[Mercer Law Review](https://digitalcommons.law.mercer.edu/jour_mlr)

Volume 50
Number 4 *Eleventh Circuit Survey*

Article 6

7-1999

Bankruptcy

W.H. Drake Jr.

Christopher S. Strickland

Bankruptcy

by The Honorable W.H. Drake, Jr.*
and
Christopher S. Strickland**

I. INTRODUCTION

Undeniably, 1998 proved to be an important year for bankruptcy in the Eleventh Circuit Court of Appeals, with the circuit ultimately producing a total of fourteen opinions having material bearing upon the debt relief process. In keeping with the cosmopolitan nature of bankruptcy practice, these decisions involved the court's performance of diversified tasks, ranging from the interpretation of intricate Bankruptcy Code provisions, to the construction of governing requirements from the Uniform Commercial Code, and the resolution of potential conflicts between the bankruptcy process and various constitutional or state law provisions. Provided below is an overview of each decision rendered during the 1998 calender year.

II. *LEVINE V. WEISSING*

The Eleventh Circuit began its bankruptcy jurisprudence for the year in *Levine v. Weissing (In re Levine)*[1] by clarifying the extent to which a debtor's prepetition conversion of nonexempt assets into assets exempt from his or her bankruptcy estate subsequently may be avoided as a fraudulent transfer. The debtors in *Levine* filed a voluntary petition for relief under Chapter 7 of the United States Bankruptcy Code in 1991. Shortly thereafter, the trustee for their estate filed a complaint pursuant

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* United States Bankruptcy Judge, Northern District of Georgia. Mercer University (B.A., 1954; L.L.B. 1956). Member, State Bar of Georgia.

** Formerly a law clerk of Judge Drake's, Mr. Strickland is an associate with the firm of Paul, Hastings, Janofsky and Walker LLP, practicing in that firm's corporate lending and bankruptcy practice groups.

1. 134 F.3d 1046 (11th Cir. 1998).

to 11 U.S.C. § 544[2] and Florida Statute section 726.105,[3] seeking to set aside as fraudulent the transfer of approximately $440,000 in purchased annuities exempted from the claims of creditors under Florida law, to the extent that such purchases were made in an effort to hinder, delay, or defraud creditors.[4]

Finding that there were not two distinct, identifiable parties acting as transferor and transferee in the subject transaction, and therefore, that there had been no transfer of funds which could be set aside as fraudulent, the bankruptcy court initially dismissed the trustee's complaint.[5] In doing so, the bankruptcy court opined that "because the Debtors still retain control and ownership of the assets acquired with funds they obtained from disposition of their nonexempt assets . . . the fact that this conversion effectively removed the former assets from the reach of the creditors is of no consequence."[6] The district court thereafter reversed the bankruptcy court's order of dismissal, however, concluding that there had been such a transfer, and furthermore opining that the trustee had stated a cause of action under 11 U.S.C. § 544 and Florida Statute section 726.105.[7]

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2. The Bankruptcy Code provides, in relevant part:

> (a) The trustee shall have, as of the commencement of the case, and without regard to any knowledge of the trustee or of any creditor, the rights and powers of, or may avoid any transfer of property of the debtor or any obligation incurred by the debtor that is voidable by—(1) a creditor that extends credit to the debtor at the time of the commencement of the case, and that obtains, at such time and with respect to such credit, a judicial lien on all property on which a creditor on a simple contract could have obtained such a judicial lien, whether or not such a creditor exists; (2) a creditor that extends credit to the debtor at the time of the commencement of the case, and obtains, at such time and with respect to such credit, and execution against the debtor that is returned unsatisfied as such time, whether or not such a creditor exists; or (3) a bona fide purchaser of real property, other than fixtures, from the debtor, against whom applicable law permits such transfer to be perfected, that obtains status of a bonafide purchaser and has perfected such transfer at the time of the commencement of the case, whether or not such a purchaser exists.

11 U.S.C. § 544(a) (1994 & Supp. 1998).

3. Likewise, Florida law provides that:

> [a] transfer made or obligation incurred by a debtor is fraudulent as to a creditor, whether the creditor's claim arose before or after the transfer was made or the obligation was incurred, if the debtor made the transfer or incurred the obligation . . . [w]ith actual intent to hinder, delay, or defraud any creditor of the debtor.

FLA. STAT. ch. 726.105 (1995 & Supp. 1999).

4. 134 F.3d at 1048.

5. *Id.*

6. *Id.* (citing *In re* Levine, 139 B.R. 551, 553 (Bankr. M.D. Fla. 1992)).

7. *Id.*

On remand, the bankruptcy court held an evidentiary hearing to ascertain whether the challenged annuities had been purchased with fraudulent intent.[8] Noting that the debtors had discussed the exempt status of annuities with an estate-planning lawyer while anticipating the entry of a substantial court judgment against them, and that they purchased the subject annuity contracts within a short period of time thereafter, the court found such fraudulent intent indeed to have existed and set aside the annuities purchase on that basis.[9] This decision was affirmed summarily by the United States District Court for the Middle District of Florida.[10]

Applying Florida law, the Eleventh Circuit explained that an individual who purchases an annuity remains the technical owner of the asset, but he does not retain total control over that asset and does not have unfettered access to such property.[11] As such, when they purchased the subject annuities, the debtors did in fact "transfer" assets from nonexempt to exempt status.[12] Furthermore, as the court clarified, the avoidance of such transfers does not fall under the thirty-day limitations period governing objections to claimed exemptions, but instead shall be timely filed under the two-year statute of limitations governing exercises of the trustee's avoidance powers.[13] Otherwise finding no clear error in the bankruptcy court's factual determination that the debtors had purchased exempt annuities with an intent to hinder or defraud known creditors, the Eleventh Circuit affirmed.[14]

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8. *Id.*
9. *Id.* at 1049.
10. *Id.*
11. *Id.* at 1049-50.
12. *Id.* at 1050.
13. *Id.* at 1053. As the court noted:

> The Federal Rules of Bankruptcy Procedure mandate that objections to listing of property to be claimed as exempt must be filed within thirty days after the creditors' meeting. FED. R. BANK. P. 4003. As previously noted, however, the trustee in this action does not seek to contest the exemptions per se; rather, this is an adversary action filed pursuant to 11 U.S.C. § 544, which permits the trustee to "avoid any transfer of the property of the debtor . . . ." 11 U.S.C. § 544(a). The Bankruptcy Code provides that an adversary action filed under this provision may be filed within two years after the entry of the order for relief. *See* 11 U.S.C. § 546(a)(1)(A). It is undisputed that the trustee has complied with the two-year limitation on the filing of this action. Having determined that the statute of limitations governing objections to exemptions does not control this case, we conclude that the trustee's action to contest the transfer of funds is not time-barred.

134 F.3d at 1053.

14. *Id.* at 1054.

III. *MILLER V. FLORIDA MINING & MATERIALS*

In its second bankruptcy opinion of the year, *Miller v. Florida Mining & Materials (In re A.W. & Associates, Inc.)*,[15] the Eleventh Circuit resolved questions regarding the need to consider industry standards in determining whether disputed payments fall within the "ordinary course of business" exception to the trustee's preference avoidance powers. Pursuant to its operation as a construction company, the debtors in *A.W. & Associates* had regularly purchased concrete and concrete-related products from Florida Mining & Materials. Historical dealings between the parties also had often involved the debtor's failure to make timely payments on the Florida Mining account, and numerous checks issued to that company by the debtor had subsequently been dishonored for insufficient funds. Indeed, delinquent and dishonored payments appeared to have become a matter of custom between the debtor and Florida Mining.[16]

In keeping with that course of dealing, on March 5, 1993, the debtor tendered a $6,131.05 check to Florida Mining in payment of certain invoices dated January 29, February 1, February 2, February 3, and February 4, 1993. The check was initially dishonored, but was resubmitted and paid on March 10, 1993. As among the various invoices which were satisfied in that transaction, payment upon the January 29 invoice came late, but all other payments upon the subject invoices were received in a timely fashion.[17]

Subsequent to these payments, the debtor sought relief under the Bankruptcy Code on May 3, 1993. The trustee appointed to administer the debtor's estate thereafter filed a complaint in the bankruptcy court seeking to avoid the March 10 payment as a preferential transfer under 11 U.S.C. § 547(b).[18] As a defense to the trustee's action, Florida

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15. 136 F.3d 1439 (11th Cir. 1998).
16. *Id.* at 1440.
17. *Id.*
18. *Id.* at 1440-41. A bankruptcy trustee may avoid pre-petition transfers of estate property under the following terms:

> (b) Except as provided in subsection (c) of this section, the trustee may avoid any transfer of an interest of the debtor in property—(1) to or for the benefit of a creditor; (2) for or on account of an antecedent debt owed by the debtor before such transfer was made; (3) made while the debtor was insolvent; (4) made—(A) on or within 90 days before the date of the filing of the petition; or (B) between ninety days and one year before the date of the filing of the petition, if such creditor at the time of such transfer was an insider; and (5) that enables such creditor to receive more than such creditor would receive if—(A) the case were a case under Chapter 7 of this title; (B) the transfer had not been made; and (C) such creditor

Mining responded that the payment had been made in the ordinary course of business, and therefore, it was exempt from avoidance under 11 U.S.C. § 547(c)(2).[19]

Following a trial on the matter, the bankruptcy court concluded the transfer was made in the ordinary course of business between the parties and was not the result of extraordinary collection efforts.[20] In a key point of its analysis, however, the court ruled as a matter of law that the section 547(c)(2) exception depends "upon the debtor's internal operations and the circumstances of the transactions in question, not industry standards."[21] In an unreported decision, the district court affirmed this legal conclusion, as well as the findings of fact attending the bankruptcy court's application of section 547(c)(2).[22]

On appeal, the Eleventh Circuit first noted the parties' stipulation that the debtor's payment to Florida Mining qualified as a preferential transfer under section 547(b).[23] Thus, the appeal's outcome depended solely upon whether section 547(c)(2) applied, and specifically, whether courts must consider industry standards in determining that defense's application.[24] This question, the court observed, was one of first impression for the Eleventh Circuit.[25]

> received payment of such debt to the extent provided by the provisions of this title.

11 U.S.C. § 547(b) (1994).

19. 136 F.3d at 1441. This section provides that a trustee may not avoid a transfer:

> (2) to the extent that such transfer was (A) in payment of a debt incurred by the debtor in the ordinary course of business or financial affairs of the debtor and the transferee; (B) made in the ordinary course of business or financial affairs of the debtor and the transferee; and (C) made according to ordinary business terms.

11 U.S.C. § 547(c)(2). This exception operates as an affirmative defense; a creditor asserting that a transfer falls within section 547(c)(2) bears the burden of proving each of the three elements. *Id.* § 547(g).

20. 136 F.3d at 1441.

21. *Id.*

22. *Id.*

23. *Id.*

24. *Id.* at 1441-42.

25. *Id.* In a prior case, the Eleventh Circuit had discussed whether a debtor's payments by cashier checks to a creditor had been made in the ordinary course of business, therein noting that resolution of the issue "turns on the specific events surrounding [debtor's] payments to [creditor]." *See* Marathon Oil Co. v. Flatau (*In re* Craig Oil Co.), 785 F.2d 1563, 1566-67 (11th Cir. 1986). While acknowledging that dicta from *Craig Oil* suggests that a bankruptcy court may focus exclusively on the relationship between the parties, the panel distinguished that case, noting that "[b]ecause the disputed payment in *Craig Oil* was extraordinary in the course of business between the creditor and the debtor, this Court did not need to determine whether a creditor must withstand an additional inquiry into the relevant industry standards to establish the affirmative defense provided

As the panel in *A.W. & Associates* noted, however, other circuits had considered the issue, reaching a consensus that the language of section 547(c)(2)(C) requires bankruptcy courts to consult industry standards in classifying a disputed transfer.[26] Thus, the court joined in the nearly unanimous view that such an examination of industry standards forms a necessary part of the application of section 547(c)(2)(C).[27] To the extent they depended upon a ruling otherwise, the decisions of the bankruptcy and district courts were overturned.[28]

IV. *KEY BANK OF MAINE V. JOST*

Also in the 1998 term, in *Key Bank of Maine v. Jost (In re Jost)*[29] the circuit addressed issues regarding a creditor's objection to the debtor's allegedly fraudulent asset exemption. In July 1991 the debtor had purchased a home in Florida, using proceeds from the sale of her prior home in Missouri as a downpayment. Roughly three months later, she satisfied the $138,000 mortgage on the Florida residence, using payments she had received from her brother-in-law under a promissory note. When she subsequently filed for bankruptcy protection on April 6, 1994, the debtor claimed an exemption in the home valued at $184,000.[30] Pursuant to Bankruptcy Rule 4003(b),[31] a creditor of the

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by § 547(c)(2)." 136 F.3d at 1442 (citing *Craig Oil*, 785 F.2d at 1565, 1566). Therefore, the court in *A.W. & Associates* viewed the issue before it as one of first impression, notwithstanding *Craig Oil*. *Id.*

26. 136 F.3d at 1442 (citing Lawson v. Ford Motor Co. (*In re* Roblin Indus., Inc.), 78 F.3d 30, 41 (2d Cir. 1996); Fiber Lite Corp. v. Molded Acoustical Prods., Inc. (*In re* Molded Acoustical Prods., Inc.), 18 F.3d 217, 225 (3d Cir. 1994); Advo-System, Inc. v. Maxway Corp., 37 F.3d 1044, 1048 (4th Cir. 1994); Logan v. Basic Distrib. Corp. (*In re* Fred Hawes Org., Inc.), 957 F.2d 239, 244 (6th Cir. 1992); *In re* Tolona Pizza Prods. Corp., 3 F.3d 1029, 1032-33 (7th Cir. 1993); Jones v. United Sav. & Loan Ass'n (*In re* U.S.A. Inns of Eureka Springs, Arkansas, Inc.), 9 F.3d 680, 684 (8th Cir. 1993); Mordy v. Chemcarb, Inc. (*In re* Food Catering & Hous., Inc.), 971 F.2d 396, 398 (9th Cir. 1992); Clark v. Balcor Real Estate Fin., Inc. (*In re* Meridith Hoffman Partners), 12 F.3d 1549, 1553 (10th Cir. 1993)).

27. *Id.* at 1442-43.

28. *Id.* at 1443.

29. 136 F.3d 1455 (11th Cir. 1998).

30. *Id.* at 1456-57. Pursuant to the following terms, the Florida Constitution provides an unlimited homestead exemption:

> (a) There shall be exempt from forced sale under process of any court, and no judgment, decree or execution shall be a lien thereon, except for the payment of taxes and assessments thereon, obligations contracted for the purchase, improvement or repair thereof, or obligations contracted for house, field or other labor performed on the realty, the following property owned by a natural person:
> (1) a homestead . . .

FLA. CONST. art. X, § 4(a)(1).

31. The Bankruptcy Rules provide, in relevant part:

estate objected to her claimed exemption in the home, alleging that the debtor had purchased her Florida home, an exempt asset, with nonexempt assets with the intent to hinder, delay, or defraud her creditors.[32]

In overruling the creditor's objection, the bankruptcy court concluded that the creditor had failed to establish a prima facie case for disallowing the debtor's homestead exemption because the record was

> devoid of any evidence of . . . threat of levy, attachment, garnishment, or execution on a judgment just prior to the debtor's purchase of the Florida homestead [and] there was no credible evidence produced to indicate that the Debtor was being pursued by creditors at the time of the purchase of the disputed homestead property.[33]

The creditor thereafter moved for rehearing, which the bankruptcy court denied.[34] The creditor then appealed to the United States District Court for the Southern District of Florida, which affirmed the bankruptcy court's judgment.[35]

The creditor's further appeal to the Eleventh Circuit framed the core point of the legal dispute as to whether a claimed Florida homestead exemption may be challenged on the basis that the subject home has been purchased with nonexempt assets in an attempt to hinder, delay, or defraud creditors in violation of Florida Statute section 726.105.[36] Nevertheless, the panel in *Jost* found it unnecessary either to resolve that question of state law or to certify it for determination to the Florida Supreme Court; such legal questions would have to be decided only if the bankruptcy court had made a finding of fact that the debtor's purchase

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> The trustee or any creditor may file objections to the list of property claimed as exempt within 30 days after the conclusion of the meeting of creditors held pursuant to Rule 2003(a) or the filing of any amendment to the list or supplemental schedules unless, within such period, further time is granted by the court. Copies of the objections shall be delivered or mailed to the trustee and to the person filing the list and the attorney for such person.

FED. R. BANKR. P. 4003(b).

32. 136 F.3d at 1457.
33. *Id.* (quoting lower court's unreported decision).
34. *Id.*
35. *Id.* at 1457-58.
36. *Id.* at 1458. That statutory provision directs:

> (1) A transfer made or obligation incurred by a debtor is fraudulent as to a creditor, whether the creditor's claim arose before or after the transfer was made or the obligation was incurred, if the debtor made the transfer or incurred the obligation: (a) With actual intent to hinder, delay, or defraud any creditor of the debtor;

FLA. STAT. ch. 726.105.

of her home and/or her prepayment of the home mortgage were in fact made with intent to hinder, delay, or defraud some creditor.[37] Because the lower court had yet to determine such issues, the panel remanded the case with instructions that the bankruptcy court should hold further proceedings and make detailed findings upon whether the debtor's purchase of her Florida home and/or her prepayment of the home mortgage constituted transfers made with an intent to hinder, delay, or defraud any creditor in violation of Florida law.[38]

V. *UNITED STATES V. GILBERT*

In another of its 1998 decisions, *United States v. Gilbert*,[39] the Eleventh Circuit resolved a dispute over the statute of limitations applicable to bankruptcy crimes. Defendant had been the president and sole stockholder of Corporate Air Limited, Inc. ("CAL"). In 1985, CAL contracted to purchase a piece of real estate. Before closing the sale of the property to CAL, defendant formed a second corporation, Isle of Fantasy, Inc. ("IOF"), for the purpose of taking title to the property. IOF paid for the property using funds received from CAL. The funds provided by CAL represented either loans to IOF or an anticipated interest in the real estate.[40]

In 1987, CAL filed a petition for bankruptcy under Chapter 11 of the Bankruptcy Code. The petition included the necessary schedules of CAL's assets, but did not disclose any interest in connection with the aforementioned property. Upon the case's conversion to one of liquidation under Chapter 7, the trustee discovered CAL's interest in the property.[41]

Following referral of the matter to the United States Attorney, defendant was indicted in July 1996 for concealing assets of the bankrupt's estate.[42] Defendant then moved to dismiss the indictment

37. 136 F.3d at 1459. Even if the bankruptcy court had made such a finding of fact, however, the court of appeals noted that it still would not have affirmed. Because the bankruptcy court had declined to consider admissible evidence from the debtor's testimony at the section 341 meeting and during her Rule 2004 examination, any fact findings thereby produced would have been unsustainable. *Id.*

38. *Id.* at 1459.

39. 136 F.3d 1451 (11th Cir. 1998).

40. *Id.* at 1452-53.

41. *Id.* at 1453.

42. *Id.* Section 152 provides, in relevant part, that:

> [a] person who . . . knowingly and fraudulently conceals from a custodian, trustee, marshal, or other officer of the court charged with the control or custody of property, or, in connection with a case under title 11, from creditors or the United States Trustee, any property belonging to the estate of a debtor . . . shall be fined under this title, imprisoned not more than 5 years, or both.

as barred by the statute of limitations.[43] That motion was denied and defendant was convicted, at which point he pursued an appeal.[44]

The court of appeals began analyzing the issue by noting that statutes of limitations normally begin to run when the crime is complete.[45] In cases of asset concealment, however, Congress has directed that such acts "shall be deemed to be a continuing offense until the debtor shall have been finally discharged or a discharge denied, and the period of limitations shall not begin to run until such final discharge or denial of discharge."[46]

In the case sub judice the court observed that discharge was no longer possible when CAL, a corporate debtor, converted its case from Chapter 11 to Chapter 7.[47] As a result, a "final discharge or denial of discharge" would never be given to that debtor.[48] Considering the government's position, that no statute of limitations applies to such situations, to be untenable, the panel in *Gilbert* applied a contextual reading of 18 U.S.C. § 3284, finding that the period of limitation runs from the date of the event when discharge becomes impossible.[49] Because this point of impossibility was reached at conversion, the statute of limitations began to run at that time, meaning that defendant was immune from prosecution.[50]

VI. *HALL MOTORS, INC. v. LEWIS*

The fifth opinion handed down by the Eleventh Circuit in 1998, *Hall Motors, Inc. v. Lewis (In re Lewis)*,[51] addressed the extent to which debtors' rights in property foreclosed prepetition may be resurrected upon filing. The debtors in *Lewis* purchased a used car from Hall Motors in August 1992 in a seller-financed transaction. As a consequence of existing defaults in payment, Hall repossessed the car two days prior to the debtors' filing a bankruptcy petition under Chapter 13 of the Code. When the debtors proposed to pay the creditor sixty-two cents on the dollar on the outstanding secured balance that they owed, Hall refused to return the automobile. At that point, the debtors filed

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18 U.S.C. § 152.

43. 136 F.3d at 1453.
44. *Id.*
45. *Id.*
46. *Id.* (quoting 18 U.S.C. § 3284 (1994)).
47. *Id.* at 1454 (citing 11 U.S.C. § 727 (1994)).
48. *Id.*
49. *Id.* at 1454-55.
50. *Id.* at 1455.
51. 137 F.3d 1280 (11th Cir. 1998).

an adversary proceeding for turnover of the vehicle pursuant to 11 U.S.C. § 542(a).[52]

Applying Alabama law, the bankruptcy court concluded that the debtors had both title and a right of redemption in the repossessed vehicle.[53] As a result, the bankruptcy court found the vehicle to be property of the estate and ordered its expeditious return to the debtors.[54] Hall appealed, and, after holding that Alabama law merely provided the debtors with a right of redemption in the repossessed vehicle, the district court found that the vehicle did not constitute an asset of the estate which would be subject to compulsory turnover.[55] Therefore, it reversed the bankruptcy court's order.[56] The debtors then appealed the district court's holding.[57]

On appeal, the Eleventh Circuit first noted that the vehicle's status as property of the estate *vel non* turned on questions of federal law.[58] At the same time, however, the nature and existence of the debtor's rights in such property had to be determined by reference to state law.[59] Accordingly, the court looked to Alabama law to determine the debtors' interest in the repossessed vehicle.[60]

Thus, pursuant to state law, the debtors lost both possessory rights in the vehicle and title thereto upon its repossession.[61] Likewise, the

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52. *Id.* at 1281-82. Section 542(a) provides:

> Except as provided in subsection (c) or (d) of this section, an entity, other than a custodian, in possession, custody, or control, during the case, of property that the trustee may use, sell, or lease under section 363 of this title, or that the debtor may exempt under section 522 of this title, shall deliver to the trustee, and account for such property or the value of such property, unless such property is of inconsequential value or benefit to the estate.

11 U.S.C. § 542(a) (1993).

53. 137 F.3d at 1282.

54. *Id.*

55. *Id.*

56. *Id.*

57. *Id.*

58. *Id.* at 1283 (citing Southtrust Bank Ala. v. Thomas (*In re* Thomas), 883 F.3d 991, 995 (11th Cir. 1989)).

59. *Id.*

60. *Id.*

61. *Id.* at 1284. The Eleventh Circuit opined:

> Both the Lewises and the bankruptcy court in [Matter of Turner, 209 B.R. 558 (Bankr. N.D. Ala. 1997)] list many logical reasons why a debtor upon default should lose only his or her right to possess the secured personalty. *See Turner*, 209 B.R. at 564-68. Nevertheless, their view as to what Alabama's law should be simply does not comport with what the law is. Accordingly, we conclude that, at the commencement of the Lewises' second Chapter 13 case, Elgin Lewis did not retain title, possession or any other functionally equivalent ownership interest in the repossessed automobile.

vehicle ceased to be property of the estate from and after that time.[62] While the debtors did retain a right of redemption pursuant to Alabama's version of the Uniform Commercial Code,[63] this right, standing alone, was not enough to render the vehicle itself property of the estate.[64]

Furthermore, the debtors' Chapter 13 estate held no greater rights in the vehicle than the debtors did, meaning that the estate could only redeem the vehicle by tendering fulfillment of all secured obligations.[65] Finding that a proposal to pay sixty-two cents on the dollar over an extended period of time did not reflect a proper act of redemption under Alabama law, the panel in *Lewis* saw no basis for ordering Hall to return the vehicle.[66] Thus, it affirmed the district court's ruling.[67]

VII. *GEORGIA V. BURKE*

In *Georgia v. Burke (In re Burke)*,[68] the Eleventh Circuit entered the fray of one of bankruptcy's most contentious debates in recent time—the impact of the Supreme Court's decision in *Seminole Tribe of Florida v.*

Id.

62. *Id.*

63. Alabama law provides, in relevant part:

> At any time before the secured party has disposed of collateral or entered into a contract for its disposition under Section 7-9-504 or before the obligation has been discharged under subsection (2) of Section 7-9-505, the debtor or any other secured party may unless otherwise agreed in writing after default redeem the collateral by tendering fulfillment of all obligations secured by the collateral, as well as the expenses reasonably incurred by the secured party in retaking, holding and preparing the collateral for disposition, in arranging for the sale, and to the extent provided in the agreement and not prohibited by law, his reasonable attorneys' fees and legal expenses.

ALA. CODE § 7-9-506 (1993).

64. 137 F.3d at 1284 (citing *In re* Smith, 85 F.3d 1555, 1558 (11th Cir. 1996)).

65. *Id.*

66. *Id.* at 1285. It should be noted, however, that a different outcome might be reached had Alabama law not controlled. As one court has noted in the wake of the *Hall* decision:

> Honda argues that the outcome of this case is controlled by the recent Eleventh Circuit Court of Appeals decision . . . in *Hall v. Lewis (In re Lewis)*, 137 F.3d 1280 (11th Cir. 1998). [The court concludes, however,] that Georgia law applies with respect to a car repossessed in Georgia when the parties have not specified in a contract that another state's law would apply to determine rights after repossession . . . . The court finds that . . . under Georgia law, upon repossession, a creditor acquires the right of possession, but not absolute title. As a result, a debtor retains a title interest in the vehicle . . . . Furthermore, the court finds that this interest is sufficient to make the vehicle property of the estate.

In re Littleton, 220 B.R. 710, 714-15 (Bankr. M.D. Ga. 1998).

67. 137 F.3d at 1285.

68. 146 F.3d 1313 (11th Cir. 1998).

Florida[69] upon a state's immunity from compelled participation in the bankruptcy process. The debtors in *Burke* sought joint relief under Chapter 13 of the Bankruptcy Code in August 1992. The Georgia Department of Revenue filed a proof of claim that included an unsecured priority claim of $12,437.40 for unpaid state income taxes covering the tax years 1980-84, a claim later adjudged to be a general unsecured claim.[70] Upon the case's conversion to Chapter 7, the bankruptcy court entered a general discharge order releasing the debtors from liability for all dischargeable debts.[71] However, neither the debtors nor the State of Georgia requested a determination of whether the taxes that accrued in 1980-84 had been discharged.[72]

In May 1994, three months after the entry of a discharge in the debtors' favor, the Georgia Department of Revenue wrote them a letter demanding payment of the foregoing taxes and warning that nonpayment could result in collection by garnishment, attachment, or levy. On receipt of this demand, the debtors reopened their Chapter 7 case and filed an adversary action against the State of Georgia, alleging that the Department of Revenue violated the discharge injunction of 11 U.S.C. § 524(a) by sending the demand letter for unpaid state income taxes.[73] After its motion for summary judgment was denied, the State of Georgia moved to dismiss the debtors' action, relying on *Seminole* and arguing that the relief sought by the debtors was barred by the Eleventh Amendment.[74]

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69. 517 U.S. 44 (1996).
70. 146 F.3d at 1315.
71. *Id.*
72. *Id.*
73. *Id.*
74. *Id.* The Eleventh Amendment to the Constitution provides that, "[t]he Judicial power of the United States shall not be construed to extend to any suit in law or equity, commenced or prosecuted against one of the United States by Citizens of another State, or by Citizens or Subjects of any Foreign State." U.S. CONST. amend. XI. To the extent the Eleventh Amendment "bars suits which seek either damages or injunctive relief against a State, an 'arm of the State,' its instrumentalities, or its agencies," *Franceschi v. Schwartz*, 57 F.3d 828, 831 (9th Cir. 1995), in order for a suit for damages to be brought against a State, either that sovereign must have waived its right to Eleventh Amendment immunity or the United States Congress must have abrogated that immunity through a valid exercise of power. *See generally* Pennhurst State Sch. & Hosp. v. Halderman, 465 U.S. 89, 99 (1984).

Prior to the Supreme Court's decision in *Seminole*, the latter appeared to be the case. Bankruptcy Code section 106 offered a clear statement of Congress' intent to abrogate state immunity within the bankruptcy context, and the amenability of the states to bankruptcy court litigation, therefore, seemed beyond contradiction. *See* 11 U.S.C. § 106(a) (Supp. 1998); *see also* Sparkman v. Florida Dep't of Rev. (*In re* York-Hannover Dev.), 181 B.R. 271, 278 (Bankr. E.D.N.C. 1995) (noting that "Congress made its intention to abrogate sovereign

The bankruptcy court initially declined to address this issue, instead relying on its finding that the State of Georgia had waived its sovereign immunity by filing a proof of claim against the debtors' bankruptcy estate.[75] In denying a subsequent motion by the State of Georgia to alter or amend the previous order, however, the bankruptcy court also concluded that section 106(a) of the Bankruptcy Code unequivocally expressed congressional intent to abrogate states' sovereign immunity for violations of the discharge injunction of section 524, and that section 106(a) furthermore represented a valid exercise of congressional power under the Fourteenth Amendment.[76] In an alternate holding, the bankruptcy court concluded that any existing immunity from suit had been waived by the State of Georgia's filing of a proof of claim against the debtors' estate.[77] The State of Georgia then appealed to the district

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immunity 'unmistakably clear' in § 106" and finding such abrogative measures to fall within the plenary authority granted by the Constitution's Bankruptcy Clause). In *Seminole*, however, the Court essentially held that Congress's power to abrogate immunity only may be exercised pursuant to section 5 of the Fourteenth Amendment, and provisions of abrogation that are based upon Article I of the Constitution, such as Bankruptcy Code section 106, consequently do nothing to diminish the protection that each of the states enjoys under the Eleventh Amendment. *See Seminole*, 116 S. Ct. at 1125-32. Thus, the amenability of states to bankruptcy court jurisdiction became a matter of great uncertainty.

75. 146 F.3d at 1315 (citing *In re* Burke, 200 B.R. 282, 287-88 (Bankr. S.D. Ga. 1996)).

76. *Id.* (citing *In re* Burke, 203 B.R. 493, 497 (Bankr. S.D. Ga. 1996) (reasoning that in light of *Seminole* the Bankruptcy Clause of Article I did not empower Congress to abrogate the Eleventh Amendment, but that abrogation could be accomplished under the Fourteenth Amendment)).

77. *Id.* at 1315-16. A companion case to the *Burke* appeal turned upon the same questions of law, and received disposition under the same opinion. In that bankruptcy proceeding the debtors, husband and wife, filed a petition for relief under Chapter 13 of the Bankruptcy Code in December 1994. The Georgia Department of Revenue filed a proof of claim for state income taxes. Thereafter, in October 1995, the Department of Revenue issued an "Official Assessment and Demand for Payment" against the debtors and then issued a "Collection Notice," demanding immediate payment of the taxes and warning that nonpayment would result in collection by levy, garnishment, or attachment. Subsequently, the debtors filed an adversary action against the State of Georgia, alleging the collection attempts violated the automatic stay prescribed by 11 U.S.C. § 362. The State of Georgia moved for summary judgment, arguing that it was entitled to sovereign immunity and, alternatively, that as a matter of law it had not violated the automatic stay. The bankruptcy court found both grounds to be without merit and denied the motion. *In re* Headrick, 200 B.R. 963, 965-69 (Bankr. S.D. Ga. 1996) (adopting the same reasoning as in *In re* Burke, and thus finding that the State of Georgia's immunity was abrogated because section 106(a) was enacted by Congress pursuant to a valid exercise of authority under the Fourteenth Amendment, or alternatively, that the State of Georgia waived its immunity by filing a proof of claim against the debtors). The State of Georgia's motion to alter or amend the previous order denying summary judgment was denied. *In re* Headrick, 203 B.R. 805 (Bankr. S.D. Ga. 1996). This prompted an appeal to the Eleventh Circuit. 146 F.3d at 1316.

court, which held that section 106(a) validly abrogates Georgia's sovereign immunity because "the bankruptcy code creates privileges and immunities enforceable by Congress under [section] 5 of the Fourteenth Amendment."[78]

In addressing the State of Georgia's subsequent appeal from the order of the district court, the Eleventh Circuit acknowledged that the Eleventh Amendment bars suits brought against a state by its own citizens but pointed out two well-established exceptions to such immunity: (1) a state may waive its Eleventh Amendment immunity and consent to suit in federal court, and (2) Congress can abrogate states' Eleventh Amendment immunity if it unequivocally expresses an intent to abrogate state immunity and acts pursuant to a valid exercise of power.[79] On the former question, the panel in *Burke* found guidance in *Gardner v. New Jersey*,[80] in which the Supreme Court found a state waived its sovereign immunity by filing a proof of claim and voluntarily participating in the bankruptcy process.[81] Deeming the logic of *Gardner* still controlling of the ultimate question before it, the court ruled that the State of Georgia had waived its sovereign immunity by filing a proof of claim and that such waiver extended to the bankruptcy court's enforcement of its discharge injunction and automatic stay, respectively.[82]

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78. 146 F.3d at 1316.
79. *Id.* at 1316-17.
80. 329 U.S. 565, 573-74 (1947).
81. 146 F.3d at 1317-18. At the outset of its analysis, the panel in *Burke* cautioned that nothing found therein should be construed as an application of 11 U.S.C. § 106(b), which provides:

> [a] governmental unit that has filed a proof of claim in the case is deemed to have waived sovereign immunity with respect to a claim against such governmental unit that is property of the estate and that arose out of the same transaction or occurrence out of which the claim of such governmental unit arose.

11 U.S.C. § 106(b). Rather, the court assumed, arguendo, that the State of Georgia's Eleventh Amendment immunity had not been validly abrogated by section 106(a) and went so far as to concede that "the power to define waiver can become the functional equivalent of the power to abrogate." 146 F.3d at 1317. Nonetheless, in dicta, the court did suggest that section 106(b)'s terms may present a correct restatement of the jurisprudence regarding Eleventh Amendment waiver. *Id.*

82. 146 F.3d at 1319-20. Having so disposed of the matter before it, the panel found it unnecessary to address whether section 106(a) validly abrogates states' sovereign immunity as an exercise of Congress's power under section 5 of the Fourteenth Amendment. *Id.* at 1317.

VIII. *SECURITIES & EXCHANGE COMMISSION V. BILZERIAN*

Also in 1998, in *Securities & Exchange Commission v. Bilzerian (In re Bilzerian)*,[83] the Eleventh Circuit provided further definition of that brand of conduct warranting exception from discharge under 11 U.S.C. § 523(a)(2)(A). In *Bilzerian* the debtor was convicted in 1989 for nine counts of securities fraud for violations of section 10(b) of the Securities Exchange Act of 1934,[84] the general antifraud provision of the securities laws. In the wake of that conviction, the SEC also brought civil proceedings to force disgorgement of the debtor's fraudulently obtained profits.[85] Based upon his criminal conviction, the District Court for the District of Columbia found the debtor to be collaterally estopped from challenging the civil action and ordered the debtor to disgorge approximately $33 million, plus interest.[86] The D.C. Circuit upheld the judgment of disgorgement on appeal.[87]

During the foregoing litigation, however, the debtor had filed a petition for bankruptcy relief. Thus, when the disgorgement award was upheld, the SEC sought to except that right to payment from discharge in bankruptcy under 11 U.S.C. § 523(a)(2)(A), arguing that it represented a debt for money obtained by fraud.[88] The SEC also contended that the doctrine of collateral estoppel compelled a decision in its favor.[89] The bankruptcy court disagreed, holding that the previous judgments against the debtor did not include the requisite findings of "reliance" and "consequent loss," as required by Bankruptcy Code section 523(a)(2)(A).[90] On appeal, the district court reversed that decision, finding all necessary elements for collateral estoppel of such issues to be clear from the securities litigation record.[91]

When the debtor sought appeal from the district court's order reversing the bankruptcy court, the Eleventh Circuit first found that applications of section 523(a)(2)(A) require the traditional elements of common law fraud: (1) that the debtor made a false representation to deceive the creditor, (2) that the creditor relied on the misrepresentation,

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83. 153 F.3d 1278 (11th Cir. 1998).
84. 15 U.S.C. § 78j(b) (Supp. III 1997).
85. 153 F.3d at 1280.
86. *Id.*
87. *Id.* at 1281 (citing SEC v. Bilzerian, 29 F.3d 689 (D.C. Cir. 1994)).
88. *Id. See* 11 U.S.C. § 523(a)(2)(A) (1993) (excepting from discharge any debt "for money . . . to the extent obtained by . . . false pretenses, a false representation, or actual fraud").
89. 153 F.2d at 1281.
90. *Id.*
91. *Id.*

(3) that the reliance was justified, and (4) that the creditor sustained a loss as a result of the misrepresentation.[92] Finding without question that the judgment at issue qualified as a "debt" within the meaning of 11 U.S.C. § 523(a)(2)(A), the court of appeals construed the issue before it as one of whether a criminal conviction for securities fraud, combined with a civil disgorgement judgment in favor of the SEC, satisfies the requirements of collateral estoppel for determining "fraud" under section 523(a)(2)(A).[93] This question, in turn, depended upon whether the criminal conviction and disgorgement judgment satisfied the collateral estoppel requirement of identical issues having been actually litigated and determined in a means critical and necessary to the preceding judgment.[94] Specifically, the court in *Bilzerian* found it necessary to determine whether findings of "loss" and "actual reliance" were critical to the previous litigation which was resolved in favor of the SEC.[95]

With regard to loss, the court of appeals noted that the debtor had based an appeal of the disgorgement order upon the contention that no one was injured by his fraudulent schemes.[96] Although deeming the presence of such injury irrelevant to the question at hand, the D.C. Circuit specifically found that "others were injured by the debtor's deceptions—investors paid the debtor an inflated price for his stocks because of his illegal actions."[97] In view of this unequivocal statement by the D.C. Circuit, the panel in *Bilzerian* concluded that the district court properly deemed the debtor to be collaterally estopped from challenging whether a loss had occurred.[98]

Although noting that some courts have not required proof of actual reliance in SEC enforcement actions, the Eleventh Circuit nevertheless found the causation requirement of "materiality" in Rule 10b(5) sufficiently analogous to the requirement for actual reliance under section 523(a)(2)(A).[99] Such an interpretation, the court reasoned, justifiably reflected an expansive view of "debts obtained by fraud" because "'the malefic debtor may not hoist the Bankruptcy Code as

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92. *Id.* (citing Field v. Mans, 516 U.S. 59, 73-75 (1995)).
93. *Id.*
94. *Id.* at 1281-82.
95. *Id.* at 1282.
96. *Id.*
97. *Id.*
98. *Id.* at 1283.
99. *Id.* at 1282 & n.19 (citing Affiliated Ute Citizens v. United States, 406 U.S. 128, 153-54 (1972) (causation in fact presumed if plaintiff's claim based on defendant's failure to disclose material information); Basic Inc. v. Levinson, 485 U.S. 224, 243-47 (1988) (fraud-on-the-market theory permits plaintiffs to rely on integrity of open, well-developed markets rather than requiring proof of direct reliance)).

protection from the full consequences of fraudulent conduct.'"[100] Thus, the Eleventh Circuit affirmed the district court's decision that a discharge of the debtor's obligations under the disgorgement order was proper.[101]

IX. *KEATING V. SPANGLER*

Another bankruptcy decision from the circuit's 1998 calendar year, *Keating v. Spangler (In re XYZ Options, Inc.)*,[102] required the court of appeals to determine whether a bankruptcy court can look behind a prior consent judgment to examine potential fraud against creditors. The debtor in *XYZ Options* had entered into a contract with Machinery Trade Company ("Machinery Trade") in 1998, whereby it agreed to build a plant in Iraq for the manufacture of carbide cutting tools. To secure payment and performance under the $14,000,000 contract, the agreement required both Machinery Trade and the debtor each to post letters of credit in the other's favor. Specifically, the contract required Machinery Trade to produce a $1,400,000 down payment and post a letter of credit in an amount equal to the remainder due under the contract. The agreement likewise required that the debtor post two letters of credit—one letter as a performance bond for approximately $400,000 and another letter of approximately $1,400,000 to ensure that Machinery Trade could recover the down payment in the event of a default.[103]

Unable to come up with the required letters of credit themselves, principals of the debtor approached First Phoenix Capital ("First Phoenix"), which agreed to arrange financing for the two letters of credit and to lend the debtor $400,000 in working capital for the project. In return, the debtor agreed to repay First Phoenix for any draws it made on the letters of credit and signed a note for the amount of the letters of credit, plus the working capital loan. The joint agreement also provided that the debtor would use funds received from the Machinery Trade

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100. *Id.* at 1282 (quoting St. Lavrent, II v. Ambrose, 991 F.2d 672, 680 (11th Cir. 1993)).

101. *Id.* at 1283. As a supplement to its main conclusion, the panel in *Bilzerian* also rejected out of hand the debtor's contention that such a finding of nondischargeability would violate the Excessive Fines and/or Double Jeopardy clauses of the United States Constitution, finding such constitutional claims to be "groundless." *Id.* (citing U.S. CONST. amends. V & VIII).

102. 154 F.3d 1262 (11th Cir. 1998).

103. *Id.* at 1264.

contract to collateralize the letters of credit and to eventually remove First Phoenix from the deal.[104]

Thereafter, progression of the construction project and the business relationship of the parties severely deteriorated. Litigation ensued in several different jurisdictions, and the parties ultimately came to resolve their differences by means of a settlement agreement, the terms of which were reduced to a consent judgment in an Arizona state court.[105] The judgment, rendered in favor of First Phoenix and against the debtor, totaled approximately $2,300,000, and roughly equaled the sum to be received by the debtor's settlement of litigation against a third party.[106]

When the debtor thereafter commenced a bankruptcy case, the trustee for the estate sued First Phoenix and certain insiders, contending that the transfer of $2,300,000 in settlement with First Phoenix constituted a fraudulent transfer and an avoidable preference.[107] In turn, First Phoenix argued that the subject transfer was shielded by the Arizona consent judgment in its favor to the extent that a bankruptcy court lacked the power to look behind that judgment's terms.[108]

After withdrawing the reference, the United States District Court for the Northern District of Alabama found that it held sufficient equity power in bankruptcy to look behind a state court consent judgment between the debtor and creditors to determine whether a fraudulent transfer had occurred.[109] As to the underlying merits of the case, however, the district court held that the trustee had not raised a genuine issue of fact regarding his allegations of actual and constructive fraud under Bankruptcy Code sections 544 and 548.[110] The court, therefore, entered partial summary judgment in favor of the creditors.[111]

On subsequent appeal by the trustee, the Eleventh Circuit began by noting the well-established holding of *Pepper v. Litton*,[112] in which the Supreme Court rejected a claim of res judicata and sustained the power of a bankruptcy court to look behind a previous state court judgment.[113] In view of such a clear license, the court of appeals found no

104. *Id.* at 1264-65.
105. *Id.* at 1266.
106. *Id.* at 1266-67.
107. *Id.* at 1267. *See* 11 U.S.C. §§ 544, 547, 548.
108. 154 F.3d at 1267.
109. *Id.*
110. *Id.* at 1271.
111. *Id.*
112. 308 U.S. 295 (1939).
113. 154 F.3d at 1267-68 (citing Pepper v. Litton, 308 U.S. 295 (1939)).

question that the district court had equity power in bankruptcy to look behind a state court consent judgment between the debtor and its creditors.[114] Thus, it affirmed the district court's decision in this regard.[115]

As to the existence of material questions of fact on the trustee's avoidance actions, the panel in *XYZ Options* found the district court in error.[116] In particular, the panel determined that material issues of fact existed regarding the inflated nature of values assigned by the consent judgment's terms and whether assets transferred in satisfaction of the debtor's obligations thereunder had been diverted.[117] In view of such material and unanswered questions, summary judgment on claims of actual or constructive fraud was deemed inappropriate by the *XYZ Options* panel, and the district court's ruling was reversed.[118]

X. *DIONNE V. KEATING*

In a companion appeal from the preceding case, *Dionne v. Keating (In re XYZ Options, Inc.)*,[119] the Eleventh Circuit also found itself compelled to decide whether section 5-116(2) of the Uniform Commercial Code precludes a valid assignment of the proceeds of a letter of credit at a point when the performance of the conditions of the credit have already occurred, that is, at a time when the right to payment under the letter of credit has already been earned.[120] Recall that the debtor executed a document purporting to assign the Machinery Trade's letter of credit to First Phoenix at an October 1988 closing of the financing arrangements, but the debtor did not deliver possession of the letter of credit at that time. In November 1989, at a time when the debtor still had possession of the Machinery Trade letter of credit, the issuer of that letter stopped making payments to the debtor and filed a declaratory judgment action in federal court for a determination that it was no longer liable under the letter of credit.[121] On July 21, 1993 the court entered a memorandum opinion concluding that the debtor had in fact performed construction work under the contract and had presented appropriate documentation entitling it to draw on the letter of credit,

114. *Id.* at 1270-71.
115. *Id.* at 1271.
116. *Id.*
117. *Id.* at 1272.
118. *Id.* at 1275.
119. 154 F.3d 1276 (11th Cir. 1998).
120. *Id.* at 1277.
121. *Id.*

and that the issuer had erroneously refused to honor the debtor's draws.[122] Thus, it was then established that the debtor had performed the conditions of the letters of credit, that is, that it had earned the right to payment under the Machinery Trade letter of credit. Subsequently, in November 1993, First Phoenix acquired a perfected security interest in the proceeds of the letter of credit to secure obligations, which the debtor had incurred in connection with financing the construction project, by taking possession of that letter in accordance with Uniform Commercial Code section 5-116(2)(a).[123]

Upon the debtor's filing for bankruptcy, the Chapter 7 trustee challenged First Phoenix's security interest in the proceeds of the letter of credit.[124] Having withdrawn reference of the case, the district court construed section 5-116(2) to permit the assignment of a security interest in the proceeds of the letter of credit only before performance of the conditions of the letter of credit.[125] Thus, the district court held the statute to preclude assignment of a security interest in the proceeds of the letter of credit if the right to payment under the letter of credit had already been earned.[126] Because the debtor's assignment of a security interest in the proceeds of the letter of credit was not perfected until November 1993, at which time the debtor's right to payment under the letter had already been earned, the district court held that the assignment was invalid.[127]

Noting the silence on the question of post performance assignments in section 5-116(2), the Eleventh Circuit turned its attention to U.C.C. section 5-102(3), and its cautionary statement that the existence of a rule should "not by itself require, imply or negate application of the same or a converse rule to a situation not provided for."[128] In keeping with this directive, the panel reasoned that it would be inappropriate to construe section 5-116(2)'s license of preperformance assignment as a prohibition upon such action in the wake of performance.[129] Indeed, to the contrary, the court in *XYZ Options* found section 5-116(2)'s Official Comment unequivocally provided that a letter of credit "is [to be] treated like any other contract calling for money to be earned," a strong

122. *Id.* at 1277-78.

123. *Id.* at 1278. U.C.C. § 5-116(2)(a) expressly provides that "the assignment is ineffective until the letter of credit or advice of credit is delivered to the assignee, which delivery constitutes perfection of the security interest under Article 9."

124. 154 F.3d at 1277.

125. *Id.* at 1278.

126. *Id.*

127. *Id.*

128. *Id.* at 1278-79 (quoting U.C.C. § 5-102(3)).

129. *Id.* at 1279.

indication that it should be deemed freely assignable, both before and after the right to payment has been earned.[130] Thus, the Eleventh Circuit reversed the district court's ruling to the contrary.[131]

XI. *CHEMICAL BANK V. FIRST TRUST OF NEW YORK*

In September 1998 the Eleventh Circuit, in *Chemical Bank v. First Trust of New York (In re Southeast Banking Corp.)*,[132] clarified the vitality of the "rule of explicitness" in the wake of Bankruptcy Code section 510's passage. Under the terms of a prepetition indenture (the "Senior Indenture"), the debtor had issued $60 million in principal amount of unsecured notes (the "Senior Notes"). The Senior Indenture provided the debtor with a continuing obligation to repay principal and interest on the Senior Notes and, in the event of a default, obligated the debtor to pay the entire amount of principal and interest due on the Senior Notes, including interest until the date of payment upon overdue principal. To the extent enforceable, the agreement also purportedly obligated the debtor to pay interest upon the overdue interest at the same rate specified in the Senior Notes. Finally, the Senior Indenture provided that in the event of a default, the debtor also would be liable to the Senior Trustee for reasonable fees and costs of collection, including attorney fees.[133]

Under five separate indentures (the "Subordinated Indentures"), the debtor also issued in excess of $300 million in principal amount of subordinated notes ("the Subordinated Notes"). Each of the Subordinated Indentures contained language subordinating collection on the Subordinated Notes to the prior payment in full on the Senior Notes. The Subordinated Indentures also provided that upon the debtor's bankruptcy or liquidation, the holders of the Senior Notes would have to be fully paid before the debtor could make any payment on the Subordinated Notes, and that all payments otherwise owing to the holders of the Subordinated Notes must first be paid to the holders of the Senior Notes. Significantly, however, the Subordinated Indentures made no specific mention of the issue of postpetition interest or of the Senior Trustee's fees and costs, instead merely noting that New York law would govern the enforcement and interpretation of the agreement's terms.[134]

130. *Id.*
131. *Id.*
132. 156 F.3d 1114 (11th Cir. 1998).
133. *Id.* at 1116.
134. *Id.* at 1116-17.

When the debtor thereafter filed a petition under Chapter 7 of the Bankruptcy Code, both the Senior Trustee and the Junior Trustees filed proofs of claim as unsecured nonpriority claims on behalf of their holders in the debtor's Chapter 7 proceedings.[135] Pursuant to the orders of the bankruptcy court, the debtor distributed amounts sufficient to satisfy the principal on the Senior Notes and all interest that accrued on the Senior Notes prior to the petition date.[136] Because the debtor's estate was insolvent, however, the Senior Trustee did not receive any of the interest that had accrued on the Senior Notes after the petition date.[137]

In view of the foregoing, holders of the Senior Notes commenced a proceeding to compel the payment of postpetition interest until the date of payment on the Senior Notes (including interest upon that interest), as well as reimbursement of the Senior Trustee's fees and costs associated with the action, from the distributions otherwise payable to holders of the Subordinated Notes. In support of this request, the Senior Trustee and note holders relied on contractual language in the Subordinated Indentures subordinating the junior note holders' rights to those of the Senior Note holders, as well as to section 510(a) of the Bankruptcy Code, which provides for the enforcement of subordination agreements.[138] All parties moved for summary judgment.[139]

The bankruptcy court denied the Senior Trustee's and note holders' motion for summary judgment in part, and granted the Junior Trustees' cross-motion for summary judgment in part.[140] The Senior Trustee and holders of the Senior Notes appealed to the District Court for the Southern District of Florida, but the district court affirmed the judgment of the bankruptcy court.[141] Both the bankruptcy court and the district court based their holdings on the judicially-created doctrine of the rule of explicitness, which effectively prevents a senior creditor from recovering postpetition interest from junior creditors unless the subordination agreement articulates the obligation in unusually clear

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135. *Id.* at 1117.
136. *Id.*
137. *Id.*
138. *Id.* As part of its comprehensive 1978 revision of the bankruptcy laws, Congress enacted a code provision allowing for the legal enforcement of subordination agreements in bankruptcy courts: "A subordination agreement is enforceable in a case under this title to the same extent that such agreement is enforceable under applicable non-bankruptcy law."
11 U.S.C. § 510(a) (1994).
139. 156 F.3d at 1117.
140. *Id.* at 1118 (citing *In re* Southeast Banking Corp., 188 B.R. 452 (Bankr. S.D. Fla. 1995)).
141. *Id.* (citing *In re* Southeast Banking Corp., 212 B.R. 682 (Bankr. S.D. Fla. 1997)).

terms.[142] Applying the same logic, the bankruptcy and district courts also denied the Senior Trustee's claim for reasonable costs and fees, including attorney fees, incurred after the petition date.[143] Finally, relying on New York law that made a contract for compound interest unenforceable, prevailing at the time the parties entered the relevant contracts, the bankruptcy and district courts also rejected the Senior Trustee's and holders of the Senior Notes' claims for compound interest (interest upon the postpetition interest).[144]

On further appeal, the court of appeals acknowledged the traditional governance of a rule of explicitness, severely restricting a senior creditor's ability to recover postpetition interest from junior creditors.[145] At the same time, however, the panel in *Southeast Banking* noted that section 510(a)'s instruction to enforce subordination agreements on a par with other contracts under nonbankruptcy law constituted a plain departure from the prior practice of enforcing and interpreting those agreements pursuant to the bankruptcy courts' equitable powers.[146] Thus, in the wake of that section's inclusion within the Bankruptcy Code, the equitable underpinnings relied upon to fashion this rule of explicitness no longer existed.[147] In keeping with the mandate of section 510 and the indentures' choice of law provision, the question of what language had to be included in the agreement to alert junior debenture holders that they were subordinating their claims to senior holders' claims for interest was certified to the New York Court of Appeals.[148] In all other respects, the judgment of the district court was reversed.[149]

XII. *HENRY LEE CO. V. TOLZ*

In its eleventh bankruptcy decision of the year, *Henry Lee Co. v. Tolz*,[150] the circuit settled a priority battle under Florida's version of the Uniform Commercial Code. The Chapter 7 trustee sought recovery of funds held by a bank pursuant to a writ of garnishment obtained by the judgment creditor within ninety days of filing. Notwithstanding the

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142. *Id.*
143. *Id.*
144. *Id.*
145. *Id.* at 1119-20 (citing *In re* Time Sales Fin. Corp., 491 F.2d 841, 844 (3d Cir. 1974)).
146. *Id.* at 1120-21.
147. *Id.* at 1122.
148. *Id.* at 1125.
149. *Id.* at 1126.
150. 157 F.3d 1290 (11th Cir. 1998).

fact that a trustee in bankruptcy, as a hypothetical lien holder, takes priority over those holding an unperfected security interest in the assets of the debtor, the creditor claimed that its lien had priority under Florida law because a judgment creditor may obtain priority by delivering the writ of execution to the sheriff for the county where the property is located.[151] Noting, however, that a security interest in money can only be perfected under the UCC by possession, the bankruptcy court granted summary judgment for the trustee.[152] The United States District Court for the Southern District of Florida affirmed.[153]

On further appeal, the court of appeals first observed that nothing excludes garnishments from the perfection requirements of the Uniform Commercial Code.[154] Furthermore, because the collateral to be secured was not a right represented by a judgment, but instead consisted of funds contained in a bank account, that interest could only be perfected by possession of the subject funds.[155] However, the creditor had not obtained possession of the funds prior to commencement of the ninety-day period of presumptive insolvency, meaning that the trustee had a priority interest therein.[156] For this reason, the decisions of the district and bankruptcy courts to permit the trustee's recovery under 11 U.S.C. § 544 were affirmed.[157]

XIII. *PUGH V. BROOK*

In *Pugh v. Brook*,[158] the Eleventh Circuit answered the question of whether Bankruptcy Code provisions establishing time limits for actions to avoid prepetition and postpetition transactions constitute waivable statutes of limitation or jurisdictional bars. The debtors in *Pugh* had filed a voluntary petition for Chapter 11 relief on September 27, 1991, in an effort to prevent an impending foreclosure sale of their chicken ranch in Plant City, Florida. Although the schedules of assets and liabilities accompanying that filing did not adequately disclose an unliquidated breach of contract claim that they held at the time, subsequent to converting their case voluntarily to one of liquidation under Chapter 7 on February 5, 1992, the debtors filed amended

151. *Id.* at 1291.
152. *Id.*
153. *Id.*
154. *Id.* at 1292.
155. *Id.* (citing FLA. STAT. ch. 679.304(1) (1997)).
156. *Id.*
157. *Id.*
158. 158 F.3d 530 (11th Cir. 1998).

schedules reporting the litigation claim as an asset of undetermined value. They then reached an agreement with the Chapter 7 trustee whereby the estate would receive seventy percent of the net proceeds of any settlement of that claim, and the debtors would receive the remaining thirty percent of such funds.[159]

Notwithstanding their agreement to the contrary, upon settling their breach of contract action for $63,310.80, the debtors presented the trustee with only $13,400 of those settlement proceeds. This led the trustee to commence an adversary proceeding on July 21, 1995, wherein he sought turnover of those proceeds pursuant to 11 U.S.C. § 542(b), as well as certain additional relief. On September 18, 1995, the debtors filed an answer which did not include a statute of limitations defense.[160] Thereafter, disposing of the case on the merits, the bankruptcy court entered a final judgment in favor of the trustee in the amount of $44,317.56.[161]

The debtors appealed the bankruptcy court's judgment, arguing for the first time on appeal that the trustee was barred by 11 U.S.C. § 546 from commencing or maintaining the adversary proceeding against them. In response, the trustee argued that by failing to raise the two-year statute of limitations contained in either 11 U.S.C. §§ 546(a) or 549(d) in their answer, the debtors had waived any and all such defenses.[162] Agreeing with the trustee, the district court found that the two code sections presented waivable statutes of limitation rather than nonwaivable jurisdictional bars.[163] Because the debtors had waived their statute of limitations defense by not including it in their answer, the district court found them to be barred from raising such questions on appeal and affirmed the judgment of the bankruptcy court.[164]

On appeal, the Eleventh Circuit noted a division of authority regarding the true nature of the time limitations in sections 546 and 549.[165] Essentially, the court in *Pugh* noted that this distinction reflected a divided view on whether the sections themselves represent a jurisdictional grant such that parties may not avoid the limitations posed thereunder by acts of waiver.[166] In the court's view, this form

159. *Id.* at 530-31.
160. *Id.* at 531.
161. *Id.* (citing Brook v. Pugh (*In re* Pugh), 195 B.R. 787 (Bankr. M.D. Fla. 1996)).
162. *Id.* at 532.
163. *Id.*
164. *Id.* (citing *In re* Pugh, 202 B.R. 792, 795-96 (Bankr. M.D. Fla. 1996)).
165. *Id.* at 533-34.
166. *Id.* at 533. Specifically, the court in *Pugh* observed:

> The bipolar split of authority that has developed among these courts can be conceptualized in different ways. For example, we could view this split as a

of jurisdiction-based analysis offended reason, as well as legislative history suggesting that sections 546 and 549 set forth true statutes of limitation.[167] The court in *Pugh*, therefore, found the time limitation imposed under those sections to be waivable statutes of limitation, not jurisdictional bars, and it consequently affirmed the district and bankruptcy courts on that basis.[168]

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dispute over whether these code provisions constitute statutes of repose or statutes of limitations. *See Frascatore v. Secretary of HUD (In re Frascatore)*, 98 B.R. 710, 718-19 (Bankr. E.D. Pa. 1989); *cf. Bradway v. American Nat'l Red Cross*, 992 F.2d 298, 301 (11th Cir. 1993) (explaining that, while a statute of limitations is contingent, a statute of repose is absolute in that it "destroys the previously existing rights so that, on the expiration of the statutory period, the cause of action no longer exists" (quoting *Wright v. Robinson*, 262 Ga. 844, 845, 426 S.E.2d 870, 871-72 (1993))). Alternatively, we could consider whether the provisions are "substantive" (also called "jurisdictional") or "procedural" statutes of limitations. *See Bartlik v. United States Dep't of Labor*, 62 F.3d 163, 166 n.1 (6th Cir. 1995) (en banc) (citing *Martin v. First Nat'l Bank of Louisville (In re Butcher)*, 829 F.2d 596, 600 (6th Cir. 1987); *Rust v. Quality Car Corral, Inc.*, 614 F.2d 1118, 1119 (6th Cir. 1980)); *cf. Burnett v. New York Cent. R.R. Co.*, 380 U.S. 424, 425-27 & n.2 (1965), *rev'g* 332 F.2d 529 (6th Cir. 1964) (noting that "the 'substantive'—'procedural' distinction would seem to be of little help in deciding questions of extending the limitation period"). It is more conducive to reasoned analysis, however, to conceptualize this split as a disagreement over whether these code provisions constitute grants of subject matter jurisdiction that leave a court without any authority to hear certain proceedings—i.e., that extinguish the right of action itself by divesting a court of its subject matter jurisdiction over certain proceedings—after the limitations period has elapsed, or whether they are true statutes of limitations that restrict the power of a court to grant certain remedies in a proceeding over which it has subject matter jurisdiction. *See Beach v. Ocwen Fed. Bank*, 523 U.S. 410 (1998); *Midstate Horticultural Co. v. Pennsylvania R.R. Co.*, 320 U.S. 356, 358-59 (1943); WILLIAM L. NORTON, JR., NORTON BANKRUPTCY LAW AND PRACTICE § 4:1 (2d ed. 1991). Because subject matter jurisdiction cannot be conferred by waiver, *see Insurance Corp. of Ireland v. Compagnie des Bauxites de Guinee*, 456 U.S. 694, 702 (1982), the debtors would prevail under the former interpretation; the latter interpretation, on the other hand, would support the trustee's argument that the debtors waived their statute of limitations defense by failing to assert it in their September 1995 filing. *See* FED. R. CIV. P. 8(c); *American Nat'l Bank of Jacksonville v. FDIC*, 710 F.2d 1528, 1537 (11th Cir. 1983).

158 F.3d at 533-34.

167. 158 F.3d at 538 (citing S. REP. NO. 95-988 at 87 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5873 ("Subsection (c) [enacted as (a)] adds a statute of limitations to the use by the trustee of the avoiding powers.")).

168. *Id.*

XIV. *COMMUNITY BANK OF HOMESTEAD V. TORCISE*

In *Community Bank of Homestead v. Torcise (In re Torcise)*,[169] the Eleventh Circuit navigated the often tortuous intersection of collateral estoppel and bankruptcy. The underlying saga began in April 1989 when Community Bank of Homestead, Florida loaned the debtor $1.5 million for use in his tomato farming operations, with the loan being secured by a lien on certain real property and farm equipment. The debtor made no payments on the loan before filing for Chapter 11 bankruptcy relief in the United States Bankruptcy Court for the Southern District of Florida in late November 1989.[170] As part of that case's disposition, the bankruptcy court approved a liquidation plan that required the debtor to sell the farm equipment securing Community Bank's loan, and then lifted the automatic stay to allow Community Bank to foreclose on the real property.[171]

In the course of a resulting judicial foreclosure, the Circuit Court of Dade County, Florida, held the debtor liable for the principal amount of the note, plus interest accruing at the contractual default rate until the time of the foreclosure, and entered judgment for that amount, plus postjudgment interest at the Florida statutory rate of twelve percent per annum.[172] The debtor did not appeal the state court's judgment, and a foreclosure sale of the real property was closed.[173]

The mortgagee then moved the bankruptcy court for release of the proceeds from an escrow account where they had been placed pending the resolution of certain ancillary litigation between it and the estate.[174] Over the debtor's objection, the bankruptcy court approved payment of the mortgagee's claim as provided in the state court foreclosure judgment, precipitating an appeal to the United States District Court for the Southern District of Florida.[175] Concurring in the debtor's analysis of state law, the district court held the circuit court's foreclosure judgment had imposed "interest on interest" in violation of Florida law.[176] Furthermore, the district court viewed 11 U.S.C. § 506(b) as requiring the calculation of both prejudgment and

169. 162 F.3d 1084 (11th Cir. 1998).
170. *Id.* at 1085-86.
171. *Id.* at 1086.
172. *Id.*
173. *Id.*
174. *Id.*
175. *Id.*
176. *Id.* (citing Community Bank of Homestead v. Torcise (*In re* Torcise), 187 B.R. 18, 23 (Bankr. S.D. Fla. 1995)).

postjudgment interest awards at the contract rate (rather than the respective default or Florida statutory rates).[177] Thus, the court reversed the bankruptcy court's ruling.[178]

When the mortgagee sought further appeal, the Eleventh Circuit deemed any contention that Florida law does not permit interest on interest to be an argument that should have been made in the circuit court foreclosure proceeding.[179] Likewise, according to the court in *Torcise*, if 11 U.S.C. § 506(b) were relevant in determining the amount of Community Bank's claim, that argument should have been made in the state court.[180] To the extent the debtor had failed to address such questions as part of the foreclosure proceeding, the Eleventh Circuit held that the amount of interest awarded on the mortgagee's claim in postconfirmation state court foreclosure proceedings had a collateral estoppel effect, barring the debtor from contesting calculation of interest in the bankruptcy court.[181]

XV. *UNITED STATES V. HAAS*

The last of the Eleventh Circuit's 1998 opinions having material bearing upon bankruptcy practice and procedure, *United States v. Haas (In re Haas)*,[182] raised the question of when and to what extent a plan may modify employment tax claims against the debtor's estate. The debtors in *Haas* filed their joint petition under Chapter 11 of the Bankruptcy Code in 1991 on the eve of an involuntary sale of their home to satisfy $68,000 of "responsible person" employment tax obligations and $617,000 of income tax obligations arising from the operation of the husband's legal practice.[183]

At the time of filing, the debtors had assets with a total value of $259,000, to which they added $71,600 during the pendency of the Chapter 11 case.[184] The bankruptcy court confirmed a plan of reorga-

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177. *Id.*

178. *Id.*

179. *Id.* at 1086-87. So as to demonstrate the impropriety of such action, the panel in *Torcise* explained:

> By the district court's reasoning, if the bankruptcy court had granted relief from the automatic stay for an injured party to pursue an auto accident claim in Florida circuit court, the bankruptcy court could subsequently (when the injured party attempted to collect on the judgment) decide that the circuit court had improperly applied the Florida law of negligence.

Id. at 1087.

180. *Id.*

181. *Id.*

182. 162 F.3d 1087 (11th Cir. 1998).

183. *Id.* at 1088.

184. *Id.* at 1089.

nization which provided that the $68,000 employment tax debt, a priority claim that could not be discharged by operation of 11 U.S.C. § 523(a), would be treated as a secured claim and paid from the $71,600 in funds on hand, thereby purportedly reducing the scope of any corresponding secured tax claim upon the other $259,000 in assets to $191,000.[185] Regarding the remainder of the income tax obligations, the plan provided that such debts would be treated as unsecured. While the secured portion of the income tax claim was to be paid in installments over a thirty-year period with eight percent interest, only $10,000 would be paid upon the portion of such taxes deemed unsecured; beyond such limited distribution, the remainder of the unsecured tax claim was to be discharged by operation of 11 U.S.C. § 1141(d).[186]

Relying upon *United States v. Energy Resources, Inc.*,[187] the debtors in *Haas* asserted that their immediate satisfaction of the employment taxes liability from funds on hand qualified as a permissible allocation of plan payments.[188] The bankruptcy court concurred in this estimation of governing law, and confirmed the plan over the objection of the Internal Revenue Service.[189] On appeal, the District Court for the Southern District of Alabama affirmed.[190] Thereafter, the IRS sought further appeal in the Eleventh Circuit.[191]

The court of appeals began its resolution of the issues presented in that appeal by distinguishing *Energy Resources* to the extent that the reasoning contained therein merely permitted a trustee to direct the application of initial plan payments to such trust fund taxes when the underlying plan effected a full payment of all tax liabilities of the estate.[192] Furthermore, the court in *Haas* observed that nothing in *Energy Resources* suggested that the plan might fail subsequent to confirmation.[193]

Turning to the case at bar, the panel in *Haas* noted that the marginal payment offered to the IRS reduced its recovery by $68,000, effectively

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185. *Id.*

186. *Id.*

187. 495 U.S. 545 (1990). In *Energy Resources*, the Supreme Court concluded that a bankruptcy court has the authority to order the IRS to treat tax payments made by a Chapter 11 debtor corporation as reducing trust fund liabilities when the bankruptcy court determines that the designation by the plan proponent is necessary for the success of a reorganization plan. *Id.* at 550.

188. 162 F.3d at 1089.

189. *Id.*

190. *Id.* at 1090.

191. *Id.* at 1088.

192. *Id.* at 1089.

193. *Id.*

undermining that claim's priority status.[194] Furthermore, in contrast to *Energy Resources*, the *Haas* plan had little likelihood of success because it presupposed that the sixty-eight-year-old debtor husband would continue to practice law for the next thirty years.[195] In the Eleventh Circuit's view, the unrealistic nature of such a premise destined the plan to fail, in violation of the feasibility requirements imposed by Bankruptcy Code section 1129(a)(11).[196] Thus, the order of confirmation was reversed, and the case was remanded for further disposition in light of the panel's ruling.[197]

XVI. CONCLUSION

To varying degrees, the foregoing opinions from the 1998 calendar year maintain the Eleventh Circuit's central role in the resolution of bankruptcy-related disputes and the continued development of case law in this area. Both practitioners and judges will benefit substantially from the clarifications provided in these decisions, and other courts of appeals most assuredly will look to their well-reasoned terms in settling related bankruptcy disputes. The fine judicial effort reflected by these decisions warrants commendation, and its character should lead those within the bankruptcy bench and bar to eagerly anticipate what 1999 portends for Eleventh Circuit bankruptcy jurisprudence.

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194. As the court in *Haas* noted in this regard:

> If we adopted the debtors' approach in this case we would essentially be ruling that when a creditor takes a lien to secure debt which Congress has classified as priority, the creditor has forfeited the protection Congress has specifically assigned to that debt to the extent the debt exceeds the value of the property subject to the security interest. Thus, to the extent the debt is under-secured, the creditor receives less protection than Congress intended.

Id. at 1089-90.

195. *Id.* at 1090.

196. *Id.* Among its other preconditions, the Bankruptcy Code directs that no Chapter 11 plan shall be confirmed unless such confirmation is "not likely to be followed by liquidation, or the need for further financial reorganization." 11 U.S.C. § 1129(a)(11) (1994).

197. 162 F.3d at 1090.