcy, insolvency and restructuring field. This year's award was presented to Robert F. Remian, CIRA, Managing Director with Conway MacKenzie, Chicago, for his services to AIRA, during the Association's 26th annual meeting in San Diego, California. The Award was presented to Bob by Ken Malek, Past President of AIRA (Ken was a member of the original Board of AIRA when it was formed in 1984 and he continues to serve on the Board).

Bob Remian has been a member of AIRA since 1993, and during most of that period he served with Ken Malek as AIRA's tax advisor, answering questions from AIRA's staff, filing necessary returns for AIRA to change its year-end, filing the annual tax returns, and helping AIRA satisfy all of the Income tax reporting requirements (which has increased significantly during the last two years). Filing has to be done for two entities—the Association of Insolvency and Restructuring Advisors, and the Association of Insolvency and Restructuring Advisors Fund for Education.

Bob has over 20 years of experience in accounting, bankruptcy, litigation and valuation matters. His bankruptcy and distressed business experiences involve all facets of the revitalization process, including acting as a financial advisor to borrowers and debtors-in-possession, lenders, individual creditors and creditor committees, trustees and other stakeholders. He has extensive experience developing and negotiating plans of reorganization and employee retention plans, conducting merger and acquisition and plan feasibility due diligence, and performing other financial and operational analyses. He regularly consults on fraudulent conveyance and preference actions, and has significant expertise in evaluations of solvency. Bob earned his Bachelor of Science and Master of Science degrees from DePaul University.

SAVE THE DATE – Upcoming AIRA Events

AIRA Opening Reception at the NCBJ Annual Conference
October 13, 2010 - New Orleans, LA

AIRA Breakfast Presentation at the NCBJ Annual Conference
October 15, 2010 - New Orleans, LA

AIRA VALCON Conference
February 23-26, 2011 - Las Vegas, NV

AIRA 27th Annual Bankruptcy & Restructuring Conference
June 4-7, 2011 - Boston, MA

NEW AIRA MEMBERS

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Jimmie Cummins
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CLUB 10

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Grant Thornton LLP	**37**
Zolfo Cooper	**29**
Deloitte.	**26**
Loughlin Meghji + Company	**23**
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LECG LLC	**21**
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Huron Consulting Group LLC	**20**
Mesirow Financial Consulting LLC	**19**
BDO Consulting	**17**
CRG Partners Group LLC	**16**
PricewaterhouseCoopers LLP	**14**
Ernst & Young LLP	**12**
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