No. 17-16350

IN THE

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

In re: MARK L. NEBEL and AMY L. NEBEL,
Debtors.

MARKL. NEBEL and AMY L. NEBEL,
Debtors/Appellants,

– v. –

LAWRENCE J. WARFIELD,
Trustee/Appellee.

On Appeal from the United States District Court
For the District of Arizona
Case No. CV-16-08240-PCT-GMS

BRIEF OF AMICI CURIAE NATIONAL ASSOCIATION OF CONSUMER BANKRUPTCY ATTORNEYS AND NATIONAL CONSUMER BANKRUPTCY RIGHTS CENTER IN SUPPORT OF APPELLANTS AND SEEKING REVERSAL OF THE DISTRICT COURT'S DECISION

NATIONAL ASSOC. OF CONSUMER
BANKRUPTCY ATTORNEYS, AND THE
NATIONAL CONSUMER BANKRUPTCY RIGHTS
CENTER, *AMICI CURIAE*
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November 16, 2017

RULE 26.1 CORPORATE DISCLOSURE STATEMENT

Nebel et al. v. Warfield, No. 17-16350

Pursuant to Fed. R. App. P. 26.1, Amici Curiae, the National Association of Consumer Bankruptcy Attorneys and the National Consumer Bankruptcy Rights Center, make the following disclosure:

1) Is party/amicus a publicly held corporation or other publicly held entity? **NO**

2) Does party/amicus have any parent corporations? **NO**

3) Is 10% or more of the stock of party/amicus owned by a publicly held corporation or other publicly held entity? **NO**

4) Is there any other publicly held corporation or other publicly held entity that has a direct financial interest in the outcome of the litigation? **NO**

5) Does this case arise out of a bankruptcy proceeding? **YES**. If yes, identify any trustee and the members of any creditors' committee. **Lawrence J. Warfield, Chapter 7 Trustee**

This 16th day of November, 2017.

/s/ Jon Erik Heath
J. Erik Heath, Esq.
Attorney for Amici Curiae

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STATEMENT OF INTEREST OF AMICI CURIAE

NCBRC is a nonprofit organization dedicated to preserving the bankruptcy rights of consumer debtors and protecting the bankruptcy system's integrity. The Bankruptcy Code grants financially distressed debtors rights that are critical to the bankruptcy system's operation. Yet consumer debtors with limited financial resources and minimal exposure to that system often are ill-equipped to protect their rights in the appellate process. NCBRC files *amicus curiae* briefs in systemically-important cases to ensure that courts have a full understanding of the applicable bankruptcy law, the case, and its implications for consumer debtors.

NACBA is also a nonprofit organization, with approximately 3,000 consumer bankruptcy attorney members nationwide. NACBA advocates on issues that cannot adequately be addressed by individual member attorneys. It is the only national association of attorneys organized for the specific purpose of protecting the rights of consumer bankruptcy debtors. NACBA has filed *amicus curiae* briefs in various cases seeking to protect the rights of consumer bankruptcy debtors. *See, e.g., Am.'s Servicing Co. v. Schwartz-Tallard*, 803 F.3d 1095 (9th Cir. 2015) (en banc).

NCBRC and NACBA have a vital interest in the outcome of this case. The bankruptcy court below alluded to the floodgates that this case would open up in the administration of chapter 7 cases. NACBA member attorneys represent

individuals in a large portion of all these chapter 7 cases, the vast majority of whom are honest but unfortunate debtors who seek nothing more than a fresh start under the Bankruptcy Code. However, that fresh start would be denied to insolvent debtors who are forced to make decades of additional payments to trustees to compensate them (at inflated values) for property that cannot be liquidated.

AUTHORSHIP AND FUNDING OF AMICI BRIEF

Pursuant to Fed. R. App. P. 29(c)(5), no counsel for a party authored this brief in whole or in part, and no person/entity other than NACBA, its members, NCBRC, and their counsel made any monetary contribution toward the preparation or submission of this brief.

SUMMARY OF ARGUMENT

The oft-cited principal purpose of the Bankruptcy Code is to grant a fresh start to the honest but unfortunate debtor. *Harris v. Viegelahn*, — U.S. —, 135 S. Ct. 1829, 1838 (2015); *Kokoszka v. Belford*, 417 U.S. 642, 645 (1974). Very few bankruptcy cases on appeal have the capacity to threaten that fresh start as much as this one. The bankruptcy court's decision sets a deeply disturbing precedent that will fundamentally change the nature of chapter 7 bankruptcies.

Chapter 7 grants the honest, but unfortunate debtor a fresh start by promptly liquidating certain assets and distributing the proceeds to creditors in the order specified by the Bankruptcy Code. This liquidation process is a balancing act guided by a number of principles under which trustees cannot (a) obtain a greater interest in property than held by debtors themselves; (b) liquidate property that provides little or no benefit to the estate; and (c) thwart a debtors' fresh start by prolonging case administration. Here, the trustee seeks payment for property interests that are at best of nominal value to the estate. In the process, administration of the estate may continue for decades into the future. Most concerning is that, rather than liquidating these interests by selling them to third parties, the trustee implicitly recognizes that they are not marketable, and therefore seeks payment only from the debtors themselves.

Forcing the debtors to make such payments here would result in their

paying much more for the property than it its fair market value. Assuming there is any marketable value to these interests, that value is considerably less than the hostage values the bankruptcy court ordered the debtors to pay.

The approach below, if affirmed, will fundamentally alter chapter 7 bankruptcy within the Ninth Circuit. Almost all chapter 7 debtors have property interests that cannot be liquidated for whatever reason. Typically this property is abandoned as being of nominal value to the estate. Allowing a trustee to seek additional payments from insolvent debtors based on these interests rewrites chapter 7 of the Bankruptcy Code. The court below recognized the "administrative nightmare" that will result if the floodgates are opened by this case.

This Court should reject this overhaul of chapter 7 bankruptcy, and reverse the bankruptcy court's decision.

ARGUMENT

The oft-cited principal purpose of the Bankruptcy Code is to grant a fresh start to the honest but unfortunate debtor. *Harris*, 135 S. Ct. at 1838; *Kokoszka*, 417 U.S. at 645. Very few bankruptcy cases on appeal have the capacity to threaten that fresh start as much as this one. Not only does the trustee's unprecedented tactic disrupt many of the principles underlying chapter 7

bankruptcy, but it results in the insolvent debtors being held hostage to inflated valuations of their own property. This Court should reject this approach.

I. TRUSTEE'S METHOD OF EXTRACTING MONEY FROM INSOLVENT CHAPTER 7 DEBTORS VIOLATES SEVERAL CORE BANKRUPTCY PRINCIPLES.

The decision below disrupts the Bankruptcy Code's delicate balance between providing a fresh start for the debtor and facilitating the fair and orderly repayment of creditors to the extent possible. *Kokoszka*, 417 U.S. at 645; *In re Sanchez*, 372 B.R. 289, 296 (Bankr. S.D. Tex. 2007). In the context of a chapter 7 bankruptcy, this balance is struck by "allow[ing] a debtor to make a clean break from his financial past, but at a steep price: prompt liquidation of the debtor's assets." *Harris*, 135 S. Ct. at 1835.

The Bankruptcy Code creates jurisdictional and practical constraints in this liquidation process. The threshold issue is whether an interest constitutes property of the bankruptcy estate, and if so, to what extent. *See* 11 U.S.C. 541. Even if an interest constitutes estate property, the Code requires it to have more than nominal value to the estate if it is to be liquidated. This is consistent with the Code's command for expeditious administration of the estate. *See* 11 U.S.C. 704.

A. The Bankruptcy Estate Has No Broader Interest Than The Debtor.

The legal issues in this matter first require a consideration of what property interest belongs to the estate. *Lawrence v. Commonwealth of Ky. Transp. Cabinet*,

775 F.3d 789, 793 (6th Cir. 2015) ("[f]undamental to the concept of 'Turnover' is that the asset to be turned over must be property of the debtor's bankruptcy estate.")

The commencement of a bankruptcy case creates an estate which, with limited exceptions, consists of all of the debtor's property. *Ohio v. Kovacs*, 469 U.S. 274, 284 n.12 (1985) (citing 11 U.S.C. 541). This broad estate includes all legal or equitable interests of the debtor at commencement of the case. *United States v. Whiting Pools*, 462 U.S. 198, 204-205 (1983); *see also Gladstone v. U.S. Bancorp*, 811 F.3d 1133, 1139-40 (9th Cir. 2016). As a result, even intangible interests, such as possessory interests, are included within the estate. *Cuffee v. Atl. Bus. & Cmty. Dev. Corp.*, 901 F.2d 325, 328 (3d Cir. 1990); *see also In re Ryerson*, 739 F.2d 1423, 1425 (9th Cir. 1984) (contingent future interest is estate property).

As broad as this bankruptcy estate is, however, there are limits. For example, the estate excludes "any power that the debtor may exercise solely for the benefit of an entity other than the debtor." 11 U.S.C. 541(b)(1). Thus, interests held by a debtor's minor child do not automatically enter the bankruptcy estate, even if the debtor holds some form of legal title to that property. *See, e.g.*, *Darby v. McGregor*, 226 B.R. 126, 130 (Bankr. M.D.Ala. 1998) (prepaid tuition contracts for debtor's children were not estate property); *Dally v. Bank One, N.A.*, 202 B.R.

724, 727-28 (Bankr. N.D.Ill. 1996) (minors' investment accounts, naming debtor parent as custodian, were not estate property); *In re Mills*, 41 B.R. 849, 850-51 (Bankr. W.D.Pa. 1984) (debtors had no interest in property held in trust for children).

The estate also cannot take on any greater interest than that already held by the debtor. It is a

> basic tenet of bankruptcy law that a bankruptcy trustee succeeds only to the title and rights in property that the debtor had at the time she filed the bankruptcy petition. Filing a bankruptcy petition does not expand or change a debtor's interest in an asset; it merely changes the party who holds that interest. Further, a trustee takes the property subject to the same restrictions that existed at the commencement of the case. To the extent an interest is limited in the hands of a debtor, it is equally limited as property of the estate.

In re Sanders, 969 F.2d 591, 593 (7th Cir. 1992); *see also Lawrence*, 775 F.3d at 794; *First Fid. Bank v. McAteer*, 985 F.2d 114, 117 (3d Cir. 1993) ("the estate's legal and equitable interests in property rise no higher than those of the debtor"); *Keller v. Keller*, 185 B.R. 796, 800-801 (B.A.P. 9th Cir. 1995) (quoting *In re Paderewski,* 564 F.2d 1353, 1356 (9th Cir. 1977)). If the debtor's interests are not assignable, then the trustee similarly cannot transfer the property. *In re Schauer*, 835 F.2d 1222, 1225 (8th Cir. 1987); *see also In re Prof'l Bar Co.*, 537 F.2d 339, 340 (9th Cir. 1976).

These fundamental limitations on the reach of the bankruptcy estate are important here because it is not entirely clear that all of the property at issue in this case falls within the estate. Further, the courts' rulings assume the extent of the estate's interest without any factual findings, such that those assumed interests may actually be greater than what the debtors actually possessed when they filed for bankruptcy. For example, neither court below placed any importance on whether the ABT tuition was refundable or transferrable – even though such characteristics define the estate's interest in the property. In a similar context, the *Darby* Court excluded from the estate prepaid tuition contracts held by the debtor to benefit his minor children. *Darby*, 226 B.R. at 130. Although the *Darby* debtor may have held legal title to the contracts, the equitable interest – the right to attend class – was owned by the children. The debtor's rights to exercise any powers on behalf of the children was for their benefit, and was thus excluded from the estate pursuant to section 541(b)(1). *Id.*

Instead of parsing out the interests at stake with the ABT tuition, the courts below adopted a binary approach, apparently assuming that the whole property was either part of the estate or it was not. In the view of the district court, it was irrelevant "whether the tickets and the course were refundable and/or transferable… all of the payments created property interests to which the estate was entitled regardless of their transferability." ER4; *see also* ER35 ("This

payment was an estate asset… [s]o, that money needs to come back to the estate.”). This approach is problematic because the refundability and/or transferability of the ABT tuition helps determine (1) to what extent the interest belongs to the debtor, as opposed to the child; and (2) what the bankruptcy estate can do with any interest that is attributable to the debtor. Here, as in *Darby*, the equitable interest in the ABT tuition would clearly belong to the child, as she is the one entitled to attend the program. Further, the debtors had no right to receive a refund from the program. *See* ER55. Thus, the only value the ABT tuition could add to the estate is if the spot could be sold to someone else. The transferability of admission to the program was contested below, but neither court reached the issue, erroneously believing it was irrelevant.

By way of another example, there was a supposition below that the airline tickets could have been sold to someone else, although for security reasons that is atypical. *See* ER 10. For example, Delta Air Lines[1] contract terms clearly specify that tickets "are not transferrable." Delta Domestic General Rules Tariff, Rule 100.D. (modified Oct. 26, 2017), available at https://www.delta.com/content/dam/delta-www/pdfs/legal/contract_of_carriage_dom.pdf. The record is silent on the refundability of these tickets (again because the courts deemed the question

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[1] The airline tickets here were purchased on Delta Air Lines. *See* ER83.

irrelevant), but Delta states that it "will not refund any portion of a fare that is nonrefundable." *Id*. at Rule 270.B.1. No hearing was conducted to determine whether the airline tickets were transferable or refundable. It is entirely possible that the adult debtors (and thus the estate) had no interest in the daughter's airline ticket, and only a non-assignable possessory interest in the adult's ticket.

The question of whether, and to what extent, such property interests enter the estate is an important threshold inquiry that was not fully addressed below. If a non-refundable and/or non-transferable interest enters the estate, the trustee is just as limited in disposing of the asset as the debtor. As discussed below, these limitations have significant impact on the value of the property.

B. Nominal Assets Should Be Abandoned Under Section 542, Not Sold Under Section 363.

The turnover mechanism is expressly limited *only* to estate property that the trustee "may use, sell, or lease under section 363." 11 U.S.C. 542(a). But neither court below addressed whether the property at issue here was available for "use, [sale], or lease under section 363." Under well-established bankruptcy practice, this property was not subject to the trustee's powers under section 363, and should have been abandoned instead.

An asset's inclusion in the bankruptcy estate does not automatically result in its liquidation. Instead, the trustee's power to liquidate property under section 363 is constrained by the debtor's ability to exempt the property, *see* 11 U.S.C. 522(b),

and the practical requirement that the liquidation actually yield more than an "inconsequential value and benefit to the estate," 11 U.S.C. 554. If an asset can provide only a nominal benefit to the estate, then abandonment is the appropriate course.

"Abandonment is the release from the debtor's estate of property previously included in that estate." *Midlantic Nat'l Bank* 474 U.S. at 508 (Rehnquist, J., dissenting) (internal citations and quotations omitted). The concept of abandonment, now codified in the Bankruptcy Code, derives from the common law practice barring asset sales that would not result in distribution to creditors. *See, e.g.*, *Hoehn v. McIntosh*, 110 F.2d 199, 203 (6th Cir. 1940); *see also* Pub. L. No. 95-598, 92 Stat. 2549, 2603 (1978). Indeed, it is now "almost universally recognized that where the estate has no equity in a property, abandonment is virtually always appropriate because no unsecured creditor could benefit from the administration." *In re Feinstein Family Pshp.*, 247 B.R. 502, 507 (Bankr. M.D. Fla. 2000); *see also In re Jaussi*, 488 B.R. 456, 458-59 (Bankr. D. Colo. 2013); *In re Rambo*, 297 B.R. 418, 433 (Bankr. E.D.Pa. 2003) ("Where property is of inconsequential value to the estate, abandonment under section 554, rather than sale under section 363, is the proper course.").

The abandonment, rather than sale, of such property serves several purposes. First and foremost, abandonment "serve[s] the overriding purpose of bankruptcy

liquidation: the expeditious reduction of the debtor's property to money, for equitable distribution to creditors," because liquidating worthless assets would necessarily "slow[] the administration of the estate and drain[] its assets." *Midlantic*, 474 U.S. at 508 (Rehnquist, J., dissenting). In fact, the Chapter 7 "trustee's duty to expeditiously close the estate [is] his 'main' duty." *In re Riverside-Linden Inv. Co.*, 925 F.2d 320, 322 (9th Cir. 1991); *In re Dorn*, 167 B.R. 860, 865 (Bankr. S.D. Ohio 1994).

Historically, allowing trustees to sell assets with nominal value invites self-dealing by less scrupulous trustees. In codifying the abandonment procedures in section 554,

> Congress was aware of the claim that formerly some trustees took burdensome or valueless property into the estate and sold it in order to increase their commissions. Some of the early cases condemned this particular practice in no uncertain terms, and decried the practice of selling burdensome or valueless property simply to obtain a fund for their own administrative expenses.

In re K.C. Machine & Tool Co., 816 F.2d 238, 246 (6th Cir. 1987); *see also In re KVN Corp.*, 514 B.R. 1, 7 (B.A.P. 9th Cir. 2014) (describing "past abuses"). Indeed, "[t]he existence of nominal asset cases, in which the bankruptcy system is operated primarily for the benefit of those operating it, has been one of the most frequently expressed criticisms" of the prior bankruptcy system. H. Rep. No. 95-

595, at 94 (1977). "Congress has [thus] encouraged the abandonment of nominal assets." 6 Collier on Bankruptcy ¶ 704.02[1] (16th ed.).

The statistics arising out of the bankruptcy courts in the District of Arizona raise questions about whether its Chapter 7 trustees are reverting back to the concerning practices Congress sought to curtail. In 2014, only 2.7% of all Chapter 7 bankruptcy cases nationwide are filed in Arizona. U.S. Bankruptcy Courts - Business and Nonbusiness Cases Filed, by Chapter of the Bankruptcy Code, United States Courts (Dec. 31, 2014), *available at* http://www.uscourts.gov/sites/default/files/statistics_import_dir/1214_f2.pdf (last visited Nov. 16, 2017). Despite this small portion, Arizona Chapter 7 trustees administered 13.6% of all Chapter 7 asset cases involving gross receipts less than $2,000. Many creditors in these cases saw no payout, and others received payouts as low as $29.38. Further, the average gross receipts for cases administered by Arizona trustees $5,535.84, compared with $27,979.19 nationwide, further illustrating their emphasis on nominal value cases. Chapter 7 Trustee Final Reports, U.S. Trustee Program (Calendar Year 2014) ("2014 Trustee Asset Report"), available at https://www.justice.gov/ust/file/452631/download (last visited Nov. 16, 2017).[2]

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[2] A history of these reports is available on website of the U.S. Trustee Program at https://www.justice.gov/ust/bankruptcy-data-statistics/chapter-7-trustee-final-

The values at issue in this case fall well within the realm of "nominal." As Appellants point out, a 2001 decision required the trustee to abandon a specific asset that would have resulted in a "de minimis" distribution of $1,119.51 to unsecured creditors (approximately 1.7% of the total $66,784 in unsecured debts). Appellants' Br., at 30 (citing *In re Thornton*, 269 B.R. 682, 685 (Bankr. W.D.Mo. 2001)). Even higher distribution amounts have been found to be inconsequential. *In re W.A.R. LLP*, 467 B.R. 543 (D. Colo. 2012) (cash sum of $4,611.66 too small to warrant expense of distribution); *Mohns, Inc. v. Wilson*, 475 B.R. 674 (E.D. Wis. 2012) (additional $2,982 that sale could have brought was not worth hassle of sale). Because there is no market for the assets at stake here, as discussed *infra* at 26, their value is at or around zero.

Even adopting Trustee's inflated valuation, both parties overestimate the likely distribution to the creditors from these assets. Looking at Trustee's valuations alone, the total $5,788.77 sought in the turnover order represents 3.5% of the debtors' total unsecured debt of $166,013.59, *see* ER95, which is already paltry. But not all of that amount would go to creditors. For example, Appellants

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reports. This website includes a codebook that describes the headings used in these reports, available at https://www.justice.gov/ust/file/ch_7_trustee_final_reports_codebook.pdf/download.

explain that, after deducting the trustee's 25% commission, only $1,725 of the PTO property itself would be available for distribution. Appellants' Br. at 12.

Even Appellants' more realistic number assumes that the trustee's commission is the only amount that would be deducted from the pool before it is distributed. There are other expenses, such as administrative expenses, *see* 11 U.S.C. 503, that further reduce distributions. In Arizona in 2014, almost every asset case incurred administrative expenses, which on average reduced the distribution to creditors by an additional 6%. 2014 Trustee Asset Report. That same year, the district saw 204 chapter 7 asset cases resulting in zero distributions to creditors, mostly because any receipts after the trustee's commission were consumed by the trustee's or outside counsel's legal fees. *Id*. Altogether, these transaction costs are quite high in Arizona for smaller cases. For the 1,542 cases that were administered in 2014 with gross receipts less than $2,000, on average, the unsecured creditors ultimately received only 57% of those gross receipts. *Id*.

Accounting for these additional costs, any amount remaining for distribution to the creditors here would be small, and likely, no more than 57% of Trustee's inflated values (or $3,299.60 for the ABT and PTO assets combined, resulting in a best-case distribution of 2%). In other words, even assuming the Trustee's inflated valuation is correct, these are assets that truly have nominal value to the estate.

Because a sale of these assets would not result in any meaningful distribution to creditors, the proper course below should have been to deny the request for turnover.

C. Protracted Chapter 7 Proceedings Preclude Fresh Starts, and Undermine Public Trust in the Bankruptcy System.

Clearly, the "fresh start" promised by the Bankruptcy Code cannot be achieved if chapter 7 debtors are required to make payments to the trustee for an indefinite period – perhaps decades. But prolonging case administration for extended periods undermines various other goals of the bankruptcy process.

The chapter 7 trustee has a statutory mandate to "collect and reduce to money the property of the estate for which such trustee serves, and [to] close such estate as expeditiously as is compatible with the best interests of parties in interest." 11 U.S.C. 704(a)(1). As this Court has long recognized, the chapter 7 "trustee's duty to expeditiously close the estate [is] his 'main' duty." *Riverside-Linden*, 925 F.2d at 322.

Reflecting the importance of efficient estate administration, chapter 7 bankruptcies are processed faster than Chapter 13 cases. In a chapter 7 case where there are insufficient assets to distribute to creditors (commonly referred to as a "no-asset" case), the trustee is required to a file a report of no distribution within 60 days of the meeting of creditors. Handbook for Chapter 7 Trustees, published by the Executive Office for United States Trustees, at 4-3 (2012) (hereafter

"Handbook"). "A typical 'no-asset' bankruptcy case is discharged and closed within three to four months." *In re Pigg*, 2015 Bankr. LEXIS 3975, at *73 (Bankr. W.D.Mo. Nov. 20, 2015).

Even when there are assets to administer, trustees are urged to do so quickly. *See* 11 U.S.C. 704(a)(1). Thus, they "shall not administer an estate or an asset in an estate where the proceeds of liquidation… will unduly delay the resolution of the case." Handbook, at 4-1. For example, "[g]enerally, the trustee should avoid sales of estate assets involving buyer payments which will extend beyond one year." Handbook, at 4-18. In exceptional cases where such future payments are warranted, "the trustee should attempt to discount the future income stream to an appropriate present value and liquidate the asset as expeditiously as possible." *Id.* This direction clarifies what should happen when dealing with a stream of future payments as here: the right to that income stream should be sold if there is a willing buyer for a discounted price that is more than nominal. The future payments should not be collected by the trustee. Under these guidelines, chapter 7 asset cases average 2.3 years in duration. Chapter 7 Asset Cases Closed: Distribution Statistics and the Impact of Case Filing Trends, Executive Office for United States Trustees, *available at* https://www.justice.gov/sites/default/files/ust/legacy/2014/11/20/nabtalk_summer2014.pdf (last visited Nov. 9, 2017).

Allowing Chapter 7 cases to linger beyond these "prompt" time frames presents real policy concerns. As described by the Executive Office for U.S. Trustees:

> Delays in case closure diminish the return to creditors, undermine the creditors' and public's confidence in the bankruptcy system, increase the trustee's exposure to liability, raise the costs of administration, and, in cases involving non-dischargeable pre-petition tax liabilities, expose the debtor to increased penalties and interest. Delays also give rise to public criticism of the bankruptcy process. To ensure compliance with section 704(a)(1), the United States Trustee monitors the number and age of open cases and the reasons they remain open.

Handbook, at 4-25.

These concerns have deep historical roots. As explained above, the public's confidence in the previous bankruptcy system was eroded by lengthy cases that appeared to benefit those running the system more than debtors and creditors. This system was also costly to maintain: nearly 40% of the costs of the bankruptcy system in 1972 were attributable to no-asset or nominal asset cases. *In re Neiheisel*, 32 B.R. 146, 158 n.66 (Bankr. D. Utah 1983) (citing A Report Of The Commission on the Bankruptcy Laws of the United States, July 1973, H.R. Doc. No. 93-137, at 3 (1973).)

Unfortunately, the trustee's tactic here reverts back to the very system the Bankruptcy Code was intended to overhaul. "Most chapter 7 cases involving individual debtors are no asset cases." Chapter 7–Bankruptcy Basics, U.S. Courts,

available at http://www.uscourts.gov/services-forms/bankruptcy/bankruptcy-basics/chapter-7-bankruptcy-basics (last visited Nov. 9, 2017). The vast majority of the debtors in these no-asset cases have some form of interest that cannot be liquidated – whether that is an underwater asset (i.e., a home or car), or whether it is an intangible interest that cannot be reduced to cash (nonrefundable airline ticket, term life insurance, etc.). To that extent, it is hardly remarkable that the debtors here have property that cannot be liquidated.

What is remarkable about this case, however, is that it may take more than 20 years for the court to administer small increments of a total $2,297.57 in PTO benefits.[3] This delay is astonishing, given that the nominal assets at issue would typically mandate the case be closed within a few short months as a no-asset case. While allowing this unprecedented result, the bankruptcy court acknowledged that "this could be a long haul," ER36, creating an "administrative nightmare," ER29.

Moreover, the bankruptcy court recognized this case opens the floodgates to multi-decade administration of countless nominal asset cases. *Id*. (noting sheer "number of cases that [the trustee] might [be] wanting to do this in."). In turn, these floodgates heap profits on chapter 7 trustees. By administering nominal asset cases over decades, they can reap the highest commissions allowed in the

[3] The debtors are in their forties, ER24, and the PTO may not be fully administered until retirement. ER36.

Bankruptcy Code over a large swath of cases. *See* 11 U.S.C. 326(a) (25% commission on first $5,000 recovered). If this Court approves the Trustee's method, then the volume of chapter 7 cases subject to this tactic makes this an lucrative practice for bankruptcy professionals at the expense of both debtors and creditors.

Of course, there is nothing wrong in providing incentive compensation to zealous trustees, but Trustee here goes too far. By reaping a 25% commission on thousands of cases, just so creditors can stand a chance at a 1% recovery many years (even decades) in the future, the trustee sets up the same grinding model that Congress sought to abolish in 1978– it delays fresh starts, provides very little benefit to creditors, and handsomely compensates the operators of the bankruptcy system. The district court may not have realized the importance of efficient estate administration within the context of this one small case, *see* ER7, but it is no hyperbole to point out that the roadmap here threatens to "undermine the creditors' and public's confidence in the bankruptcy system." *See* Handbook, at 4-25.

D. Trustee's Method Subverts the Chapter 7 Liquidation Process.

This case, if affirmed, will turn the chapter 7 liquidation process on its head. Although chapter 7 trustees are tasked with the liquidation of estate property, 11 U.S.C. 704(a)(1), the methodology here has nothing to do with "liquidation."

Instead, Trustee seeks to be paid money from the debtors themselves, ostensibly as remuneration for unmarketable assets. The debtors' discharge presumably hinges on their ability to afford these new payment obligations. The practical effect of Trustee's method is to turn chapter 7 bankruptcy into something more akin to a chapter 13 repayment plan. *See Harris*, 135 S.Ct. at 1835 (delineating Chapters 7 and 13). But the debtors' case here lacks many of the benefits and procedural safeguards of Chapter 13. For example, the trustee here requires payments long after the strict five-year statutory limit in chapter 13 cases. *See* 11 U.S.C. 1322(d).

Quite simply, this Court should not allow such a fundamental rewrite of the bankruptcy process by requiring chapter 7 debtors to pay for their discharge rather than earning it through the statutory framework of liquidation.

II. THE COURT IMPROPERLY VALUED THE PROPERTY BASED ON A PREVOIUS PURCHASE PRICE INSTEAD OF CURRENT MARKET VALUE.

The express terms of the Code render turnover inapplicable to assets that are "of inconsequential value or benefit to the estate." 11 U.S.C. 542(a).[4] An asset's proper valuation is therefore crucial in determining whether section 542(a) applies.

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[4] This analysis is intertwined with Section 542's requirement that the property be available for administration under Section 363. As described *supra* at 10, nominal assets should be abandoned, and not liquidated under Section 363.

Correctly valuing the instant property shows that it most likely has no value to the estate because it cannot be sold on the open market. But even if it could be sold, the price would be considerably less than the face value of the property to the debtor. Not only would the ultimate price tag on these interests come from a distress sale, but there are a number of other factors that would substantially lower the price. Rather than taking these practicalities into account, Trustee proposed, and the bankruptcy court improperly accepted, methods that were tantamount to imposing hostage values on the debtors.

In the Ninth Circuit, a bankruptcy court's method of valuation is subject to *de novo* review. *In re Prejean*, 994 F.2d 706, 708 (9th Cir. 1993). This Court should therefore reverse the bankruptcy court's valuation of these assets, and hold that the assets are of nominal value to the estate.

A. "Value" Refers to the Price Estate Property Can Fetch From A Buyer in a Distress Sale, Not What the Debtor Paid Months Beforehand.

Although the courts below recognized that value is dependent on what someone is willing to pay for an asset, they overlooked how that marketplace works.

As recognized by the district court, "'[f]air market value' refers to 'the price that a seller is willing to accept and a buyer is willing to pay on the open market.'" *United States v. Kaplan*, 839 F.3d 795, 800 (9th Cir. 2016) (quoting *Fair Market*

Value, Black's Law Dictionary (10th ed. 2014)); *see also In re Ozark Rest. Equip. Co.*, 83 B.R. 591, 593 (Bankr. W.D.Ark. 1987) (applying fair market value in 542 turnover action). Based on this definition, the district court upheld the bankruptcy court's valuation finding that the "fair market value of the ballet course was the price that the Debtors paid and the sellers accepted." ER5.

This finding, however, is based on the fiction that the open market in which the ballet course was *sold* to the debtors is the same as the open market in which the ballet course can be *resold* by the debtors' estate. After all, when this chapter 7 bankruptcy petition was filed, the estate's interest in the property was second-hand. If this property cannot be resold or transferred in the open market, then those restrictions can significantly reduce – or even eliminate – the asset's fair market value after the debtor's initial purchase. Further, for whatever interests could be transferred, if there is not a buyer who is willing to pay for them, then it is axiomatic that they have no marketable value.

The market value of an asset in bankruptcy faces further headwinds because it is not sold in a perfectly efficient market. As this Court has explained, "it is well recognized that for various reasons foreclosure sales (and liquidation sales) do not bring the same value as a non-distress (fair market) sale." *In re Ehring*, 900 F.2d 184, 188 (9th Cir. 1990). This is because "[d]istress sales are rushed, poorly advertised, done on a cash, not credit, basis, do not allow buyers to examine the

property well, and may entail potential future litigation. All of these factors reduce the field of potential buyers, reducing the price [a distressed asset] will command." *Id*., at 188 n. 2. Because asset sales in a chapter 7 liquidation are by nature distress, they seldom fetch a price reflective of true market value. These market forces were not taken into account below.

The bankruptcy court's apparent presumption that the property here could fetch a price in this theoretical distress sale equal to the initial purchase price is flawed. Many assets have values entirely different from purchase price. Term life insurance presents a typical example of an asset that a debtor may purchase pre-petition, but that almost invariably has no marketable value to the estate. When a debtor files chapter 7 bankruptcy, any interest the debtor has in a term life insurance policy undoubtedly becomes property of the estate. *See* 11 U.S.C. 541(a)(1). However, its inclusion within the estate does not mean that the asset has any monetary value for the estate. Courts therefore routinely reject attempts to administer term life insurance policies that have no cash surrender value. *See e.g.*, *Lekas v. Mann*, 299 B.R. 597, 602-03 (Bankr. D. Ariz. 2003); *see also In re Herrell*, 210 B.R. 386, 390 (Bankr. N.D. Fla 1997) ("the bankruptcy estate would have an interest in the life insurance policy only to the extent of the policy's cash surrender value"); *Cf. Gladstone v. U.S. Bancorp*, 2013 U.S. Dist. LEXIS 190039, at *9 (S.D. Cal. Apr. 18, 2013) (outlier policy that the debtor "sold on the

secondary market"). In short, these policies are not valued based on the premiums paid by the debtor, but by their liquidation value, which is typically zero.

There are many other common examples of assets that provide no value to the estate, even though debtors paid a specific price for them, such as underwater homes, depreciated cars, and used household goods. No litigant could argue in good faith that the bankruptcy court should ignore the existence and/or state of the market for such goods, and instead value them based on the price the debtor previously paid for them.

Looking to a more current market value, as opposed to what the debtor previously paid, is also more consistent with other aspects of the Bankruptcy Code. Notably, valuation determinations to measure the extent of a debtor's exemptions are generally made "as of the date of the filing of the petition." 11 U.S.C. 522(a)(2). Valuations to measure the secured status of liens are made keeping in mind "the proposed disposition or use of such property." 11 U.S.C. 506(a)(1). In drafting the Code, Congress was obviously aware that "value" was not tantamount to purchase price, and should take into account the price that the bankruptcy estate could actually obtain.

Market value to the estate is a very different question from the price a debtor paid for a specific asset. For an asset to have marketable value to the estate, there

must first be a market for it. Assuming there is a market, then the price paid in that market reflects the distressed nature of the sale.

B. In The Unlikely Event These Interests Held Any Value, It Was Substantially Less Than the Bankruptcy Court's Amount.

Applying the above valuation principles to the assets in this case, it becomes clear that the bankruptcy court's valuations were erroneous. There is simply no marketable value for these items. If there were, the trustee surely would have availed himself of that market opportunity without feeling the need to resort to the debtors for some kind of payment.

First, although deemed irrelevant below, Trustee's belief that he could have sold the ABT property is questionable. Before doing so, Trustee would first need to parse the debtor's interest in the ABT property, which would be estate property, from the child's interest, which is beyond his reach. Properly recognizing the bounds of the bankruptcy estate would leave very little that he could administer. But even assuming *arguendo* that the entire ABT asset was estate property, then Trustee is still subject to the same transfer limitations faced by the debtors. These restrictions may leave him unable to sell the airline tickets, or unable to sell the spot at the ABT program, which apparently is student-specific after an audition process. In any event, these realities show that the resale value of the ABT property from the estate is substantially less than the $3,491.20 initially paid by the debtors, if not zero.

It is just as unlikely that an interested buyer would purchase the PTO interest. To start, the PTO interest for each debtor is small. The wife's PTO is limited to a face value of $76. According to Trustee's calculations, the husband's PTO has a face value of $2,297. Appellants' Br. at 28. It may be years, even decades, before these values are realized. It is farfetched to believe that anyone would want to buy this future income stream from the estate, and no party has shown that there is a willing buyer ready to do so. But in the unusual circumstance that a buyer could be found, the price would certainly reflect a number of risks, including that the value may not ever be realized, or that it may not be realized for 20 years. In other words, the highly speculative nature of the asset, combined with the distress nature of the sale, would command a steep discount over the face value of the PTO. Whatever that amount is, it is also considerably less than the amount the bankruptcy court ordered the debtors to pay.

Under the bankruptcy court's own valuation, these assets are nominal. Valuing them correctly reveals how truly nominal they are.

C. The Bankruptcy Court Improperly Accepted Trustee's Proposed Valuations, Which Were Tantamount to Imposing A Hostage Value on the Debtors.

If these interests could fetch any price, that price is unquestionably far less than the values imposed on the debtors. Trustee, and the approving bankruptcy court, improperly held the debtors' interests hostage to obtain these inflated values.

When drafting the Code, Congress was concerned about the ability of certain parties to leverage inflated valuations upon debtors. In 1977, this conduct was commonly exhibited by secured creditors, who forced debtors to pay more than their property was worth in order to avoid repossession. *See, e.g.*, H.R. Rep. No. 95-595, at 124 (1977) ("the mere threat of repossession operates as pressure on the debtor to pay the secured creditor more than he would receive were he actually to repossess and sell the goods"), 128 (exemptions would be meaningless "if the debtor must pay more than the property is worth for the privilege of continuing to use the property"), 163. These "hostage" values are driven by leverage, as opposed to market forces. *See Dymarkowski v. Savage*, 561 B.R. 384, 391 (B.A.P. 6th Cir. 2016).

It is highly doubtful that the property at issue here has any value beyond its hostage value to the debtors. The record contains no indication that there are *any* willing buyers for these interests. Further, even if some small aspect of the property interests could be sold, the ultimate value of these interests is unquestionably far less than the value imposed on the debtors of $5,788.77.

Unfortunately, the bankruptcy court was complicit in the hostage valuation here. In justifying these valuations, the court explained, "[o]bviously, what this is going to do is give some motivation to the Debtors and the Trustee to come to terms on just resolving this right now…" ER37. In other words, the court

remarkably endorsed Trustee's hostage-taking, and pressured the debtors to capitulate and pay the ransom.

This Court should reject this hostage approach, and require that assets be properly valued.

III. DEBTORS ARE NOT APPROPRIATE PARTIES TO 542 TURNOVER.

The bankruptcy court ordered the debtors to pay the above values based on language in the turnover statute requiring certain parties to "deliver… [the] property or the value of such property." 11 U.S.C. 542. But this approach presumes that section 542 turnover is applicable to debtors, which it is not. Instead, a debtor's duties as to estate property are governed by section 521(a)(4), which requires debtors to "surrender to the trustee all property of the estate."[5]

It is clear that section 542 is applicable only to third parties for a host of reasons. First, "[s]tatutory construction canons require that where both a specific and a general statute address the same subject matter, the specific one takes precedence regardless of the sequence of the enactment, and must be applied first." *In re Padilla*, 222 F.3d 1184, 1192 (9th Cir. 2000) (internal quotations omitted) (applying canon to the Bankruptcy Code). Here, because Section 521(a)(4) applies

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[5] A "constructive delivery is made at the time the case is filed and physical delivery can be made, where suitable, on the trustee's request." *In re Figueira*, 163 B.R. 192, 194 (Bankr. D. Kan. 1993).

specifically to property held by a debtor, whereas section 542 applies more generally, it is clear that the debtor's conduct is governed exclusively by section 521(a)(4). *See id.*

Second, if section 542(a) applied to debtors, then section 521(a)(4) would be rendered meaningless. *See FCC v. NextWave Personal Communications, Inc.*, 537 U.S. 293, 302 (2003) (rejecting interpretation of the Code that would render provisions inoperative); *In re Cervantes*, 219 F.3d 955, 960 (9th Cir. 2000) ("statutes should not be construed in a manner which robs specific provisions of independent effect."). After all, it is senseless to impose section 542 turnover rules on parties who are already obligated to deliver property by operation of section 521.

The legislative history behind these distinct mechanisms further supports this interpretation. Congress enacted Section 542(a) because of "the need for a provision authorizing the turnover of property of the debtor in the possession of secured creditors." *Whiting Pools*, 462 U.S. at 207-08. Nowhere in this history did Congress suggest that turnover served any useful purpose in obtaining estate property from debtors themselves.

Of course, the bankruptcy court is not powerless to order debtors to deliver property to trustees. But its power is governed by the different terms of Section

521, which does not contain the valuation language the bankruptcy court relied upon here.

CONCLUSION

For the above reasons, *amici curiae* ask this court to reverse the decision of the district court.

Respectfully submitted,

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STATEMENT OF RELATED CASES

Pursuant to Ninth Circuit Local Rule 28-2.6, Amici hereby states that there are no related cases in this Court.

CERTIFICATE OF COMPLIANCE

1. This brief complies with the type-volume limitation of Fed. R. App. P. 29(d) and Ninth Circuit Local Rule 29(d) because this brief contains 6,982 words, excluding parts exempted by Fed. R. App. P. 32(a)(7)(B)(iii).

2. This filing complies with Fed. R. App. P. 32(a)(5) and the type style requirements of Fed. R. App. P. 32(a)(6) because this brief has been prepared in a proportionally spaced typeface using Microsoft Word in Times New Roman 14-point type.

3. This brief has been scanned for viruses pursuant to Rule 27(h)(2).

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CERTIFICATE OF SERVICE

I hereby certify that I electronically filed the foregoing with the Clerk of the Court for the United States Court of Appeals for the Ninth Circuit by using the appellate CM/ECF system on November 16, 2017. I certify that all participants in the case are registered CM/ECF users and that service will be accomplished by the appellate CM/ECF system.

/s/ Jon Erik Heath
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