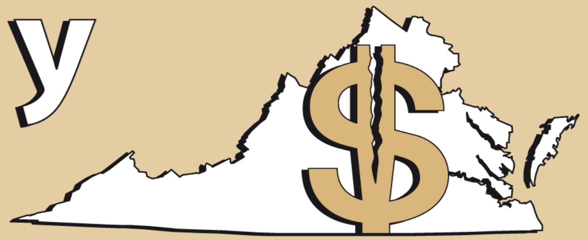
Bankruptcy Law News



Published by the Bankruptcy Law Section of the Virginia State Bar for Distribution to Its Members

Volume XXIV, No. 31 Spring 2020

Redefining the *Brunner* Test for the Allowance of Discharge of Student Loans, Sometimes

By Christian Reese

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A. Introduction

The student loan debt crisis has been constantly growing and is commonly in the news. The current debt has risen to over 1.5 trillion dollars and the repayment rate is alarmingly low.[1] "[T]he amount of student loan debt has presented bankruptcy lawyers and judges with individual debtors who are genuinely unable to repay the full amount of their education debt."[2] It has long been the norm that student loan debt cannot be discharged in a bankruptcy.

The *Brunner* test has been the precedent cited for not allowing discharge of student loan debt,[3] but the recent movement to allow discharging student loan debt may have finally received its much-needed traction. The recent *Rosenberg v. New York State Higher Education Services Corp.* decision transforms how to apply the *Brunner* test and could lead to a major change in the ability to discharge student loan debt.[4]

The exceptions to discharge under the Bankruptcy Code are rooted in § 523.[5] The ability to discharge student loans, or lack thereof, relies on § 523(a)(8), which was the basis for the *Brunner* test. The court in *Brunner* focused on defining "undue hardship" and used its definition to create a test for when student loan debt may be discharged.[6] The three-prong test allowed for discharge if the debtor showed:

> (1) that the debtor cannot maintain, based on current income and expenses, a "minimal" standard of living for herself or her dependents if forced to repay the loans; (2) the additional circumstances exist indicating that this state of affairs is likely to persist for a significant portion of

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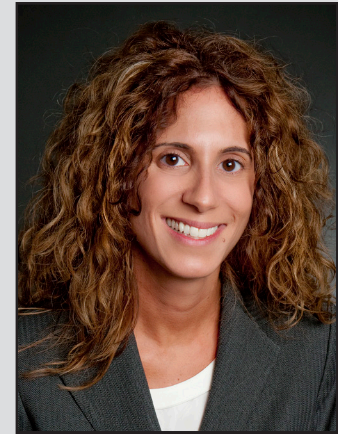
Message from the Chair of the Section

Erika Morabito



This will be my last message as outgoing Chair and I write it with both a heavy heart and great optimism. The effects of the Covid-19 pandemic changed the world, including the legal profession, and prevented most of us from seeing our colleagues and friends for many months. Conferences, seminars, workshops, programs and CLE's were cancelled or postponed for the safety of all of us and for the global community as a whole. We know these programs and conferences are meaningful to you, as they are to our Board of Governors. Fortunately, many of our colleagues came together during this difficult time and helped build a virtual community that we should all be very proud of. Additionally, the courts have adjusted their rules, forcing professionals and advisors to work together to offer a lifeline to struggling families and businesses amid this global pandemic.

In ordinary times, bankruptcy courts expect debtors to keep cases moving along in order to secure a prompt and effectual resolution of bankruptcy cases within a limited period. In the past few months, however, we have seen numerous bankruptcy courts confronted with requests by debtors to temporarily suspend their cases under the courts' equitable powers in an effort to weather the COVID-19 storm and, hopefully preserve value for all creditors. Many of those requests have been granted. Additionally, the federal government intervened and we saw obscure changes to the bankruptcy laws, including the Coronavirus Aid, Relief and Economic Security Act (CARES Act), increasing the debt limit to $7.5 million for small businesses. The Small Business Reorganization ACT (SBRA), together with the CARES Act, significantly enhanced the Chapter 11 protection for small businesses during the coronavirus outbreak. The CARES Act also provided some relief for consumers who filed for bankruptcy protection. For example, the direct checks, dubbed "recovery rebates," do not count as income that would otherwise get factored into a "means test" that determines if someone can file a Chapter 7 case. Additionally, the recovery rebates do not count as "disposable income" that could be applied to things like credit card debts in Chapter 13 cases. In sum, bankruptcy courts too are adjusting to the impact and uncertainty of Covid-19. And, while it is impossible to know when the pandemic will subside, we can probably expect more changes and interpretations as bankruptcy courts and practitioners continue to navigate what amounts to uncharted waters in many respects.

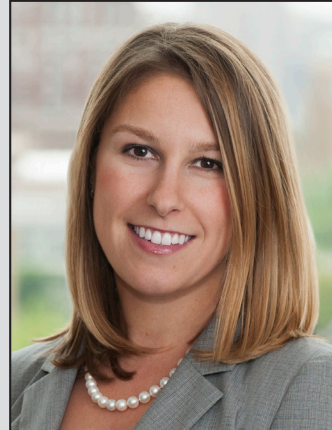
As outgoing Chair, I want to thank all of the members of the Board of Governors for the Bankruptcy Section for their hard work this year, and especially my Vice Chair and Secretary. I also want to thank Andrea Campbell Davison who served as editor of this incredible newsletter, along with past Chair Sarah Boehm, for all of her guidance and wisdom this year. I am pleased to report that Hannah Hutman will serve as the Chair next year and Dylan Trache will serve as Vice Chair. Please also join me in welcoming Andrea Davison, Janice Hansen and Mike Hastings as new members of the Board. I look forward to working with all of you again next year!

As we head into summer, and with the uncertainty of a coronavirus resurgence in the coming months, I hope that each of you and your families, friends, and colleagues remain healthy and safe. I look forward to seeing and visiting with many of you in the months ahead.

Best ~ *Erika*

Message from the Editor

Andrea Campbell Davison, Esq.



To my bankruptcy colleagues around the Commonwealth of Virginia, I hope this edition of the Law News finds you well under the heavy circumstances in our world today. While we were under a stay at home order and the state courts subject to judicial emergency, there has certainly been an uptick in bankruptcy activity at both the local and national level. I expect we'll be welcoming many of our colleagues to the bankruptcy practice as demand for such services increases; if you are new here, we're happy to have you.

As always, thank you so very much to those who contributed to this edition of the Law News and to all who read. This will be my last as editor, after a several year tenure. The Board looks forward to announcing the name of our new editor, but in the meantime, if you have a suggested article topic or would like to contribute, please contact me at adavison@beankinney.com.

~ Andrea

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> the repayment period of the student loans; and (3) that the debtor has made good faith efforts to repay the loans.[7]

In the case of *Brunner*, the court found this standard was not met and that the debtor was not discharged from her debts because she failed to show that the current state of affairs would persist.[8]

Current caselaw has used this *Brunner* test to deny discharge for student loan debts for debtors. Many cases have even gone so far as to deny discharge solely based on the percentage of their debt that is student loan debt.[9]

B. Reinterpreting the *Brunner* Test

The court in *Rosenberg* illustrates that this trend could be misguided and that it has "become a quasi-standard of mythic proportions so much so that most people (bankruptcy professionals as well as lay individuals) believe it impossible to discharge student loans." [10] Judge Morris explains in her opinion that the harsh treatment of student loan debt in previous cases is not a consequence of courts applying the *Brunner* test, but instead of courts interpreting the test to create this harsh treatment.[11] Judge Morris, instead of *interpreting* the *Brunner* ruling, applied the *Brunner* test and concluded that debtor's student loan debt should be discharged.[12]

The debtor's student loan had a principal of $116,464.75 and an outstanding balance of $221,385.49.[13] The debtor had a negative current monthly income.[14] This illustrated to the court that the debtor's current situation would not allow him to pay back his loans while maintaining a minimal standard of living.[15] Unlike *Brunner* and many cases citing to it, the debtor was not a recent degree recipient and had not received new students loans since 2004.[16] The court also highlighted that in the case of this debtor the loan had already became due in full, so the second prong had been satisfied because the repayment period had expired, and the debtor's circumstances had not changed.[17]

The last hurdle was whether the debtor made a good faith effort to pay off the student loans. Courts regularly have linked filing in lieu of large student loan debt as a sign of bad faith and have used student loans to reject a discharge for not satisfying the good faith prong.[18] *Rosenberg* ignores this misguided trend and draws the attention back to the actual wording of *Brunner*, which puts the focus on the good faith effort of the repayment of student loans. Further, the Court emphasize that the good faith effort to be scrutinized should be the prepetition efforts only.[19]

The court found that the debtor made a good faith effort to pay back the student loan debts and cited the numerous payments in varying amounts that the debtor made over the course of the repayment period and also after the repayment period had ended.[20] Thus, the Court determined that the debtor may obtain a discharge of his student loan debts.

This ruling is not a rejection of the *Brunner* test but instead a new application. Previous caselaw has used the *Brunner* test as a rejection of discharge of student loan debt, but this opens the door for the possibility that courts could begin to redefine the test to allow for discharges in certain situations.

C. Using the *Rosenberg* Ruling as a Middle Ground

In 2019 the concept of student loan debts being discharged was introduced to Congress.[21] The Discharge Student Loans in Bankruptcy Act of 2019 presented to Congress was a much more blanketed allowance for discharging student loans. The Act proposes a complete deletion of § 523(a)(8),[22] which makes the *Brunner* test completely null and void. Looking solely at previous caselaw and the Act creates a black and white approach to the discharging of student loan debts—forgive them all or forgive none. *Rosenberg* could be a middle ground between the two options that would allow for debtors who truly need the relief

to receive it, while not allowing the system to be abused by new graduates trying to avoid the cost of higher education.

Rosenberg acknowledges that cases in the past have been dismissed for bad faith for debtors who were filing to discharge student loans shortly after graduation.[23] *Rosenberg* does not discuss treatment of those situations, but instead shows how the *Brunner* test can be applied differently in situations where debtors are not new graduates and have in fact made a substantial effort to pay off their student loans before filing.

New graduates can still be barred from student loan discharge without any adjustment to *Rosenberg* or the *Brunner* test because of the second prong of the test. The first prong is calculated using the debtor's currently monthly income (CMI). The CMI is comprised of looking at the debtors previous six months of income,[24] which is then compared to the debtor's expenses to determine whether the first prong of the test is satisfied. While this may allow a new graduate to have a CMI that does not reflect their ability to pay in the foreseeable future, the second prong of the test can catch these situations and deny the discharge of the student loan debt—as was the case in *Brunner*.[25] To satisfy the second prong of the test, debtors must show that their current situation is not likely to change over a substantial portion of the loan repayment; recent graduates would, in most cases, be unable to provide evidence that there would be no change to their financial situation post-graduation.[26]

Further, the third prong of the test, requiring a good faith attempt to repay the debt, allows for the court to use its discretion in cases where a debtor has been purposely trying to avoid obligations that could have been paid. The presence of good faith or lack of bad faith is a common argument in the bankruptcy court and there is plenty of caselaw that may be relied on. This makes the ease of transition to the new application of the *Brunner* test much easier.

D. The Effect of *Rosenberg* on Chapter 13 Plans

Section 1322(b)(1) does not allow for unfair discrimination against a class of creditors of equal rank.[27] The *Bentley* test states that student loans are not priority claims and should be treated as unsecured.[28] Since student loans should be treated as unsecured, they should be treated no differently than other unsecured debts because the "expectation…is that unsecured creditors would share *pro rata* from distributions funded with the debtor's *mandatory contributions*."[29]

Not being able to discharge student loans has led to debtors filing plans that do not follow a pro rata payment to unsecured creditors from distributions, but instead filing plans that pay more to student loans creditors than other unsecured creditors. The motive for filing these plans are obvious: debtors want to pay the most to debts that will not be discharged. The effect though, if these plans are confirmed, is problematic—the consequence is other unsecured creditors are basically paying for part of the debtor's education. Allowing for the *Rosenberg* interpretation of the *Brunner* test could solve this problem.

Judge Davis discusses the treatment of student loan debts in her ruling in *Bennett*. The debtors before Judge Davis had varying Chapter 13 plans, but at the heart of their plans they all had large student loan debt which was the focus of their Chapter 13 plan. While the court was "sympathetic to debtors who face increasingly large and problematic student loan debt,"[30] the "power of the bankruptcy judges to address [student loan debt]…is limited."[31] Understanding their hardship was not grounds for Judge Davis to confirm plans that gave student loan debts different treatment than other unsecured creditors and for that reason she was forced to deny four out of the six plans before her.[32] The trustee asked for a bright line rule that would allow student loan creditors to receive more than other unsecured creditors, so long as the excess did not exceed 20%, but the

court rejected this rule.[33]

The application of the *Brunner* test would not change the treatment of student loan unsecured creditors in a Chapter 13 plan, but it could change the incentive of the debtor to attempt to submit a plan that pays out greater to student loan creditors than others. Allowing for the possibility that student loan debts could be discharged, like general unsecured claims, would take away a debtor's incentive to file a plan favoring student loan creditors—fixing the dilemma before Judge Davis in *Bennett*.

E. Conclusion

The purpose of bankruptcy is to give debtors, who truly need it, a fresh start. The new application of the *Brunner* test in *Rosenberg* could allow for this fresh start to be extended to the unfortunate debtor who made poor financial choices when it came to their education. This falls within the purpose and goals of bankruptcy and could ultimately be more effective than legislative actions that have been proposed.

The administrative ease of adopting the ruling of *Rosenberg* would be far superior to legislative changes and could be more amenable. Student loan discharge has been a controversial subject with valid arguments on both sides. The court in *Rosenberg* allows for the interests of both sides to be taken into account. It allows the wiggle room that is needed to prevent new graduates from abusing bankruptcy, but also allows for the debtor filing in good faith to receive the appropriate relief.

Christian Reese is rising 3L at the Washington and Lee University School of Law. This article was selected as the winner of the Virginia State Bar Bankruptcy Law Section's Annual Bankruptcy Law Writing Competition.

Endnotes

1. *In re Bennett*, 2020 Bankr. LEXIS 295, at *1 (Bankr. N.D.N.Y. Feb. 4, 2020) (citing Jason Iuliano, *Student Loan Bankruptcy and the Meaning of Education Benefit*, 93 Am. Bankr. L.J. 277, 277-79 (2019) (explaining that the debt has grown to over 1.5 trillion dollars and that only sixty percent of student loans are in active repayment)).

2. *See id.* (citing Susan E. Hauser, *First Glance, Problems in the Code I, Separate Classification of Student Loan Debt in Chapter 13: An Examination of the Conflict Between 1332(b)(1) and (5)*, 32-3 ABIJ 38, 38 (Apr. 2013)).

3. *See generally Brunner v. N.Y. State Higher Educ. Servs. Corp.*, 831 F.2d 395 (2d Cir. 1987) (analyzing whether a debtor should be allowed to discharge her student loan debts in her Chapter 7 case).

4. *See Rosenberg v. N.Y. State Higher Educ. Servs. Corp. (In re Rosenberg)*, Adv. P. No. 18-09023, 2020 Bankr. LEXIS 73, at *15 (Bankr. S.D.N.Y. Jan. 7, 2020) [hereinafter *Rosenberg*] (ruling that debtor's student loan debt can be discharged because it passes the *Brunner* test)

5. *See* 11 U.S.C. § 523(a) (2020) (stating a discharge under the given sections of the Bankruptcy Code do not apply to the debt within this section).

6. *Brunner*, 831 F.2d at 396.

7. *Id.*

8. *Id.* at 396-97

9. *See Rosenberg*, at *7 (citing *In re L.K.*, 351 B.R. 45, 55-56 (Bankr. E.D.N.Y. 2009) (denying discharge because student loans constituted 70% of the debt in the bankruptcy)).

10. *Id.*

11. *See id.* at *6 ("The harsh results that often are associated with *Brunner* are actually the result of cases interpreting *Brunner*. Over the past 32 years, many cases have pinned Brunner punitive standards that are not contained therein.").

12. *See id.* (explaining that the court will not follow other courts, which have interpreted the *Brunner* test, but instead this court will apply the test to the facts of the current case).

13. *Id.* at *3.

14. *Id.* at *9 ("Leaving the petitioner with a current monthly income of -$1,548.74 at the time of filing").

15. *See id.* at *8-11.

16. *Id.* at *3.

17. *Id.* at *12.

18. *See id.* at 6-7 (citing *Holzer v. Wachovia Servs., Inc. (In re Holzer*), 33 B.R. 627, 632 (Bankr. S.D.N.Y. 1983) (stating good faith prong is not satisfied when student loan debt is only debt listed on debtor's schedules)).

19. *Id.* at *12-13 ("The *Brunner* test asks the Court to look at whether the Petitioner 'has made' good faith efforts to repay the loan, which indicates that the Court should only consider Petitioner's past (*i.e.* prepetition) behavior in repaying the loans").

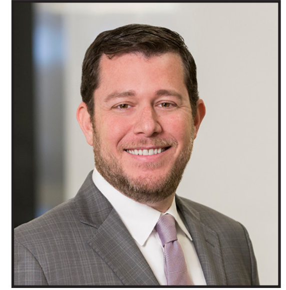
20. *See id.* at *13-14.

21. H.R. 770, 116th Cong. (2019).

22. *Id.* § 2 ("Section 523(a) of Title 11, United States Code, is

amended—(1) by striking through paragraph (8)…").
23. *See Rosenberg*, at *6 (citing *Gesinde v. U.S. Dep't. of Educ. (In re Gesinde*), Adv. No. 18-01434, 2019 WL 5090080, (Bankr. S.D.N.Y. Oct. 10, 2019) (denying discharge of student loans due to debtor filing less than one year after graduating)).
24. *See* 11 U.S.C. § 101(10A) (2020) (explaining that the calculation of current monthly income is derived from a backwards looking 6-month period).
25. *See Brunner*, 831 F.2d at 396-97 (stating that debtor had only graduated ten months earlier and there was no showing that her inability to find work would persist for a significant portion of the loan repayment period and therefore finding the debtor does not meet the requirements for receiving a discharge of student loan debt).
26. *See id.*
27. *See* 11 U.S.C. § 1322(b)(1) (2020) (stating that class or classes of unsecured claims may not be unfairly discriminated against under a chapter 13 plan).
28. *See Bennett*, 2020 Bankr. LEXIS 295, at *25 (citing *Bentley v. Boyajian (In re Bentley*), 266 B.R. 229 (1st Cir. 2001) (stating that under the *Bentley* test student loan debt should not be treated differently than other unsecured debts)).
29. *Id.* at *26 (emphasis in original).
30. *Id.* at *35.
31. *Id.* at *36.
32. *See id.* at *30-36 (analyzing each of the six debtors and whether their plans pass the *Bentley* test).
33. *Id.* at *18.

Staying Ordinary Course Post-Petition Obligations: A New Normal In Retail Bankruptcy Cases?



By Jeffrey N. Rothleder, Esq.

In the past several years, the United States has seen a wave of retail sector chapter 11 cases. The end result for most of those cases has been going out of business and liquidation sales. The COVID-19 pandemic and the resulting government ordered shelter-in-place and closure orders has taken the recent wave of retail cases and turned it into a tidal wave. As a result of this tidal wave and the inability of almost any retail store to operate "normally," retail debtors have been forced to reassess and search for new tools to bring about a successful chapter 11 case.

The first retailer to confront this new reality was Modell's Sporting Goods, which commenced its bankruptcy case just before the shutdown orders were implemented. Modell's originally sought to follow a similar path taken by other retailers by closing all 153 sporting goods stores in a controlled liquidation but such plans were derailed with the shutdown. In order to combat the fatal blow that COVID-19 and the state directives would have on Modell's liquidation, and in an effort to preserve value for stakeholders, Modell's took the unusual step of filing a motion to suspend its chapter 11 case for several months pursuant to Section 305 of the Bankruptcy Code.

Section 305 of the Bankruptcy Code provides that, after a notice and a hearing, the Bankruptcy Court may dismiss or **suspend** a case at any time if the interest of creditors would be best served by such dismissal or suspension. Generally, section 305 was used for, and results in, dismissal of a bankruptcy case. Modell's sought to use section 305 to suspend its bankruptcy case for 45 days and during such suspension the company would "mothball" its operations, defer payments owed, including rents, terminate employees at the stores and distribution centers and utilize a skeleton crew at the corporate headquarters. The company would operate under a modified cash collateral budget during the suspension with limited expenditures. The company argued that this suspension is in the best interest of all stakeholders because it would preserve the *status quo* while all non-essential business are shuttered, and allow the company to continue its liquidation efforts when the COVID-19 emergency has passed.

Modell's faced opposition from its landlords, which argued that the suspension, as proposed, would force the landlords to be non-consenting lenders to the company without any attendant protections. They argued that the landlords would be required to go without rent for the suspension period and not be able to recoup those losses for several months, if at all, after the suspension ended. Essentially, the landlords asserted that they would be providing interest-free loans to Modell's in the form of the rent payments that Modell's would be permitted not to make. And, according to the landlords, there is no guarantee that Modell's would ever be required to remit the missed rent notwithstanding the clear requirements of the Bankruptcy Code protecting landlord rights.

Notwithstanding the opposition, the Bankruptcy Court ruled that it would grant a suspension of the case for approximately thirty days to April 30, 2020.

During this suspension, the Court made it clear that Modell's only may pay for essential expenses and all parties' rights are reserved with respect to the budget and issues arising under section 365 of the Bankruptcy Code. Thereafter, the Bankruptcy Court has continued to extend the suspension as Modell's delays the potential reopening of the stores while also mediating its disputes with its landlords.

With Modell's as the model, other retail stores have commenced their bankruptcy cases and immediately sought to suspend either the whole case or their obligations to pay rent. Of interest in Virginia is J. Crew, which filed a motion to suspend its obligation to make rent payments for 60 days. J. Crew commenced its case in early May, just as states were starting the reopening process, but still sought to suspend its rental obligations for 60 days. J. Crew's landlords and its creditors committee objected on similar grounds as were asserted in the Modell's case. Judge Keith Phillips, the bankruptcy judge handling the J. Crew case, overruled those objections and granted J. Crew's request. In ruling, the Bankruptcy Court recognized that while states were beginning to reopen, the COVID-19 pandemic was still very much a reality and impacting the company's operations. The Court cautioned the debtor to use the time wisely but found that the landlords were not entitled to any sort of "adequate protection" resulting from the 60-day stay. The Court noted that the suspended rent payments would be made in time and that while the landlords had legitimate concerns, the landlords were not the only creditors in the case and granting such motion was in the best interest of the estates.

Modell's and J. Crew (as well as other cases implementing a similar strategy such as JC Penney and True Religion) show that all parties need to adapt and change in the unusual world in which we currently live. Bankruptcy cases today cannot necessarily follow the same playbook as they would have followed a year ago but, instead, the debtors and the professionals advising the debtors, must adapt and look for creative tools to address the issues. In addition, the creditors, such as landlords, are forced the bear the brunt of this new reality and a mechanism needs to be devised whereby such creditors are not unfairly prejudiced by circumstances out of their control. Indeed, we are living in a new world and we are all going to have to adapt and find solutions to these new problems.

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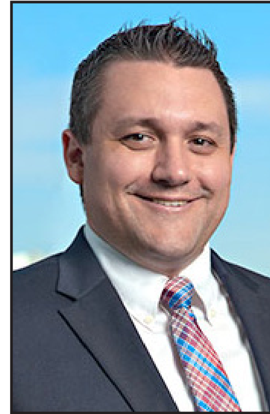
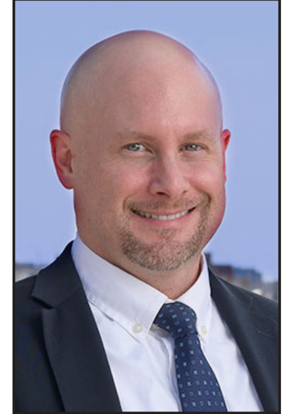
Small Business Reorganization Under the Cares Act and SBRA, and What that Means for Creditors

By Samuel J. Banks, Esq. and Joseph L. Meadows, Esq.





While the CARES Act (Coronavirus Aid, Relief, and Economic Security Act) is most known for its introduction of the PPP (Paycheck Protection Program), it also included amendments to the SBRA (Small Business Reorganization Act of 2019). The amendments expand SBRA's reach to help small businesses use bankruptcy protections under Chapter 11 Subchapter V, Small Business Debtor Reorganization.

The SBRA went into effect on February 19, 2020 – pre-pandemic. It provides greater access to the bankruptcy reorganization process for small business by adding Subchapter V to the Bankruptcy Code. Despite earlier congressional attempts to make reorganization more practical for small businesses, few such debtors reorganized versus liquidated. The SBRA addressed that issue by creating a process for small business reorganization that reduces several administrative obstacles and expenses to reorganization.

On March 27, 2020 -- less than a month after the SBRA went into effect and post-pandemic -- Congress amended the SBRA through the CARES Act. The amendment expands the debt ceiling limitation for small business reorganization under Subchapter V as described below. The amendment is temporary, sun setting in a year.

Through the SBRA and CARES Act, Congress sought to help distressed small businesses reorganize in bankruptcy in lieu of liquidation. Creditors should be aware of how these new laws may affect their rights to participate in small business bankruptcy cases.

CARES ACT CHANGE TO SBRA

The CARES Act increases the debt ceiling under the SBRA and allows more businesses to reorganize in bankruptcy. In particular, the CARES Act temporarily (one year) amends Section 1182 of the Bankruptcy Code to increase the debt ceiling from $2,725,625 to $7,500,000 for reorganizations under Chapter 11's Small Business Debtor Reorganization subchapter. Qualifying debt under Section 1182 still excludes debt owed to affiliates or insiders and debt incurred that less is than 50 percent from the commercial or business activities of the debtor.

This temporary expansion of who may qualify for small business reorganization could lead to an increase in Subchapter V filings. Businesses that might otherwise liquidate or enter into unfavorable terms with their creditors may now seek reorganization protection in the bankruptcy courts. Monitoring a debtor's financial condition, if credit terms allow for such monitoring (e.g. requiring debtors to provide or maintain key financial ratios), will be important for creditors to manage the potential increase in small business reorganizations.

KEY SBRA PROVISIONS AFFECTING CREDITORS

Existing SBRA provisions to the bankruptcy reorganization process continue to impact creditor

rights in small business cases. Four of them are highlighted below.

First, under Section 1102(a)(3), the SBRA eliminates the requirement for a committee of unsecured creditors, unless the court orders one for cause. Creditor committees can add to the administrative expense and complexity of a bankruptcy. At the same time, unsecured creditors often rely on a committee to protect their interests and provide leverage against difficult debtors.

Second, unlike Section 1129(b)(2)(B)(ii) of typical Chapter 11 reorganizations, new Section 1191 eliminates the "absolute priority rule" requirement in cramdown plans that creditors must be repaid, or new value (cash) provided, before any equity holder can maintain an ownership interest in the debtor. The absolute priority rule made it challenging for small business debtors to reorganize because most small business owners chose liquidation over losing their equity. Now, these debtors may reorganize with the same equity holders and without any new infusions of capital. For creditors, this change removes a bargaining chip to negotiate an acceptable reorganization plan that minimizes harm to their interests.

Third, under Section 1191(b), the SBRA authorizes a court to confirm a small business reorganization plan even if all classes of impaired creditors object. In typical reorganizations, under Section 1129(a)(8) and (10), at least one impaired class of creditors have to accept the plan for it to be confirmed. For small business reorganizations, the new SBRA removes the requirement that an impaired class accept the plan; provided that the court determines that the plan is "fair and equitable," does not "discriminate unfairly" against any class of impaired creditors who object to the plan, and otherwise complies with Section 1129(a). Naturally, this expanded form of cramdown plan dilutes the voting rights of impaired creditors.

Fourth, for a small business reorganization plan to be "fair and equitable" under Section 1191(c), Congress requires a debtor to use its disposable income to repay creditors over a three-to-five year period. Disposable income includes reasonable compensation to equity holders for their services to the debtor and other expenses related to the continuing operation of the business. Under consensual reorganization plans, the debtor itself makes these payments to creditors. Under Section 1194(b), in cases of a cramdown plan, the trustee is required to make the payments unless the plan or court order provides otherwise. It is important for creditors to understand these nuances to protect their interests, and enforce debtor obligations under the plan. Debtors that fail to meet their obligations are subject to remedies that are included in the debtor's plan, per Section 1191(c)(3)(B), including, for example, liquidation of the debtors' non-exempt assets. Creditors should be aware of what these remedies are and be prepared to enforce the terms of any plan as necessary.

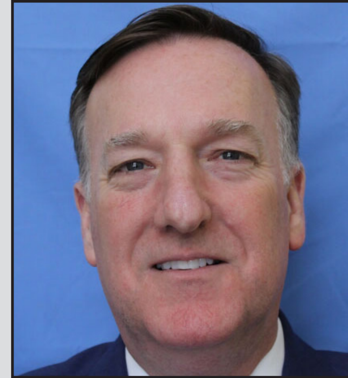
CONCLUSION

Chapter 11 reorganization has often been too expensive and burdensome for small business. The CARES Act and SBRA attempt to remedy that by expanding the small business debt ceiling and by contracting various procedural and administrative roadblocks to confirming plans of reorganization. These legislative efforts, however, come at a cost to some creditors. Those creditors must now monitor whether their larger borrowers or vendors might file a small bankruptcy case and force upon them an unfavorable reorganization plan without the benefit of a motivated creditors' committee or the acceptance of the plan by at least one impaired class of creditors. Creditors in small business reorganization cases must also continue to monitor their interests after confirmation by enforcing the terms of the plan.

Joe Meadows (jmeadows@beankinney.com) is a shareholder and Sam Banks (sbanks@beankinney.com) is an associate of the firm Bean Kinney & Korman P.C. in Arlington, Virginia.

Clerk's Corner

James W. Reynolds
United States Bankruptcy Court
Western District of Virginia



COVID-19 Issues

In response to the COVID-19 pandemic, the Western District has implemented several changes to its procedures to allow for social distancing. Similar to most (if not all) Courts across the country, the Western District has suspended in-person hearings, unless exigent circumstances exist that would justify holding an in-person hearing. Such a determination would be made by the Judge on a case-by-case basis.

The Western District has also instituted a reopening plan, which consists of 4 phases. A copy of the plan can be found on the Court's website. On June 11, 2020, the Western District implemented phase 1 of the plan. Under phase 1, all hearings shall be conducted either by video or telephone, unless the Court orders otherwise for exigent circumstances only. Additionally the clerk's office will remain closed to the public with reference to in-person service. People requiring assistance can continue to contact the clerk's office by telephone or email (cmhelpdesk@vawb.uscourts.gov).

For parties who are unable to file electronically, drop boxes have been placed at the Harrisonburg, Lynchburg and Roanoke offices so those parties may date stamp their filings and securely submit them without entering the Clerk's Office. Additionally, parties not represented by an attorney may email filings to the Court's helpdesk (cmhelpdesk@vawb.uscourts.gov). The Clerk's Office will then file the filings in the appropriate case. Parties should sign the filings and include the case number on the filings.

It is anticipated that the Court will remain in phase 1 for many months. Accordingly, the Court has entered several standing/general orders to assist counsel and the public. A copy of these orders can be found on the Court's website by clicking on the COVID-19 banner. For example, because social distancing is such a crucial component of reducing COVID-19's spread, the Court has temporarily suspended the requirement for counsel to obtain original signatures from debtors for electronic filings. The suspension is conditioned upon the attorney, prior to filing the subject pleading, either (a) obtaining the debtor's digital signature via any commercially available digital signature software that provides signature authentication and maintaining a copy of the digitally signed document(s) in the

debtor's case file or (b) obtaining express written permission from the debtor to affix the debtor's signature to the document(s) and maintaining a copy of the writing in the debtor's case file.

COVID-19 / Meetings of Creditors

For the purposes of maintaining social distancing, the Office of the U.S. Trustee has decided that all section 341 meetings of creditor in the Western District shall be conducted telephonically for the foreseeable future. The instructions and updated procedure for participating in meetings of creditor can be found on the Court's website by clicking on the COVID-19 banner. A list of the call-in phone numbers for each trustee with the corresponding access codes can also be found by clicking on the COVID-19 banner on the Court's website.

Western District - NextGen

On March 30, 2020, the Western District (bankruptcy court only) successfully upgraded its Case Management/Electronic Case Filing System (CM/ECF) to the Next Generation of CM/ECF (NextGen). This upgrade has a central "sign-on" feature that enables users to access any NextGen court (where the user has e-filing privileges) by using one login and password. If you have problems accessing the Court's CM/ECF, it may be that you have a legacy PACER account. If so, please see the Court's website for details on how to upgrade your account so that it is compatible with NextGen.

Bankruptcy Filings / Statistics

For the 12 month period from March 31, 2019 through March 31, 2020, bankruptcy filings (nationwide) fell by 1.1%. For obvious reasons, I do not believe that this will be a trend, and cases are expected to dramatically increase over the coming months. Total nation-wide filings for the 12 months prior to March 31, 2020, were 764,282, while filings for the 12 months prior to March 31, 2019, were 772,646.

In the Western District, for the 12 month period from March 31, 2019 through March 31, 2020, bankruptcy filings decreased by 3.2%. Filings for the 12 months prior to March 31, 2020, were 5,423, and filings for the 12 months prior to March 31, 2019, were 5,605.

Case Summaries[1]

By Kelly Barnhart, Esq.

Recent Fourth Circuit Decisions

***Wells Fargo Bank, N.A. v. Highland Constr. Mgmt. Servs., L.P.*, 2020 U.S. App. LEXIS 9864 (4th Cir. Mar. 30, 2020) (Wynn, J.)**

Background: Pre-petition, the debtor, Highland Construction Management Services, LP ("Highland Construction") executed a security agreement in favor of Wells Fargo Bank, N.A. ("Wells Fargo") for the benefit of Jerome Guyant IRA ("Guyant IRA"). Pursuant to the agreement, Highland Construction assigned 50% of its interest in Sanford LLC to Guyant IRA. Highland Construction had a 20% membership interest in Sanford LLC, and it contends that it assigned to Guyant IRA 10% membership interest in Sanford. Guyant IRA, on the other hand, argued that Highland Construction assigned to it 16% of all funds it received from distributions from Sandford LLC, which was made up of not only the 10% assigned to it, but also 6% based on Highland Construction's interest in a second LLC, which also had membership interest in Sanford LLC, characterized by Guyant IRA as an "indirect" interest.

The Bankruptcy Court for the Eastern District of Virginia rejected the argument put forth by Guyant IRA and concluded that Highland Construction assigned 50% of its 20% interest in Sanford, LLC (so 10%). On appeal, the District Court affirmed.

Holding: Affirmed. Membership interest in an LLC is personal property and so when Highland Construction assigned 50% of its membership interest in Sanford, LLC it assigned a portion of its own property. Even though Highland Construction was a member also of another LLC, which also had an interest in Sanford, LLC, it had no authority to assign, and did not assign, the other entity's interest in Sanford, LLC. That was not its property to assign. In addition, none of the documents related to the transaction, including various amendments, supported the argument put forth by Guyant IRA (it was relying on a contract recital, which is merely an explanation of the reasons for entering into an agreement or the background of a transaction and such recitals are not binding on parties unless there is ambiguity in the document).

***Copley v. United States of America*, 2020 U.S. App. LEXIS 15155 (4th Cir. May 12, 2020) (Keenan, J.)**

Background: Debtors filed for bankruptcy relief under chapter 7 in 2014 and claimed their 2013 tax overpayment as exempt pursuant to 11 U.S.C. § 522. The U.S. Government objected, arguing that its setoff rights pursuant to 11 U.S.C. § 553(a) superseded any right to exempt the overpayment. The Bankruptcy Court held that the setoff rights were superseded by the debtors' right to exempt the overpayment and ordered the Government to remit the funds to the debtors. On appeal, the District Court affirmed.

Holding: Vacated and remanded. While the debtors' interest in the tax overpayment became part of their bankruptcy estate, their attempt to exempt the property did not supersede the Government's right to offset pursuant to 26 U.S.C. § 6402(a). In reaching this decision, the Court noted its decision was based on the plain language of the applicable statutes, including § 553(a),

and the District Court erred in affirming the Bankruptcy Court's order.

Recent District Court Decisions

***18601 Alderwood Mall Pkwy LLC v. Propco I Debtors*, 2020 U.S. Dist. LEXIS 38010, 2020 WL 1056303 (E.D. Va. Mar. 4, 2020) (Lauck, J.)**

Background: Pre-petition, Toy Property Associates II, acting as landlord, entered into an amended and restated lease (the "Lease") with Toys "R" Us, Inc. The initial rent period ended on May 31, 2006, and thereafter, the lease provided that the tenant shall have the option to renew the lease for five consecutive five-year renewal periods and also provided that each installment of fixed rent payable during the renewal period shall be $23,265 and be payable monthly in arrears on the last day of each month during the relevant period. However, in another section of the lease, the rent was increased for the last four five-year renewal periods if certain conditions were satisfied. Specifically, for purposes of this case, the lease provided that if the tenant, its subsidiaries and affiliates are in actual physical occupancy of less than 80% of the premises, and an assignment of the lease or a sublease of all or any part of the premises was in effect, then the annual rent would be increased to an amount equal to 15% of the acquisition cost, payable monthly in arrears. If this term was triggered, rent would increase from $23,265 to almost $33,000/month.

In 2005, the lease was assigned from Toys "R" Us to TRU 2005 RE I, LLC, which operated as an affiliate of Toys "R" Us. Alderwood Mall Parkway, LLC later acquired the lease.

As part of the bankruptcy case, a notice of assumption was filed as to this particular lease, indicating Propco I Debtors would assume the lease and asserted that the amount to cure all defaults under the existing lease was $0.00. Alderwood objected, arguing that there were a number of uncured defaults for which compensation was required, including that PropCo had vacated the premises beginning in July 2018, such that the rent increase provision was triggered. Pursuant to the fourth amended plan, PropCo I Debtors identified Hill Street as the successor in interest and it selected a purchaser for the lease, which purchaser was Southwestern Furniture, rather than Alderwood.

Propco, the holder of the lease, sought approval by the Bankruptcy Court of the private sale of the lease free and clear of liens, claims, and encumbrances, which would allow it to sell it (and later allow Hill Street) to sell the lease interest to Southwestern Furniture. Alderwood objected, raising many of the same arguments, including that the proposed sale attempted to change the economic terms of the lease under the guise of § 365(f)(1) and that the premises needed repairs to cure breaches prior to any sale.

The Bankruptcy Court conducted two hearings on the proposed sale of the lease and after hearing testimony and argument, approved the sale of the lease. The Bankruptcy Court concluded that the increased rent provision was not triggered because the assignment to an affiliate was not intended to have been an assignment for purposes of the rent-increase provision. The Bankruptcy Court also found that the assignment, in the context of a sale, of the lease to Southwestern Furniture would trigger the provision and would result in an increase in rent and the amount being offered for the lease included that increase. It further found that as to the needed repairs, to the extent required by the lease, had to be completed within 180 days of the later of such date the assignor has vacated or the closing date, subject to some exceptions. The Court also concluded that any rent increase resulting from the rent-increase provision would be unenforceable as an anti-assignment clause. Alderwood filed a motion for stay pending appeal and a motion for an

expedited hearing on same. The District Court denied both motions.

Holding: Affirmed. The District Court concluded that the doctrine of statutory mootness prohibited it from modifying the terms of the sale order, that the Bankruptcy Court correctly concluded that the rent-increase provision constituted a prohibited anti-assignment clause and that the Bankruptcy Court did not commit clear error when it did not append a property maintenance report to the order.

***Askri v. U.S. Bank, N.A.*, 612 B.R. 867 (E.D. Va. Feb. 18, 2020) (Ellis, III, J.)**

Background: In debtor's chapter 11 case, the Bankruptcy Court granted U.S. Bank, N.A. in rem relief from the automatic stay on the debtor's real property, which relief permitted foreclosure even if either the debtor or his spouse filed any other bankruptcy cases within 2 years from the date of the order.

Debtor appealed the decision, arguing that his wife, a co-obligor on the loan, did not receive proper notice of the motion and that U.S. Bank, N.A. lacked standing to pursue the motion because it did not have an interest in the loan.

Holding: Affirmed. The Bankruptcy Court's ruling was supported by the record. The Court had previously concluded that U.S. Bank, N.A. had standing to pursue the relief requested in that it did have an interest in the loan and the motion was served on the debtor's wife (she was not only named in the motion as a co-obligor, a copy of the motion was sent to her as stated in the certificate of service attached to the motion). In addition, relief pursuant to § 362(d)(4) is not limited to only a debtor/debtor's interest in the property. In rem relief may be granted as to all entities that claim to have an interest in the subject property, regardless of whether they are a debtor.

***Askri v. Fitzgerald*, 612 B.R. 500 (E.D. Va. 2020) (Ellis, III, J.)**

Background: Debtor filed for chapter 11 relief. The Bankruptcy Court converted the case to one under chapter 7 pursuant to § 1112(b), which provides that a bankruptcy court shall convert a chapter 11 case to one under chapter 7 or dismiss the case, whichever may be in the best interests of creditors and the estate. This requires a two-step analysis by a court: (a) consideration of whether cause exists to either dismiss or convert; and (b) consideration of which option is in the best interest of creditors and the estate. Here, the Bankruptcy Court made factual findings in concluding the case should be converted to chapter 7, including that the debtor was a repeat filer of bankruptcy petitions who filed the case in bad faith as part of scheme to delay or hinder his creditors from foreclosing on his property. In addition, he could not show that he could propose a feasible reorganization plan and the Bankruptcy Court found that the debtor had offered no proof of income that could be verified.

The Bankruptcy Court entered an order converting the case and entered a separate order denying approval of the proposed Disclosure Statement submitted by the debtor.

Holding: Affirmed. The Bankruptcy Court had factual findings supporting its conclusion that the case was filed in bad faith and the debtor could not submit a feasible plan. In addition, the Court found that conversion rather than dismissal was appropriate since there may be equity in the property for the benefit of creditors.

With respect to the debtor's appeal of the Bankruptcy Court's decision to deny approval of the Disclosure Statement, the Court found this order to be interlocutory and an appeal should not be granted since the disclosure statement would play no role in a chapter 7 case.

Atl. Union Bank v. Holt, 2020 U.S. Dist. LEXIS 46838 (E.D. Va. Mar. 17, 2020)

Background: Mr. and Mrs. Holt entered into a promissory note in 2012 in favor of Union First Market Bank (now referred to as Atlantic Union Bank) (the "Bank"), in the principal amount of approximately $427,000 and secured by a mortgage held by Mr. Holt in favor of the Bank, against a vessel known as "Thunderball". In making this note, Mr. and Mrs. Holt refinanced an older note with the Bank. The Holts failed to pay the amounts due under the 2012 Note and the parties entered into a forbearance agreement (the "Agreement") in April 2016 and later entered into three later amendments to the Agreement. Mrs. Holt signed the 2012 note and the Agreement, but not the later amendments. The 2012 note and the Agreement contain "no waiver" provisions. Default occurred and a demand letter was sent providing a date certain by which payment had to be received (May 1, 2019). The Holts did not pay all amounts due by this date.

Following this default, the Bank filed a verified complaint against the Holts (the "Complaint"), seeking judgment against the Holts and for the arrest and sale of the Thunderball. The Court entered an arrest warrant for the Thunderball and after it was secured the Court entered an order allowing the sale of it, and it was sold. The Holts filed an answer and the Bank filed a motion for summary judgment (the "Motion"). Mr. Holt subsequently filed for bankruptcy relief and the Court issued an order asking the parties whether it had the ability to consider the Motion. The Bank answered that the Court could not as to Mr. Holt, and should reserve it as to him, but that it could as to Mrs. Holt. The Holts did not respond to the Motion but did respond to the Court's order, arguing in opposition to the Motion. The Bank filed a response to the response by the Holts.

Holding: Motion granted as to Mrs. Holt and reserved consideration of it as to Mr. Holt. Mrs. Holt remained liable on the note, even though she did not sign amendments to the forbearance agreement and she has not filed for bankruptcy, and thus the Court could consider whether the Motion should be granted as to her. While the Holts presented no evidence to show that there was any dispute of material fact, the Holts did argue that the Bank waived its ability to seek a judgment against her because the Bank chose to forbear on collection without getting her signature and consent to the amendments to the Agreement. The Court disagreed, concluding the Bank did not waive its ability to seek judgment and the existence of the anti-waiver clauses in the note and the Agreement, signed by her, refuted the Holts' position. Further, the Bank's actions show that it did not intend to waive its ability to seek a judgment against Mrs. Holt.

The Court also rejected the Holts' argument that the Bank violated 12 C.F.R. § 202.7 when it required Mrs. Holt to sign the note and Agreement, since Mr. Holt's credit worthiness supported the loan. The Court rejected this argument because (a) the Holts failed to raise it in their Answer to the Complaint, and (b) even if the Court were to consider it, the Court concluded it was unlikely it would find this precluded summary judgment being entered.

Craig v. Bendall, 2020 U.S. Dist. LEXIS 43950, 2020 WL 1234947 (W.D. Va. Mar. 13, 2020) (Kiser, J.)

Background: Appellant Teresa Craig resides in a home that was deeded in July 2007 from Lucy Charles Bendall to Charles E. Kober and he signed a note that obligated him to pay Mrs. Bendall $120,000, which was secured by a recorded deed of trust against the property. In October of

2012, Mr. Kober transferred the home to Ms. Craig via a quitclaim deed but continued to pay on the note owed to Mrs. Bendall until November 2018, when he defaulted and foreclosure proceedings were initiated (the note was inherited and held by her sons, Charles Hunter Bendall and Robert Paschall Bendall, III).

Ms. Craig filed for chapter 13 relief, and proposed a plan that sought to modify the note on the property. In that plan, she proposed to pay a monthly sum until the property was sold or refinanced, with a deadline to do so within 24 months, at which time the balance owed on the note would be paid in full. The Bendalls objected to the plan, and the Bankruptcy Court called into question whether it had jurisdiction to consider the matter, since the debtor was not the maker of the note, according to Ms. Craig. The Bankruptcy Court granted relief from the stay and ordered Ms. Craig to sell or refinance the property within 120 days or the Bendalls could foreclose on the property. Ms. Craig appealed the Bankruptcy Court's ruling and sought a stay pending her appeal.

Holding: Stay pending appeal was granted based on Ms. Craig's showing that the four factors set forth in *Hilton v. Braunskill*, 481 U.S. 770, 776, 107 S. Ct. 2113, 95 L. Ed. 2d 724 (1987). While the Court noted that the first factor, the likelihood of success, was the closest question for the Court, but the District Court concluded that since the claim at issue was against either the debtor or her property, and thus was a claim of the debtor and thus subject to the Bankruptcy Court's authority under § 1322.

***Davis v. Fortune Inv. Enters.*, 2020 U.S. Dist. LEXIS 73994 (E.D. VA. Apr. 27, 2020) (Lauck, J.)**

Background: Chapter 13 debtor, proceeding pro se, filed various motions with the Eastern District of Virginia, Richmond Division, resulting from the Bankruptcy Court's granting relief from stay in favor of the property owner against the debtor. Among the motions filed, she sought to proceed in forma pauperis on appeal.

Holding: The District Court granted the debtor leave to proceed in forma pauperis on appeal, but dismissed the appeals pursuant to U.S.C. § 1915(e)(2), which deals with in forma pauperis proceedings, and provides that the courts shall dismiss actions or appeals that are frivolous. Here, the Bankruptcy Court's order granted relief from the stay to the property owner (the debtor was the previous owner but lost the property at a foreclosure sale and remained in the property even after the successful bidder obtained an order of possession for the property, which she appealed, and then filed for bankruptcy relief). To the extent she wished to challenge the sale of the house, the Court found that such challenge is moot (there was a completed foreclosure and sale of the property) and thus any challenge to the order granting relief from the stay would likewise be moot. If the debtor desired to challenge the validity of the sale, she could do so in state court as part of the possessory proceedings.

***Donlen Trust v. Wayne Servs. Legacy*, 2020 U.S. Dist. LEXIS 57360 (E.D. Va. Apr. 1, 2020) (Novak, J.)**

Background: The successor entity to the Toys-Delaware debtors, Wayne Services Legacy, Inc. ("Wayne Services") initiated an adversary proceeding, seeking monies it claimed was owed to it by Donlen Trust (the "Trust"), based upon an agreement to pay Toys-Delaware a portion of the proceeds from the sale of vehicles it had leased to Toys-Delaware. The Trust filed a motion to dismiss the adversary proceeding, claiming that the Bankruptcy Court lacked personal jurisdiction over it, that Wayne Services failed to state a claim for which relief could be granted in Count I and that the Bankruptcy Court lacked subject matter jurisdiction as to other counts contained in the Complaint.

The Bankruptcy Court denied the Trust's motion and the Trust filed a motion for leave to file an interlocutory appeal.

Holding: Motion denied. As to the Trust's challenge as to the first count, that the count failed to state a claim for which relief may be granted, the Court agreed with the Trust that the question did not constitute a controlling question of law, it was challenging the Bankruptcy Court's application of settled law as to the allegations and that such a question is best determined for appeal after a final judgment after the Bankruptcy Court has made a final determination not only as to the plausibility of the turnover claim under settled law but also as to its viability.

The Trust also failed to present a controlling question of law as to the Bankruptcy Court's subject matter jurisdiction over the claims. The Trust believed the Bankruptcy Court got it wrong, but that is not a basis to grant an interlocutory appeal, and in addition, the Trust did agree that the Bankruptcy Court's jurisdiction over the other counts relies on Count One, the plausibility of which is not a basis to grant the interlocutory appeal. With respect to the argument that the Bankruptcy Court lacked personal jurisdiction, this argument is based on the Bankruptcy Court's application of settled law to the facts of the matter, and the District Court determined that was to be best decided only after a final judgment had been rendered. In summary, simply because the Trust disagreed with the Bankruptcy Court's ruling did not provide a basis for granting the interlocutory appeal.

***Hall v. JP Morgan Chase Bank, N.A.*, 2020 Dist. LEXIS 20775, 2020 WL 603480 (W.D. Va. Feb. 7, 2020) (Dillon, J.)**

Background: In 2010, the Halls purchased a home as tenants by the entirety. The purchase was financed, and the note and deed of trust were only signed by Mr. Hall. The Halls later filed for bankruptcy relief under chapter 7 and received their discharge in December 2012.

In July of 2015, JP Morgan Chase Bank, N.A. ("Chase") filed a complaint in Circuit Court asserting that the deed of trust signed by Mr. Hall was valid or, alternatively, that the state court could reform it to make it valid. The Halls filed a motion to reopen their bankruptcy case and requested sanctions against Chase be entered for its violation of the discharge injunction. The Bankruptcy Court granted a temporary injunction as to the state court action, until it could resolve the motion. The Bankruptcy Court noted that a main issue in the decision of whether to enjoin the state-court action permanently or to grant sanctions turned on whether Chase had a valid deed of trust against the property. It modified the temporary injunction to allow the state court to consider whether the deed of trust was valid. It also held that if the court found that Chase had any in rem rights to the property, the discharge did not affect those rights. The state court held that the deed of trust was invalid and unenforceable since the deed of trust and note were only signed by Mr. Hall although the property was owned tenants by the entirety. The state court also held that the deed of trust could not be reformed. The Halls were divorced and therefore, at that point, they no longer owned the property tenants by the entirety, but rather owned it as tenants in common. Based on the change of ownership, Chase filed another complaint with the state circuit court, this time to Mr. Hall only, and requesting a foreclosure of Mr. Hall's interest. Chase argued that the deed of trust is valid as to Mr. Hall's interest based upon the after-acquired property provision, Va. Code Ann. § 55-52 (this section was later repealed but was in effect through the date the court issued the order on appeal. The same language is now located at § 55.1-310). In response to this complaint, the Halls requested the Bankruptcy Court reopen their bankruptcy case and sought to enjoin

Chase from proceeding in state court and hold them in contempt. The Bankruptcy Court denied the motion, which decision the Halls appealed.

Holding: Affirmed. Chase was free to pursue its in rem rights under the deed of trust, including pursuit of a foreclosure as to Mr. Hall's interest in the property and partition by sale since the discharge injunction only extinguished Chase's right to pursue in personam relief.

The District Court also rejected the argument presented by the Halls that even if the deed of trust was valid prior to the bankruptcy filing, the bankruptcy resulted in the voiding of the deed of trust and that any attempt to foreclose by Chase was a discharge violation. In making this point, the Halls asserted that the Bankruptcy Code treats deeds of trust like judgment liens and if a creditor dockets a judgment but it does not attach to any property before the debtor receives a discharge, the judgment is voided pursuant to § 524(a)(1). Thus, even if the deed of trust was valid, the Halls argue that it did not attach to the property when they filed for bankruptcy relief and therefore could not attach after they received their discharge. While the District Court noted this was an interesting comparison, they cited no authority that supported this position. The District Court concluded that there was a considerable distinction between the two (deeds of trust and judgment liens), such as one being voluntary and the other involuntary.

The District Court concluded that although the deed of trust had not yet attached at the time the bankruptcy case was filed, it was a consensual agreement between Mr. Hall and the lender that his interest in the property would secure the lender's debt.

***Hegedus v. Nationstar Mort. LLC*, 2020 U.S. Dist. LEXIS 34370 (Bankr. W.D. Va. Feb. 27, 2020) (Urbanski, J.)**

Background: Prior to their filing for bankruptcy relief, the debtors had a pending matter before the U.S. District Court for the Western District of Virginia against First Horizon Home Loan Corporation ("First Horizon"). Although their bankruptcy case was filed in November of 2018, at a time when the District Court matter was pending, they did not list the pending suit/claim in their bankruptcy schedules (they argued that the counsel failed to include it). In December of 2018, the District Court dismissed the case with prejudice and later denied a request for relief pursuant to Fed. R. Civ. P. 59 (in January 2019). The debtors then filed a motion to reopen the case filed in January 2020 and argued that grounds existed pursuant to Fed. R. Civ. P. 60 in that the automatic stay was in place at the time the District Court dismissed the case with prejudice and denied the motion for relief pursuant to Fed. R. Civ. P. 59.

Holding: Motion denied. The District Court noted that the protections afforded by the automatic stay were not intended to affect claims brought by debtors, such as those asserted by the debtors in this matter, since it was not a matter against the debtor but rather initiated by the debtor. Since the stay did not apply to void the Court's previous rulings, Rule 60 provided no basis for the relief requested.

Recent Bankruptcy Court Decisions

***In re David*, 2020 Bankr. LEXIS 217 (Bankr. E.D. Va. Jan. 27, 2020) (Kindred, J.)**

Background: The debtor had been married to his non-filing spouse since 1991 and he had been a part owner of a company with one partner. The non-filing spouse was an accountant by trade and served as a bookkeeper for the debtor's business, as well as a part owner in David-Cantrall and Associates, Inc. ("David-

Cantrall"), which was a real estate investment company, along with two partners. Over 7 years, Summit loaned more than three million dollars to David-Cantrall and other companies owned and controlled by its partners. The notes in support of these loans had the endorsements of the partners and were secured by deeds of trusts on properties owned by the partners and their spouses and by their personal guarantees. Upon default on the loans, Summit foreclosed on various properties, including the residence owned by the debtor and his non-filing spouse. Summit also sued the debtor as to the deficiency balances owed. The debtor then filed for bankruptcy under chapter 7, which case was later converted to a chapter 11 case. Summit filed 5 claims based on the deficiencies owed to it and the debtor filed objections to all of the claims, claiming that he signed the guarantees and asked the Court to disallow all of the claims.

Holding: Claim objection overruled as to one claim and sustained as to the other four. As to the one claim, the debtor admitted or confirmed that he executed the guarantee on various occasions. As to the other four claim objections, evidence showed that they were based on fabricated photocopied documents, and the debtor's spouse had a history of forging signatures and a history of fraud, and she had the opportunity, ability and motivation to forge his signature on the guarantees. The Bankruptcy Court also found that the debtor's challenge to the lender's claims based on ECOA violations failed because Summit's requirement for spouses to sign guarantees was sound commercial practice unrelated to any stereotypical view of the spouse's role.

***In re Davis*, 2020 Bankr. LEXIS 385, 2020 WL 748160 (Bankr. E.D. Va. Feb. 12, 2020) (Phillips, J.)**

Background: Chapter 13 debtor filed a motion to extend the stay in her case pursuant to § 362(c)(3) as to all creditors due to her having filed one other bankruptcy case within the one-year preceding her current case. The Bankruptcy Court denied the motion to continue the stay and the debtor filed a motion to reconsider pursuant to Fed. R. Civ. P. 59(e), incorporated by reference in Fed. R. Bankr. P. 9023.

Holding: Motion to reconsider denied since there had been no change in the law or the facts that were before the Bankruptcy Court at the time the motion to extend the stay was denied. While the debtor argued that it would be a manifest injustice for her to have to move out of her residence, the house had already been foreclosed upon by the lender who had a deed of trust against it. The Bankruptcy Court concluded that it would not be manifest injustice in requiring the debtor to comply to the filing requirements of the Court where she had been given various opportunities to do so and had failed to comply.

***Derby v. Portfolio Recovery Assocs., LLC (In re Derby)*, 2020 Bankr. LEXIS 882 (Bankr. E.D. Va. Mar. 31, 2020) (Phillips, J.)**

Background: Debtor filed for chapter 13 relief and filed his various documents, including his Schedule E/F. Schedule E/F identifies a claim owed to Capital One Bank, N.A. ("Capital One"), with a balance of $679.00. Capital One sold the claim to Portfolio Recovery Associates, LLC ("Portfolio") and it timely filed a claim in the amount of $788.53. The debtor objected to the claim and filed a complaint against Portfolio, alleging that it failed to comply with Fed. R. Bankr. P. 3001 and also asserted a claim under FDCPA. The debtor also sought class certification and to be appointed class representative on behalf of similarly situated debtors in the Eastern District of Virginia. Portfolio filed a motion to dismiss the complaint and the Bankruptcy Court issued an opinion and order granting the motion

to dismiss as to the FDCPA claim and denying the motion as to the alleged Rule 3001 violations. The debtor filed an amended complaint, seeking more specific declaratory and injunctive relief. Portfolio filed its answer and requested leave to amend its claim, using a proof of claim form that complied with Fed. R. Bankr. P. 3001. This request was opposed by the debtor, who argued that the amended claim still failed to comply with Fed. R. Bankr. P. 3001. The Bankruptcy Court concluded that the form did comply with the Rule. Portfolio then requested the Court to strike the class allegations in the amended complaint, and the Court denied the relief without prejudice. The parties then entered into settlement discussions.

The Court later entered a Stipulation and Consent Order Regarding Debtor's Objection to the Portfolio claim and amended complaint. This stipulation included a statement that the parties agreed the original claim was not in compliance with Fed. R. Bankr. P. 3001 and the amended claim's itemized statement did comply with the Rule. Portfolio agreed that any proofs of claim filed in the Eastern District of Virginia for charged-off credit cards accounts will be substantially in the form of the amended claim or otherwise comply with Fed. R. Bankr. P. 3001 and that it would amend other claims filed to bring them in compliance with the Rule. The Stipulation further provided that debtor's counsel could file a fee application and the Court may approve fees and reimbursement of expenses as appropriate under Rule 3001(c)(2)(D) and/or § 105 after notice and a hearing. Portfolio reserved its right to object to such a request for fees and costs.

Debtors later filed an application for fees and reimbursement of costs related to the claim objection and adversary proceeding, to which Portfolio objected, arguing that there is no exception to the American Rule is applicable in this case. Portfolio also filed a motion for sanctions against debtor's counsel, arguing that the attorneys crossed the line in seeking to disallow claims such as the one at issue in this case since the debtor did not legitimately contest the amount, validity or priority of the claim, and sought an award of its fees and costs.

Holding: Fee application of debtor's counsel approved. The debtor was entitled to attorney's fees and costs in connection with Portfolio's failure to comply with the requirements of Fed. R. Bankr. P. 3001(c) since it was clear that Portfolio was aware that the claims it had filed were improper based on its agreement to stop filing nonconforming claims and to withdraw previously filed claims that did not comply with Fed. R. Bankr. P. 3001.

***McCarthy v. Hotel Street Capital, LLC (In re Fetner)*, 2020 Bankr. LEXIS 584 (Bankr. E.D. Va. Mar. 5, 2020) (Kindred, J.)**

Background: Mr. Fetner filed for chapter 11 relief and in his schedules identified that he had approximately $7.63 million in assets, which included claims against third parties of approximately $2.5 million and a $5 million interest in a limited partnership he controls that owns the property where the debtor lives. He identified no secured debt owed by him and approximately $3.7 million in unsecured debt, all of which were listed as disputed other than two claims valued at less than $36,000. Three creditors filed secured claims asserting secured interest in the debtor's residence, totaling approximately $2.71 million.

In his case, the debtor sought to extend the exclusivity period for filing a plan, which motion was granted. When he filed a second request to extend the exclusivity period, the request was hotly contested by his creditors and the Court ultimately denied the relief. The debtor eventually filed a disclosure statement and plan. The Court denied

approval of the disclosure statement, finding that it proposed to modify the terms of the loans secured by the debtor's residence, provided an improper release of a federal tax lien and failed to provide proper treatment of administrative claims. The U.S. Trustee later filed a motion to convert the case to one under chapter 7, arguing that the debtor did not have sufficient monthly income to support the projected plan payments that would begin if the plan were confirmed. The Court entered an order converting the case to one under chapter 7.

While his bankruptcy case was pending, the debtor initiated a state court action against various parties, including creditors in the case and their counsel, by the filing of a complaint. This complaint included claims of legal malpractice, breaches of contract, conspiracy, defamation, fraud, RICO violations and other claims. This matter was removed to the Bankruptcy Court. Various defendants filed motions to dismiss the complaint, and after a hearing on same, the Court dismissed two of the counts and took the remaining 14 counts under advisement. The Court then granted a motion to substitute the chapter 7 trustee as plaintiff in the adversary proceeding.

The debtor then filed a motion to recuse pursuant to 28 U.S.C. § 455, arguing the Court was prejudiced against him or biased against him.

Holding: Request for recusal denied. The debtor presented no evidence or any object argument that reasonably showed the Court's prejudice or bias. In the motion, the debtor made clear that he had no suspicion or evidence of "hard" corruption by the Court (in the motion, the debtor accused the Court of "soft corruption" or "soft bias" based on a belief that the Court was manipulating the process to achieve a predetermined result, that of liquidating his house to pay his creditors. The Court concluded that there was no rush to liquidate the house and in fact the trustee had not even marketed the house for sale as he was pursuing other assets of the estate). Because the debtor did not present any facts or argument to support the assertion that the Court was either prejudiced or biased against him, there was no basis to grant the motion for recusal.

***In re Gemstone Solutions Group*, 2020 Bankr. LEXIS 1977 (Bankr. E.D. VA. May 26, 2020) (Phillips, J.)**

Background: Deutsche Bank Trust Company America ("Deutsche") initiated an adversary proceeding by the filing of a complaint against certain debtor entities and individuals alleging that the defendants (1) breached the terms of a trust, which trust was established by the confirmed plan of reorganization and confirmation order associated with the prior bankruptcy cases of The Gymboree Corporation and certain of its affiliated companies; (2) converted its property; (3) aided and abetted the breach of trust; (4) aided and abetted conversion. The complaint also requested turnover of property in count 5 and requested civil contempt against the various defendants. As was relevant to the issue before the Court, the plan that was confirmed stated that funds would be held in reserve to fund payment of allowed claims making up Class 5. The Plan did make clear that funds were to be held in trust for disputed claims and funds were to be escrowed for professional fees.

The defendants moved to dismiss the complaint for failure to state a cause of action upon which relief may be granted, asked the Court to treat it as a summary judgment motion and Deutsche moved for summary judgment.

Holding: Defendants' motion for summary judgment granted and Deutsche's summary judgment denied. The Bankruptcy Court found that the plan and confirmation order did not create a trust in favor of the creditors making

up class 5, as provided for in the confirmed plan, and thus no trust was created. Since the counts all were based on the theory that there had been a trust in favor of Class 5, no claim existed for which relief may be granted. The Bankruptcy Court also granted the defendants' motion as to count six, regarding the request for civil contempt.

***Hutchison v. First Cmty. Bank (In re Hutchison)*, 2020 Bankr. LEXIS 250 (Bankr. W.D. Va. Jan. 30, 2020) (Black, J.)**

Background: Individual chapter 11 debtor initiated an adversary proceeding by the filing of a complaint against First Community Bank (the "Bank"), seeking declaratory relief and requesting the Court determine whether the claims filed by the Bank were barred by the applicable statute of limitations, and if not barred, determine the amounts owed to the Bank, as well as to determine the validity of the claims and deeds of trusts. The Bank filed a motion for partial judgment on the pleadings pursuant to Fed. R. Bankr. P. 7012(b) and Fed. R. Civ. P. 12(c), stating that each claim was based upon a note and under applicable law the statute of limitations for enforcement of the notes was six years after the due date or dates stated in the notes, or if accelerated, within six years after the accelerated due dates. The Bank filed a total of five claims, all of which were secured, at least in part.

Holding: Motion for partial judgment on the pleadings granted as to three of the claims since they were not barred by the applicable statute of limitations and the debtors' relief requested on that basis was dismissed. In reaching its decision, the Court found that it was appropriate to apply the statute of limitations for notes to the obligations akin to a note even if not actually titled as such. Since the notes at issue for these claims had not come due by their terms, and no due date was accelerated, the statute of limitations had not yet begun to run as to Claims 1 and 3 and as to Claim 5 there were insufficient allegations in the Complaint to establish that the statute of limitations had run.

***In re Lansdowne Constr.*, LLC, 2020 Bankr. LEXIS 461, 2020 WL 930107 (Bankr. E.D. Va. Feb. 21, 2020 (Kenney, J.)**

Background: Pre-petition, the debtor entered into an agreement as a general contractor with 3 Boys, LLC ("3 Boys"), for the construction of a project. The agreement was later assigned by 3 Boys to Sheehy Stafford Property, LLC ("Sheehy"), when Sheehy purchased the property. The debtor subbed out electrical work on the project to T&B. Following completion of its work and submission of its invoices, T&B also filed a Memorandum of Mechanic's Lien in the land records, claiming a lien against the Sheehy's property. Following the filing of the Memorandum, the debtor sent an email to T&B informing it that Sheehy was issuing joint checks to the subs and that they would be available for pick-up at Sheehy's office. A joint check was issued to the debtor and T&B for approximately $82,000. Of import, T&B and the debtor never entered into any joint check agreement and T&B never executed an agreement with the debtor. Upon picking up the check, T&B executed and delivered a Certificate of Release as to the Memorandum. Approximately two weeks later, the debtor filed for bankruptcy relief under chapter 7. Following the filing, Sheehy filed a Consent Motion for Modification of the Automatic Stay, stating that it owed the debtor approximately $534,000, subject to certain offsets for costs to complete the project, and amounts it had paid to the subs so that it could get releases of mechanic's liens. Sheehy also stated that an approximately $334,000 was still owed to subs and that there would be no balance due to the debtor. The Bankruptcy Court entered the Consent Order Modifying the Automatic Stay so that Sheehy could complete the setoff and pay the subs. Sheehy

then filed a proof of claim for approximately $634,800 and claimed it had the right of setoff in the contract proceeds of approximately $534,000.

The chapter 7 trustee initiated an adversary proceeding to recover the preference payment made to T&B, pursuant to § 547(b). T&B raised four affirmative defenses: (a) the payments were made by an affiliate of the owner; (b) the joint check was property of the estate; (c) earmarking; and (d) contemporaneous exchange for new value. The trustee filed a motion for summary judgment.

Holding: Motion for summary judgment granted. The Court rejected each of the affirmative defenses, concluding that: (a) the debtor had a contractual right to payment from the affiliate, subject to any offsets by the affiliate and had rights as a payee on the joint check; (b) since there was no enforceable, non-avoidable, joint check agreement, T&B had no defense that the payment was not a preference because it was by joint check; (c) earmarking defense was not available since there was no evidence that an affiliate of Sheehy made a loan to the debtor/contractor for purposes of paying its debt to T&B; and (d) there was insufficient evidence to establish that new value had been provided in exchange for the payment, even if there was the release of the mechanic's lien since that was not new value to the debtor.

***Barrett v. Rogers (In re Lawrence)*, 2020 Bankr. LEXIS 1282 (Bankr. E.D. Va. May 14, 2020) (Huennekens, J.)**

Background: Chapter 7 trustee initiated an adversary proceeding by the filing of a complaint against a substitute trustee and her firm (the "Defendants"), stemming out of actions related to a foreclosure sale, which the trustee alleged was ineffective and the sale invalid. Among other things, the Chapter 7 Trustee alleged a breach of fiduciary duty and violation of the stay in the complaint. The Trustee also filed a motion for partial summary judgment pursuant to Fed. R. Civ. P. 56, incorporated by reference by Fed. R. Bankr. P. 7056, requesting judgment on the counts regarding breach of fiduciary duty and violation of the stay. A hearing on the motion was conducted on April 29, 2020 and the defendants, without leave from the Court, filed a supplemental memorandum in opposition to the motion.

Holding: Motion for summary judgment granted. The foreclosure sale was conducted in January of 2017 was ineffective and the sale invalid and the attempt to record the substitute trustee's deed, after the bankruptcy case was filed, and with knowledge of such filing, violated the automatic stay. The foreclosure sale, which was conducted one day prior to the filing date was invalid since the Notice of Foreclosure had not been mailed to a party at the address listed in the deeds of trust and because the Notice of Foreclosure had the incorrect date for the sale (the defendants did not dispute these facts but instead argued that these deficiencies were of no moment). The substitute trustee failed to comply with the notice requirement set forth in the deeds of trust and took her instruction to foreclose from a party other than the noteholder, rendering the sale invalid. The Bankruptcy Court also found that the defendants had violated the stay by attempting to record the substitute trustee's deed post-petition (the day of the filing) but reserved a decision for the amount of damages to be determined at trial. The Court likewise found that the substitute trustee breached her fiduciary duty by improperly foreclosing on the property without first satisfying the necessary conditions precedent (she had not received instructions from the beneficiary under the deeds of trust and failed to provide notice of the sale as required by the deeds of trust).

***Robinson v. McMurtie (In re Peak 3 Constr., LLC*), (Bankr. E.D. Va. Mar. 31, 2020) (Phillips, J.)**

Background: Chapter 7 trustee initiated an adversary proceeding by the filing of a complaint against Daniel McMurtie, a party to a contract with the debtor, whereby the Trustee sough to recover damages under the contract, along with interest and attorney's fees. Before the trial, the parties reached an agreement as to the amount remaining due under the contract and indicated to the Bankruptcy Court that the only issues remaining to be decided were whether the Trustee was entitled to pre-judgment interest and attorney's fees.

Holding: Trustee was entitled to prejudgment interest under Va. Code Ann. § 8.01-382 at the contract rate of 1.5% per month, with interest beginning to accrue on the date that was 15 days after the date of the final invoice submitted. In addition, the Trustee was entitled to reasonable attorney's fees, pursuant to the terms of the contract.

***In re Pier 1 Imps., Inc.*, 2020 Bankr. LEXIS 1242 (Bankr. E.D. Va. May 10, 2020)**

Background: Chapter 11 debtors sought approval to suspend certain expenses to be paid pursuant to the previously approved interim budget, including a suspension of its rent payments due to the coronavirus pandemic.

Holding: Motion granted. The Bankruptcy Court allowed the debtors to suspend the rent payments due for April and May 2020, and while § 365(d)(3) requires timely payment of sums due under an unexpired lease, failure to do so results in the landlords having administrative expense claims under §§ 507(a)(2) and 503(b) and those payments must be paid by the effective date of the plan. Allowing the relief requested allows the debtors an opportunity to make their cases succeed for the benefit of all creditors including the landlords/lessors.

***Cipollone v. Applestein (In re Va. True Corp.)*, 2020 Bankr. LEXIS 826 (Bankr. E.D. Va. Mar. 30, 2020) (Huennekens, J.)**

Background: Plaintiffs filed state court action against the defendants regarding an investment that had soured involving Virginia True Corporation ("VA True"), which had been formed by two of the individual defendants to purchase property in Richmond County from another corporation (also a defendant), owned by yet another individually named defendant. The plaintiffs agreed to invest $5 million into VA True as a capital contribution in consideration for their shares in VA True and they were able to recoup the contribution through either a buyout of their shares or repayment of a promissory note, which would be secured by a deed of trust lien on the property. The $5 million was used to purchase the property on the same date the agreement with the plaintiffs was entered and VA True also executed a $7 million unsecured note in favor of the seller. VA True also agreed with the owner of the seller that VA True would not encumber the property with a lien absent consent.

The plaintiffs attempted to exercise the buy-out option and VA True elected to execute a $5 million promissory note secured by a lien on the property and then defaulted on the terms of the note. Shortly after the maturity date, VA True filed for bankruptcy relief in the U.S. Bankruptcy Court for the Eastern District of New York ("NY Bankruptcy Court"). All the parties have been active in that bankruptcy case.

After the bankruptcy case was filed, the plaintiffs initiated the state court action against the defendants alleging (a) fraudulent inducement to contract against two individuals; (b) tortious interference with contract against two different individuals; and (c) conspiracy against all the defendants. As the Bankruptcy Court noted,

this lawsuit can be boiled down to an alleged conspiracy by the defendants to induce the plaintiffs to invest in VA True in order to fund the purchase of the property but to also limit their recourse though a side agreement precluding encumbrances against the property.

One of the defendants filed a notice of removal, removing the case from the state circuit court to the Bankruptcy Court and then filed a motion to transfer venue to the NY Bankruptcy Court. The plaintiffs filed a motion to remand the matter back to the state circuit court.

Holding: Motion to transfer granted pursuant to 28 U.S.C. § 1412 since the removed action was related to the bankruptcy case and the transfer would promote judicial economy and promote the economic administration of the debtors' estate.

***In re Wilner*, 2020 Bankr. LEXIS 462 (Bankr. E.D. VA. Feb. 20, 2020) (Kenney, J.)**

Background: The debtor and his wife owned a home that he valued at $6.1 million in his chapter 11 case filed in December of 2012. While that chapter 11 case was pending (for over 4 years) the bank with a lien against the home had relief from stay but did not foreclose. During the pendency of that case, the debtor and his wife had initiated a lawsuit against the JPMorgan Chase and U.S. Bank but the District Court dismissed the mater concluding that the claims arising from the original lender (Washington Mutual Bank) were barred by the Financial Institutions Reform, Recovery and Enforcement Act of 1989's administrative exhaustion requirements. The District Court also rejected the debtor's argument that U.S. Bank had submitted to the Court's jurisdiction based on its filing a claim in his bankruptcy case. The Court noted that while the debtor relied on an exception contained in this Act, which exception is for a debtor who has a claim filed against him in the bankruptcy case and then is allowed to bring a claim against the creditor outside of the administrative process, such exception did not apply because the cause of action was not brought in the bankruptcy case but in District Court. The debtor and his wife later filed suit against the same parties in the U.S. District Court for the District of Columbia, which was also dismissed.

After being denied cert by the Supreme Court, the debtor filed for chapter 13 relief, and listed the house with a value of less than $5 million and identified U.S. Bank was the holder of a disputed claim of approximately $4.325 million. In his plan, he proposed to avoid the lien of U.S. Bank. The debtor did not list any claims against any parties, including the lender. The bank filed a claim for over $2 million in arrears. The chapter 13 trustee moved to dismiss the case pursuant to 11 U.S.C. § 109(e). r

Holding: Motion to dismiss granted. The debtor's objection to the claim was barred by res judicata because he previously chose to not assert any claims or defenses to the proof of claim and the bankruptcy exception was no longer available to him. The Bankruptcy Court concluded that the amounts he owed exceeded the debt limits found at § 109(e) and he had not filed the present case in good faith given that he had been in chapter 11 for over 4 years, had made no payments on his mortgage and was only filing to delay a foreclosure by challenging the secured lien of the creditor. With respect to determining the amounts owed for purposes of § 109(e), the Court explained that debts designated as "disputed" are not excluded from the debt calculations, only debts that are either unliquidated or contingent.

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