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KEYNOTE ADDRESS

STORIES IN THE DEVELOPMENT OF BANKRUPTCY LAW

GERALD F. MUNITZ (EDITED BY K. GEBBIA)*

INTRODUCTION BY KAREN M. GEBBIA

I have the great privilege of introducing our keynote speaker, whom many of you know personally or at least by reputation. Personally, I have had the good fortune of knowing Jerry since about a week after I took the Bar exam, when I was a 24-year-old, newly-minted J.D. grad looking for a job, and he was already a renowned expert in all aspects of bankruptcy law, policy, and practice. I had never taken a bankruptcy course in law school, so we did not have a whole lot in common at the time.

Jerry is widely recognized as one of the nation's leading experts on bankruptcy law and business reorganization. He is a conferee of the National Bankruptcy Conference, which declared him a Legend of the Law in 2004. He is a Fellow of the American College of Bankruptcy. *Chambers USA* listed him as the Senior Statesman in bankruptcy in Illinois. Back in 1991, *The Wall Street Journal* identified him as one of the nation's top twelve bankruptcy experts—and he assures me that he knows a lot more now than he did then. Given that we are in California today, I should note that he has a perfect record in the Court of Appeals for the Ninth Circuit, having won every case he has argued before the

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Ninth Circuit. Jerry has authored numerous prestigious publications on every aspect of bankruptcy law and practice and has lectured extensively on these topics.

Over the years, while collecting these and other accolades, Jerry has developed a reputation for sticking to his principles in the face of adversity. His friends refer to this character trait as unflagging integrity. His adversaries . . . well, who cares what they call it?

Today, Jerry has agreed to take on the extremely delicate task of navigating us through the bankruptcy landscape in which the issues we have been discussing arise. His breadth of knowledge in this regard is truly invaluable. So, without further ado, I would like to invite Jerry Munitz to come to the podium and offer us his wisdom.

KEYNOTE BY GERALD F. MUNITZ

Thank you, Karen, for your very gracious remarks. Good afternoon to all of you. The one credential I have that permits me to speak is that, come November 21st, I will have been a practicing commercial bankruptcy lawyer for fifty-one years. Conversely, my knowledge of forfeiture law dates back to October 19th when Karen sent me the materials for this conference.

I think it is impossible, in the timeframes that we have, to reconcile the conflicts that exist between bankruptcy law and forfeiture law. I will say later on, however, based on my experience in the day and a half I have been privileged to be here, that if there is a group that can develop protocols, this group is capable of doing so. It is one thing to develop a protocol. The harder job is to find those people who participate in the process in a way that is objective and reasonable. I am interested in hearing more from people like Irving Picard as to what enabled the cooperation order to be entered between the Department of Justice and the trustee in the *Madoff* case,¹ which is included in the materials, versus the *Rothstein* case² which is up before the Eleventh Circuit Court of Appeals where there was absolute warfare over what assets belonged to what process of administration—how much belonged to the trustee in

¹ Order Pursuant to Section 105(a) of the Bankruptcy Code and Rules 2002 and 9019 of the Federal Rules of Bankruptcy Procedure Approving an Agreement By and Among the Trustee and the Picower BLMIS Account Holders and Issuing a Permanent Injunction, *Picard v. Picower*, No. 09-1197 (BRL) (Bankr. S.D.N.Y. Jan. 13, 2011), ECF No. 43 (on file with the Golden Gate University Law Review); Stipulation and Order of Settlement, *United States v. \$7,206,157,717 on Deposit at JP Morgan Chase Bank, N.A.*, No. 10 Civ. 9398 (TPG) (S.D.N.Y. filed Dec. 17, 2010), ECF No. 2 (on file with the Golden Gate University Law Review).

² Initial Brief for Appellant, *Stettin v. United States*, No. 11-10676-B (11th Cir. filed Nov. 16, 2011), 2011 WL 5908775.

bankruptcy to administer versus how much belonged to the government for administration under forfeiture laws.

Perhaps to entertain if not enlighten you, I would like to share some history of the bankruptcy side of the equation and the leaders who shaped it. I had the privilege and good fortune of being mentored by one of the foremost bankruptcy practitioners in the country, Norman Nachman. Through Norman, and again through chance, I had the opportunity to work with some of the bankruptcy legends when the new law was being developed. Professors Vern Countryman, Lawrence King and Frank Kennedy were giants back in the 1960s and 1970s, and I had the opportunity to work with them on a first-hand basis.

When I started practicing bankruptcy law in 1960, bankruptcy was in competition with ambulance chasing as to where they stood in the legal discipline. I do not mean to be exclusive in the list of names that I will cite—but it was people like Norman Nachman in Chicago, Professor Charles Seligson in New York City, a San Francisco practitioner by the name of August Rothschild, Bernie Shapiro and George Treister in Los Angeles, Bill Rochelle in Dallas, Morris Macey in Atlanta, and bankruptcy judges like Asa Herzog in New York and George Brody in Detroit, who wrote some of the clearer opinions on bankruptcy topics, who elevated bankruptcy practice to the point where it stands today.

As an illustration of the changes, I recall in 1963 appearing before a then referee in bankruptcy, to argue that Norman Nachman, the acknowledged dean of the Chicago bankruptcy bar, should be entitled to \$100 per hour for his legal services. If Norman were practicing today, I dare say that his hourly rate would be something in excess of \$1,000 or \$1,200; rates that I have seen in cases out of the Southern District of New York and perhaps also out of Delaware. It was people like these, together with changes in bankruptcy law and in the magnitude of cases being filed, that brought bankruptcy practice to where it is today.

Charles Seligson was appointed the trustee in bankruptcy of the Ira Haupt Company.³ The case, filed in 1963, presented the failure of a major Wall Street brokerage firm, a circumstance not unfamiliar to today's headlines. The magnitude of the work in that case was such that Professor Seligson said, "I need some help." So, he went and merged into Weil, Gotshal & Manges. He brought a then young partner with him by the name of Harvey Miller. Harvey today is probably the foremost bankruptcy practitioner in the country. A lawyer who chose not to go with Professor Seligson and Harvey went and started a new law firm. His name was Leonard Rosen, the Rosen from Wachtell, Lipton, Rosen

³ Chase Manhattan Bank v. Milbank, Tweed, Hadley & McCloy (*In re Ira Haupt & Co.*), 379 F.2d 884, 885 (2d Cir. 1967).

& Katz. In some respects, bankruptcy practice is incestuous because many of its most prominent practitioners have come out of the firms that specialized in bankruptcy at that point in time.

As you all know, federal bankruptcy law emanates from a grant in the Constitution to Congress to pass uniform laws on the subject of bankruptcies.⁴ Between 1787 and 1898, federal bankruptcy laws in this country were in effect for a total of just seventeen years. Bankruptcy statutes were enacted after some crisis arose, and then repealed. There was a depression or recession during George Washington's second term and John Adams' term;⁵ a bankruptcy act was passed in 1800 to deal with those problems. There was a financial crisis when Andrew Jackson terminated the National Bank in 1836; a bankruptcy act was then adopted in 1840 to address it.

There is a touch of humanity in the first of these early bankruptcy laws. The 1800 act was passed almost by unanimous consent of Congress, and John Adams could barely wait to sign the bill. The reason for that unusual process was that the passage of that act enabled a gentleman by the name of Robert Morris to be freed from debtor's prison in Philadelphia. Robert Morris was a signer of both the Declaration of Independence and the Constitution of the United States and was one of Pennsylvania's original two senators. The Bankruptcy Act of 1800 permitted him to get out of jail. Robert Morris had lost his fortune in real estate speculation. So I guess that proves the adage that sometimes things never do change.

The Bankruptcy Act of 1898 was the first comprehensive and enduring federal bankruptcy legislation. It was significantly amended in 1938 by the adoption of the Chandler Act amendment, which brought to us Roman numeral chapters X through XIII. The amendment was named for Representative Walter Chandler,⁶ a Tennessee congressman who was very knowledgeable about bankruptcy law. It remained the law (as occasionally amended) until the adoption of the current Bankruptcy Code of 1978. If you will recall, Congress had a couple of other things on its mind during the 1970s, such as a presidential impeachment proceeding.

In 1970, Congress, at the urging of a great many business interests, sought to bring bankruptcy law into the modern era. It formed a National Bankruptcy Review Commission, which ultimately gave rise to the Bankruptcy Reform Act of 1978, which became effective October 1, 1979. As an aside, particularly appropriate to San Francisco, the new

⁴ U.S. CONST. art. I, § 8, cl. 4.

⁵ Sometimes known as the Panic of 1796-1797.

⁶ For more about Congressman Chandler, see Symposium, *The Bankruptcy Amending Act of 1938: The Legacy of the Honorable Walter Chandler*, 41 U. MEM. L. REV. 769 (2011).

law, like most federal statutes, went into effect on a Sunday. It turns out that Monday, October 2, 1979 was Yom Kippur, the Jewish Day of Atonement. Pat Murphy, one of the most outstanding lawyers you would ever meet, then with Murphy, Weir & Butler here in San Francisco, said, “For one day, I had an absolute monopoly on the bankruptcy practice.”

The Bankruptcy Code came into effect at the end of the decade, and, with the benefit of hindsight, I think the major change effected was granting to the district courts pervasive jurisdiction over bankruptcy proceedings now contained in Title 28 U.S.C. section 1334(b). If you want to know about bankruptcy law, there are two statutes with which you must be familiar. The substantive law of bankruptcy is contained in Title 11, U.S.C. The provisions governing creation of the bankruptcy courts and jurisdiction, venue, procedures, appeals, entitlement to a jury trial—which is very limited but does exist—are contained in Title 28.⁷ Forgive me for using section numbers but, when I was a very young lawyer, a then referee in bankruptcy said to me, “If you have the ability to cite to the correct section, I will give you a higher hourly rate on your fees.”

The 1978 statute vested concurrent jurisdiction over civil proceedings arising under the Bankruptcy Code or arising in or related to a bankruptcy case in the district court.⁸ Section 1471(c) then vested in the bankruptcy court for the district all of the jurisdiction that was vested in the district court over such civil proceedings. The honeymoon was short-lived.

The Bankruptcy Code came into effect in 1979. A debtor in Minnesota by the name of Northern Pipeline Construction Company filed bankruptcy and sued the Marathon Oil Company. There is a touch of irony here. Probably the foremost case in bankruptcy law is known as the *Marathon* case. Marathon was not the name of the debtor, however; Marathon was the creditor. The Marathon Oil Company said, in effect, “This bankruptcy court has no subject matter jurisdiction over us, Marathon. We have not filed a proof of claim, and we are immune from the bankruptcy process.” That case went before a very independent district judge by the name of Miles Lord. Judge Lord agreed with Marathon that the provision in the statute permitting the bankruptcy judge to enter final orders was unconstitutional.⁹ A then-applicable statute permitted a direct appeal to be taken to the Supreme Court of the United States. The experts were all predicting that the Lord decision would be reversed by a vote of 6 to 3, perhaps a vote of 7 to 2. None of

⁷ 28 U.S.C.A. §§ 151, 152, 157, 158, 1334 (Westlaw 2012).

⁸ Such jurisdiction arose under former 28 U.S.C. § 1471 (superseded).

⁹ *Marathon Pipeline Co. v. N. Pipeline Constr. Co.*, 12 B.R. 946, 947 (D. Minn. 1981).

that occurred. Instead, there was a four justice plurality opinion, plus a two justice concurring opinion, and a three justice dissenting opinion. What *Marathon* did, when five consistent views from the plurality and concurring opinions were added together, was rule that a bankruptcy judge cannot enter final orders in certain types of matters absent consent of the parties.¹⁰ And that sent the statute back to Congress.

Marathon came down in June of 1982. The Supreme Court stayed the enforcement of its order until October 4, 1982 with the expectation that Congress would fix the problem.¹¹ October came, there was no fix. The Solicitor General of the United States appeared before the Supreme Court and said, in effect, “Your Honors, we are very close to a resolution. Can we have a further extension?” The Supreme Court said, “You have until December 24” to fix the problem.¹² December 1982 came and went. There was no fix. The stay lapsed, and it became necessary to develop some process for administering bankruptcy cases. The California Bar was very active and authored what became known as the Emergency Rule. The Emergency Rule was adopted by each district court as a local rule, and finally enacted by Congress in 1984 as Title 28 U.S.C. section 157, which determines what types of proceedings can be heard and determined by the entry of final orders by non-tenured federal bankruptcy judges versus what may be determined only by tenured Article III district court judges.

The best way of explaining why the pervasive scope of bankruptcy jurisdiction was perhaps the most significant change effected by the Bankruptcy Code is by example. Before the adoption of the Bankruptcy Code, under the former Bankruptcy Act, if I as the attorney for a trustee or debtor in possession in Chicago had a \$100,000 claim against Montgomery Ward for goods Montgomery Ward had purchased and resold but had not paid for, I would make a demand upon Montgomery Ward. Montgomery Ward would have three thousand reasons why it did not owe the money. There being no basis for diversity jurisdiction and no federal question, my remedy, if I had to file a lawsuit, was to go to the Circuit Court of Cook County. I filed a lawsuit in the Circuit Court of Cook County. For fifty dollars, Montgomery Ward would make a jury trial demand. The practice in the Circuit Court of Cook County was such that, if I were lucky, that jury trial might be tried six to eight years later. The effect was for me to take this very valid \$100,000 claim and, in order to get the case wound up and provide some dividend to creditors, I would try to negotiate \$30,000 or \$40,000, declare victory, and go home.

¹⁰ See *N. Pipeline Constr. Co. v. Marathon Pipe Line Co.*, 458 U.S. 50 (1982).

¹¹ *Id.* at 88.

¹² *United States v. Marathon Pipe Line Co.*, 459 U.S. 813 (1982).

The ability at least to have the district court involved, a no-nonsense court in Chicago, changed the game. It became possible to recover the true value of this asset as an asset of the estate.

Twenty-some years later, the judicial power problem has reappeared in a different configuration. There was reference at yesterday's session to the *Marshall* case,¹³ involving the former Playboy Playmate, Vickie Lynn Marshall, also known as Anna Nicole Smith, who married the 90-year-old Texas billionaire, E. Pierce Marshall. I think the facts were explained yesterday, and there is no need for me to repeat them now. The *Marshall* decision again raises the question of the scope of non-tenured judges' power to enter final orders.

Title 28 U.S.C. section 151 creates the courts of bankruptcy. The technical word in the statute is as a "unit" of the district court.¹⁴ Bankruptcy judges are appointed by the circuit courts of appeal for fourteen-year terms; they do not enjoy life tenure as do the Article III judges of the district courts, circuit courts, and Supreme Court.¹⁵ What is the extent of bankruptcy judges' power? What is meant in 28 U.S.C. section 157(b) by "core proceedings" with respect to which bankruptcy judges may enter final orders, subject to appeal?¹⁶

There is a matter before the Ninth Circuit now—which Judge Rhodes mentioned yesterday—considering the extent of a bankruptcy court judge's jurisdiction to determine a fraudulent transfer action.¹⁷ Is there a difference in terms of the bankruptcy court's powers between a fraudulent transfer action created by Congress under section 548 of the Bankruptcy Code versus one arising under state law and incorporated into bankruptcy practice under Bankruptcy Code section 544(b)? We will find out down the line.

When you get involved in the bankruptcy process, we are one of the few systems—and subject to a lot of criticism—where the first level of appeal from a bankruptcy court order may be either to a district court, or if the circuit has adopted the practice, to a bankruptcy appellate panel (a three judge panel of bankruptcy judges). The cynically accepted strategy among some bankruptcy practitioners is that, if you have a lousy case on

¹³ *Stern v. Marshall*, 131 S. Ct. 2594 (2011).

¹⁴ 28 U.S.C.A. § 151 (Westlaw 2012).

¹⁵ 28 U.S.C.A. § 152 (Westlaw 2012).

¹⁶ 28 U.S.C.A. § 157 (Westlaw 2012).

¹⁷ *In re Bellingham Ins. Agency, Inc.*, 661 F.3d 476 (9th Cir. 2011) (order dated November 4, 2011, inviting amicus briefs "addressing the following questions: Does *Stern v. Marshall*, — U.S. —, 131 S. Ct. 2594, 180 L. Ed. 2d 475 (2011), prohibit bankruptcy courts from entering a final, binding judgment on an action to avoid a fraudulent conveyance? If so, may the bankruptcy court hear the proceeding and submit a report and recommendation to a federal district court in lieu of entering a final judgment?").

the law, you take an appeal to district court in the hope of encountering judges who know little about bankruptcy law, and care even less. If the law is on your side, you would prefer having the matter decided by a three-judge bankruptcy appellate panel, again non-tenured judges, but ones sophisticated with respect to the application of the bankruptcy laws.

Although these issues concerning the scope of the bankruptcy courts' power to enter final orders in litigation involving particular causes of action may continue to haunt the system, the one thing that has not changed is the pervasive jurisdiction of the district court and its bankruptcy unit to administer property of the bankruptcy estate. The scope of the estate and the bankruptcy court's administration of it is, of course, central to the interaction between bankruptcy and forfeiture law that bring us together today.

There are problems that exist with bankruptcy law, as with everything. Most of the legislative activity now is in the consumer area. There were amendments made in 2005, which are viewed as very anti-consumer debtor. There are compulsory chapter 13 case requirements, things that I know very little about, and thank heavens we are spared the exposure to that. If you want to get an education, go sit in a bankruptcy courtroom when the consumer cases are conducted, because that is where the real human drama is. It is different when you are talking about millions of dollars. You are dealing with corporate entities that do not have actual human attributes. Nevertheless, when fraud intervenes, there are real victims, both corporate and individual.

You have the opportunity here to try to reconcile the major differences that you have been discussing in terms of how to preserve and distribute assets to those who have been affected by financial fraud. As I have said, if there is any group that can accomplish that mission, it is the people that I see before me. I hope and would look forward to continuing to work with you on these matters.

Let me finish, though, with a Karen story. First of all, I should say that if there is a task you want to have competently and timely performed, give it to Karen. This story goes back to the late 1980s. We represented Continental Bank, which was still in existence, the first of the too-big-to-fail banks. Karen and I represented Continental in a bitterly contested case involving adequate protection issues, plan issues, and the like. There was a meeting that a very, very senior vice president of Continental Bank attended. This case had developed some notoriety in the bank, and he thought that the presence of senior management would lend crucial gravitas. The debtor in possession's counsel made an impassioned plea for the continued use of cash collateral, additional funding, and the like; made all sorts of threats. Karen then responded and took his argument apart, sometimes with a scalpel and sometimes

with an axe. When Karen finished, this vice president leaned over to me and said, “Jerry, I’m glad she’s on our side.”

QUESTIONS:

QUESTION: We heard that under forfeiture law, title to certain property relates back to the government and never becomes property of the estate. How do you see that fitting in with the property of the estate concepts with which we are familiar in bankruptcy law?

GERALD F. MUNITZ: If the law is, as apparently the Supreme Court said it is, that forfeiture law applies and that relation back to the origination of the crime is the controlling date, then this property will be excluded from the estate. Bankruptcy Code section 541 states that any legal or equitable interest in property the debtor has as of the commencement of the case wherever located and by whomever held is property of the estate, but these items are excluded. It occurs to me that the only reason there are provisions in the Bankruptcy Code that effect a subordination of forfeiture and penalties owing to a governmental agency such as the United States (and there is a reference in your materials to section 726(a)(4) of the Bankruptcy Code in that regard), is that it exists only with respect to the government’s claims against non-forfeited property that is being administered in a chapter 7 case. It would only make sense in that context.

I do want to refer to a specific item that occurred to me in the materials. There were periodic references to Judge Easterbrook’s opinion in the *Frykholm* case, which goes back to 2004.¹⁸ Let me read to you what the quoted portion of the case says: “Neither side paid much attention to the fraudulent conveyance, likely because both sides are represented by forfeiture specialists”¹⁹

But Judge Easterbrook, who is one of the smarter people that you will ever meet, goes on to say:

Everything would have been clearer had the United States initiated an involuntary bankruptcy proceeding against Frykholm [the fraudster]. . . . Although [forfeiture law] allows the Attorney General to use forfeited assets for restitution, it does not create a comprehensive means of collecting and distributing assets. Bankruptcy would have made it pellucid that [the third party claimant]

¹⁸ *United States v. Frykholm*, 362 F.3d 413 (7th Cir. 2004).

¹⁹ *Id.* at 417.

cannot enjoy any priority over the other victims and cannot reap a profit while [the fraudster's] other creditors go begging.²⁰

The non-bankruptcy types might see that as saying that the government of the United States could file an involuntary petition against the debtor. With respect to an involuntary petition under the Bankruptcy Code, the United States is not specially treated (with respect to section 726(a)(4), its rights are actually diminished). The requirements for an involuntary are, if there are less than twelve creditors, you need only one petitioner; if there are twelve or more, you need three petitioners.²¹ I do not think the single petitioner rule is applicable to any of the cases that would be involved here. And in counting the twelve creditors, you include utility companies, credit card companies, current rent that may be owed to a lessor of real or personal property. A petition filed by a single creditor knowing that there are more than twelve creditors is sanctionable, and the petition is non-amendable. So if anyone thinks that there is a remedy here by having the government commence an involuntary, I do not think that is realistic. What I understand is, the government can have a receiver appointed, and the receiver commences the bankruptcy case, which is a perfectly legitimate thing to do. What concerns me is something that has been touched upon: what is the length of time to effect that filing? I think it is fairly short. But in bankruptcy, preferences and fraudulent transfers are subject to time limits. And if that period is prolonged, take an insider preference for example, if the bankruptcy case is filed within a year of the insider transfer, that transaction is avoidable. If the bankruptcy case is not filed until a year and a day after the transfer is made, the defendant has an absolute defense.²² If you file the suit, it is going to be dismissed on a 12(b)(6) pleading.²³

Again, another irony, bankruptcy law is designed to give the honest debtor a fresh economic start in life. This is the second of the twin pillars of bankruptcy. The first is equitable distribution. Ironically, what brings us here is the dishonest debtor, the ones engaged in these massive schemes for amounts that I find absolutely mind-boggling.

QUESTION: Under the Bankruptcy Act versus under the Bankruptcy Code, did the priority of a defrauded investor change?

²⁰ *Id.*

²¹ 11 U.S.C.A. § 303 (Westlaw 2012).

²² *See* 11 U.S.C.A. § 547(b) (Westlaw 2012).

²³ FED. R. CIV. P. 12(b)(6).

GERALD F. MUNITZ: Absolutely not. Under the old law and under the current law, there are three types of creditors the bankruptcy law recognizes: secured debt, money off the top for valid liens; priority claims, those enumerated in section 507 that get paid first and in full before the next highest priority, let alone unsecured creditors, receive anything;²⁴ and the third category is general unsecured creditors, which includes both victims of Ponzi schemes, and a legitimate creditor who extended credit in good faith to the Ponzi scheme operator.

There is one other change that was effected by the Bankruptcy Code, however. Under the Bankruptcy Act, in section 64, there was a priority for claims of the United States. Under the Bankruptcy Code, the only claims that are entitled to priority in favor of the United States are claims for fairly current taxes under section 507.²⁵

Karen, again, thank you for the opportunity. I look forward to further interaction with this group. If something comes up later on which you would like my input, do not hesitate to email me or call me. It would be my pleasure to try to answer your question for you.

²⁴ 11 U.S.C.A. § 507 (Westlaw 2012).

²⁵ 11 U.S.C.A. § 507(a)(8) (Westlaw 2012).