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April 2003 Vol. 8

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BANKRUPTCY RULES RECENTLY AMENDED

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Amendments to Federal Rules of Bankruptcy procedure became effective December 1, 2002. The United States Supreme Court promulgated amendments to Bankruptcy Rules 1004, 2004, 2015, 4004, 9014, and 9027. Some of the amendments are mere tweakings, while some have a broader sweep. Affected by the rule changes are: partnership bankruptcy petitions, examinations of witnesses outside of the district in which the case is pending, chapter 11 quarterly disbursement reports, chapter 7 discharges, the conduct of contested matters, and removal.

RULE 1004(a). Involuntary Petition Against Partnership

Before December 1, 2002, Rule 1004(a), which governs partnership petitions, provided in part:

> **"PARTNERSHIP PETITION**
>
> (a) Voluntary Petition. A voluntary petition may be filed on behalf of the partnership by one or more general partners if all general partners consent to the petition."

This language has been deleted in its entirety because substantive nonbankruptcy law determines who may commence a partnership bankruptcy. The Advisory Committee Notes illuminate as follows:

> "Section 303(b)(3)(A) of the Code provides that fewer than all of the general partners in a partnership may commence an involuntary case against the partnership. There is no counterpart in the Code setting out the manner in which a partnership commences a voluntary case. The Supreme Court has held in the corporate context that applicable nonbankruptcy law determines whether authority exists for a particular debtor to commence a bankruptcy case. *See Price v. Gurney*, 324 U.S. 100 (1945). The lower courts have followed this rule in the partnership context as well. *See, e.g., Jolly v. Pittore*, 170 B.R. 793 (S.D.N.Y. 1994); *Union Planters National Bank v. Hunters Horn Associates*, 158 B.R. 729 (Bankr. S.D. Oh. 1986). Rule 1004(a) could be construed as requiring the

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consent of all of the general partners to the filing of a voluntary petition, even if fewer than all of the general partners would have the authority under applicable nonbankruptcy law to commence a bankruptcy case for the partnership. Since this is a matter of substantive law beyond the scope of these rules, Rule 1004(a) is deleted as is the designation of subdivision (b).

The rule is retitled to reflect that it applies only to involuntary petitions filed against the partnerships."

As a consequence, with some minor word editing, Rule 1004 now reads as follows:

"Rule 1004. Involuntary Petition Against a Partnership.

After filing of an involuntary petition under § 303 (b)(3) of the Code, (1) the petitioning partners or other petitioners shall promptly send to or serve on each general partner who is not a petitioner a copy of the petition; and (2) the clerk shall promptly issue a summons for service on each general partner who is not a petitioner. Rule 1010 applies to the form and service of the summons."

RULE 2004(c). Examination

Before December 1, 2002, Rule 2004(c), which set forth the method of compelling attendance and production of documents at a 2004 examination, provided:

"**(c) Compelling Attendance and Production of Documentary Evidence.**

The attendance of an entity for examination and the production of documentary evidence may be compelled in the manner provided in Rule 9016 for the attendance of witnesses at a hearing or trial."

Rule 9016 simply provides that F.R.C.P. 45, which deals with subpoenas, applies to bankruptcy cases.

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Rule 2004(c) was amended to provide an additional procedure for the issuance of a subpoena to compel attendance at a 2004 examination of a witness out of reach of the district where the bankruptcy case is pending. The amendment permits an attorney to issue and sign a subpoena on behalf of the court for the district in which the examination is to be held, provided that the attorney is authorized to practice either in the court in which the case is pending or in the court in which the examination is to be held.

The rule was further amended to clarify that a 2004 examination can be conducted outside the district in which the case is pending.

The Advisory Committee Notes explain the amendments as follows:

> **"Subdivision (c)** is amended to clarify that an examination ordered under Rule 2004(a) may be held outside the district in which the case is pending if the subpoena is issued by the court for the district in which the examination is to be held and is served in the manner provided in Rule 45 F.R. Civ. P., made applicable by Rule 9016.
>
> The subdivision is amended further to clarify that, in addition to the procedures for the issuance of a subpoena set forth in Rule 45 F.R. Civ. P., an attorney may issue and sign a subpoena on behalf of the court for the district in which a Rule 2004 examination is to be held if the attorney is authorized to practice, even if admitted pro hac vice, either in the court in which the case is pending or in the court for the district in which the examination is to be held. This provision supplements the procedures for the issuance of a subpoena set forth in Rule 45(a)(3)(A) and (B) F.R. Civ. P. and is consistent with one of the purposes of the 1991 amendments to Rule 45, to ease the burdens of interdistrict law practice."

Rule 2004(c) now reads:

"(c) Compelling Attendance and Production of Documents.

The attendance of an entity for an examination and for the production of documents, whether the examination is to be conducted within or without the district in which the case is pending, may be compelled as provided in Rule 9016 for the attendance of a witness at a hearing or trial.

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As an officer of the court, an attorney may issue and sign a subpoena on behalf of the court for the district in which the examination is to be held if the attorney is admitted to practice in that court or in the court in which the case is pending."

RULE 2015(a)(5). Duty to Keep Records, Make Reports, and Give Notice of Case

Rule 2015(a)(5) was amended to require a trustee or debtor in possession to file quarterly disbursement reports only as long as there is an obligation to make quarterly payments to the United States trustee under 28 U.S.C. § 1930(A)(6).

Before December 1, 2002, Rule 2015(a)(5) provided:

"DUTY TO KEEP RECORDS, MAKE REPORTS, AND GIVE NOTICE OF CASE

(a) Trustee or Debtor in Possession. A trustee or debtor in possession shall . . .

(5) in a chapter 11 reorganization case, on or before the last day of the month after each calendar quarter until a plan is confirmed or the case is converted or dismissed, file and transmit to the United States trustee a statement of disbursements made during such calendar quarter and a statement of the fee required pursuant to 28 U.S.C. § 1930(a)6) that has been paid for such calendar quarter."

As a result of the amendment, Rule 2015(a)(5) now reads:

"(a) A trustee or debtor in possession shall . . .

(5) in a chapter 11 reorganization case, on or before the last day of the month after each calendar quarter during which there is a duty to pay fees under 28 U.S.C. § 1930(a)(6), file and transmit to the United States trustee a statement of any disbursements made during that quarter and of any fees payable under 28 U.S.C. § 1930(a)(6) for that quarter."

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The obligation to pay quarterly fees to the United States trustee provides that those fees are due until the chapter 11 case is converted or dismissed, whichever occurs first. *See* 28 U.S.C. § 1930(a)(6).

RULE 4004(c)(1)(D). Grant or Denial of Discharge

Rule 4004(c)(1)(D) was amended to provide discharge be declared in a chapter 7 case if there is pending a § 707 motion to dismiss (includes a motion brought by any party in interest under § 707(a)). Before the amendment, discharge was delayed only if a motion under subsection (b) of § 707 was pending (motion filed by United States trustee or court only for "substantial abuse").

Before December 1, 2002, Rule 4004(c)(1)(D) provided:

"GRANT OR DENIAL OF DISCHARGE

(c) Grant of Discharge.

(1) In a chapter 7 case, on expiration of the time fixed for filing a complaint objecting to discharge and the time fixed for filing a motion to dismiss the case under Rule 1017(e), the court shall forthwith grant the discharge unless:
. . .

(D) a motion to dismiss the case under Rule 1017(e) is pending."

Rule 1017, entitled **DISMISSAL OR CONVERSION OF CASE; SUSPENSION**, provides in subparagraph (e):

"(e) **Dismissal of an Individual Debtor's Chapter 7 Case for Substantial Abuse**. The court may dismiss an individual debtor's case for substantial abuse under § 707(b) only on motion by the United States trustee or on the court's own motion and after a hearing on notice to the debtor, the trustee, the United States trustee, and any other entities as the court directs."

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Rule 4004(c)(1)(D) now reads:

"(D) a motion to dismiss the case under § 707 is pending."

RULE 9014. Contested Matters

Rule 9014, which applies in contested matters, was overhauled, subdivided, and amended.

The Rule now reads:

"(a) Motion. In a contested matter not otherwise governed by these rules, relief shall be requested by motion, and reasonable notice and opportunity for hearing shall be afforded to the party against whom relief is sought. No response is required under this rule unless the court directs otherwise.

(b) Service. The motion shall be served in the manner provided for service of a summons and complaint by Rule 7004. Any paper served after the motion shall be served in the manner provided by Rule 5(b) F.R. Civ. P.

(c) Application of Part VII rules. Unless the court directs otherwise, the following rules shall apply: 7009, 7017, 7021, 7025, 7026, 7028-7037, 7041, 7042, 7052, 7054-7056, 7064, 7069, and 7071. An entity that desires to perpetuate testimony may proceed in the same manner as provided in Rule 7027 for the taking of a deposition before an adversary proceeding. The court may at any stage in a particular matter direct that one or more of the other rules in Part VII shall apply. The court shall give the parties notice of any order issued under this paragraph to afford them a reasonable opportunity to comply with the procedures prescribed by the order.

(d) Testimony of witnesses. Testimony of witnesses with respect to disputed material factual issues shall be taken in the same manner as testimony in an adversary proceeding.

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(e) Attendance of witnesses. The court shall provide procedures that enable parties to ascertain at a reasonable time before any scheduled hearing whether the hearing will be an evidentiary hearing at which witnesses may testify."

As explained by the Advisory Committee Note:

"The list of Part VII rules that are applicable in a contested matter is extended to include Rule 7009 on pleading special matters, and Rule 7017 on real parties in interest, infants and incompetent persons, and capacity. The discovery rules made applicable in adversary proceedings apply in contested matters unless the court directs otherwise.

Subdivision (b) is amended to permit parties to serve papers, other than the original motion, in the manner provided in Rule 5(b) F.R. Civ. P. When the court requires a response to the motions, this amendment will permit service of the response in the same manner as n answer is served in an adversary proceeding.

Subdivision (d) is added to clarify that if the motion cannot be directed without resolving a disputed material issue of fact, an evidentiary hearing must be held at which testimony of witnesses is taken in the same manner as testimony in an adversary proceeding or at a trial in a district court case. Rule 43(a), rather than Rule 43(e), F.R. Civ. P. would govern the evidentiary hearing on the factual dispute. Under Rule 9017, the Federal Rules of Evidence also apply in a contested matter. Nothing in the rule prohibits a court from resolving any matter that is submitted on affidavits by agreement of the parties.

Subdivision (e). Local procedures for hearings and other court appearances in a contested matter vary from district to district. In some bankruptcy courts, an evidentiary hearing at which witnesses may testify usually is held at the first court appearance in the contested matter. In other courts, it is customary for the court to delay the evidentiary hearing on disputed factual issues until some time after the initial hearing date. In order to avoid unnecessary expense and inconvenience, it is important for attorneys to know whether they should bring witnesses to a court appearance. The purpose of

the final sentence of this rule is to require that the court provide a mechanism that will enable attorneys to know at a reasonable time before a scheduled hearing whether it will be necessary for witnesses to appear in court on that particular date.

Other amendments to this rule are stylistic.

Changes Made After Publication and Comments: The Advisory Committee made two changes to subdivision (d) after considering the comments received addressing the proposed rule. First, the word "material" is inserted to make explicit that which was implied in the published version of the proposed rule. Second, the reference to F.R. Civ. P. 43(a) was removed. The purpose of proposed subdivision (d) was to recognize that testimony should be taken in the same manner in both contested matters and adversary proceedings. The revision to the published rule states this more directly.

The Committee Note was amended to reflect the changes made in the text of the rule."

Rule 9027(a)(3). Removal

Before December 1, 2002, Rule 9027(a)(3) provided:

(3) Time for filing; civil action initiated after commencement of the case under the code

If a case under the Code is pending when a claim or cause of action is asserted in another court, a notice of removal may be filed with the clerk only within the shorter of (A) 30 days after receipt, through service or otherwise, of a copy of the initial pleading setting forth the claim or cause of action sought to be removed or (B) 30 days after receipt of the summons if the initial pleading has been filed with the court but not served with the summons.

The Advisory Committee notes state:

"Subdivision (a)(3) is amended to clarify that if a claim or cause of action is initiated after the commencement of a bank-

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ruptcy case, the time limits for filing a notice of removal of the claim or cause of action apply whether the case is still pending or has been suspended, dismissed or closed."

The amended rule now reads:

"(3) Time for filing; civil action initiated after commencement of the case under the Code

If a claim or cause of action is asserted in another court after the commencement of a case under the Code, a notice of removal may be filed with the clerk only within the shorter of (A) 30 days after receipt, through service or otherwise, of a copy of the initial pleading setting forth the claim or cause of action sought to be removed, or (B) 30 days after receipt of the summons if the initial pleading has been filed with the court but not served with the summons."

SUPREME COURT RULES SETTLEMENT PAYMENTS FOR SUIT ALLEGING FRAUD CAN BE NON-DISCHARGEABLE UNDER SECTION 523

- Author, Nan Roberts Eitel, Partner

On March 31, 2003, the Supreme Court ruled that debt incurred in settlement of a suit alleging fraud can be non-dischargeable under section 523(a)(2)(A) of the Bankruptcy Code. *Archer v. Warner*, No. 01-1418, 538 U.S. ____ (2003). In so ruling, the Court resolved a conflict that had arisen among various Circuit Courts of Appeals.

The Archers purchased a manufacturing company from the Warners for $610,000 in 1991. Several months later, the Archers sued the Warners for various claims, including fraud in connection with the sale. In May 1995, the parties settled the suit for a $200,000 cash payment and a $100,000 promissory note requiring installment payments to the Archers to begin six months later. The settlement included a release of all claims–whether past, present, or future–and specified that no party admitted liability or wrongdoing. When the Warners failed to make the first payment under the note in November 1995, the Archers sued to enforce the note in state court, and the Warners

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filed for bankruptcy relief under Chapter 7.

The Archers filed an adversary proceeding against the Warners, claiming that the $100,000 note was a non-dischargeable debt under section 523(a)(2)(A) because it was a debt for money obtained by fraud. Although Mr. Warner entered a consent judgment in the case, Mrs. Warner contested the dischargeability suit. Mrs. Warner prevailed in the Bankruptcy Court, the District Court, and the Fourth Circuit Court of Appeals in a 2-1 decision. The courts below held that the settlement and release constituted a novation that replaced a debt allegedly obtained by fraud with a new contractual debt not obtained by fraud.

In a 7-2 decision, the Supreme Court reversed and held that the settlement can be–but is not necessarily–a debt for money obtained by fraud. In its ruling, the Court stated that *Brown v. Felsen*, 442 U.S. 127, (1979) controlled. *Brown* involved a state court consent judgment entered in a suit claiming money had been obtained by fraud, but the judgment itself did not indicate the nature of the debt. The *Brown* Court ruled that even though *res judicata* principles prevented Brown from making claims based on the same cause of action, they did not prevent the Bankruptcy Court from determining whether the consent decree was a debt for money obtained by fraud. Thus, according to *Brown*, a Bankruptcy Court should look beyond and behind a consent judgment to decide whether the debt embodied in the consent decree is non-dischargeable.

Although the dissent in *Warner* disputed that *Brown* controlled where a settlement included comprehensive release language (unlike the consent decree in *Brown*), the majority in *Warner* nevertheless found no difference between a settlement and a consent judgment. Among other reasons, the majority believed that if "reducing a fraud claim to settlement definitively changed the nature of the debt for dischargeability purposes–the nature of the debt in *Brown* would have changed similarly, thereby rendering the debt dischargeable." *slip op.*, at 5. The Court also noted that the Bankruptcy Code's original dischargeability provisions only excepted **judgments** based on fraud, whereas Congress later amended the statute to exclude from discharge all **liabilities** based on fraud. Thus, Congress intended a complete inquiry into all debts alleged to arise out of fraud "no matter what their form." *Id.* at 6.

The Court, however, did not decide several questions not addressed below, including whether the parties intended the settlement to have issue-preclusive–as well as claim-preclusive effect. On remand, the Court of Ap-

peals may consider the collateral estoppel or issue preclusion question if the question was properly raised and preserved.

Remember that these legal principles may change and vary widely in their application to specific factual circumstances. You should consult with counsel about your individual circumstances. For further information regarding these issues, contact our Bankruptcy practice group:

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