May 1, 2007

The Honorable Linda T. Sanchez
Chair
Subcommittee on Commercial and Administrative Law
Committee on the Judiciary
U.S. House of Representatives
Washington, D.C. 20515

The Honorable Chris Cannon
Ranking Member
Subcommittee on Commercial and Administrative Law
Committee on the Judiciary
U.S. House of Representatives
Washington, D.C. 20515


Dear Chairwoman Sanchez and Ranking Member Cannon:

On behalf of the American Bar Association (“ABA”) and its more than 415,000 members, I write to express our views concerning the subject of your Subcommittee’s hearing on “The Second Anniversary of the Enactment of the Bankruptcy Abuse Prevention and Consumer Protection Act [P.L. 109-8]: Are Consumers Really Being Protected Under the Act?” We ask that this letter be included in the official record of today’s hearing.

Although the ABA supports several narrow provisions in the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (the “Act”) that allow direct appeals of final bankruptcy orders to the courts of appeals and permit bankruptcy attorneys to pay referral fees to nonprofit attorney referral programs, the ABA strongly opposes three other provisions in the new law, explained more fully below, that dramatically increase the liability and administrative burdens of bankruptcy attorneys while denying effective legal representation to many Americans. Accordingly, the ABA has prepared a draft “technical corrections” bill that would reverse these provisions in the new law, and we encourage the Subcommittee to support this or similar legislation. We also urge the Subcommittee to support legislation that would add a partnership bankruptcy structure to the existing Bankruptcy Code.

**Direct Appeals of Bankruptcy Court Orders**

The ABA strongly supports Section 1233 of the Act, titled “Direct Appeals of Bankruptcy Matters to Courts of Appeals.” That section, codified at 28 U.S.C. § 158, reflects a compromise reached between representatives of the ABA and the Judicial Conference of the United States and established a procedure that allows parties to
appeal certain bankruptcy court decisions, judgments, orders and decrees directly to the circuit courts of appeals by means of a two-step certification and authorization process. The first step is a certification by the bankruptcy court, district court, or bankruptcy appellate panel, acting on its own motion or the request of a party, or all of the appellants and appellees acting jointly. The provision requires the lower court to certify the direct appeal if (i) the bankruptcy court, district court, or bankruptcy appellate panel determines that one or more of the standards are met or (ii) a majority of the appellants and a majority of the appellees request certification and represent that one or more of the standards are met. The provision also authorizes all of the appellants and appellees acting jointly to certify a direct appeal. Once a direct appeal has been certified by the lower court, the second step is authorization by the circuit court of appeals. Under this second step, while the court of appeals is given discretion whether to accept the direct appeal, the ABA understood at the time that direct appeals would be liberally granted once they were certified. Jurisdiction for the direct appeal will exist only in those cases in which the court of appeals chooses to authorize it.

The ABA believes that the direct appeals system created by Section 1233 is a clear improvement over the previous system of bankruptcy appeals. Under the earlier system, a bankruptcy order—unlike other federal trial court orders—was subject to an additional level of review: the appeal first had to go to either a district court or a bankruptcy appellate panel (“BAP”) before the appeal could go to a circuit court. The two-level bankruptcy appellate process was extremely unusual. In our view, the multi-tiered bankruptcy appellate structure worked poorly and imposed unnecessary delays and costs on all parties. In addition, as stated in the Judicial Conference’s 1995 Long Range Plan for the Federal Courts: “Under…[the previous] practice, district courts and BAP decisions are not treated as stare decisis in other cases—resulting in a ‘patchwork’ of differing legal interpretations that encourage forum shopping and undermine the national system of [a uniform] bankruptcy law.” (p. 48) For these and other reasons, the bipartisan National Bankruptcy Review Commission voted unanimously in 1997 to support a direct appeals system.

Although the Act has not been in force long enough to generate conclusive data as to the effects of the direct appeals provision, the ABA believes that over time, the new system—which parallels the track of civil appeals much more closely than the earlier bankruptcy appellate system—will result in:

- Faster final decisions;
- Greater certainty, uniform interpretation, and decisions of precedential value with respect to key bankruptcy issues; and
- Reduction in unnecessary bankruptcy litigation.

Ultimately, the ABA believes that the direct appeals system created by the Act will aid in achieving the important goal of reducing the time and costs associated with the bankruptcy process and will also assist in harmonizing bankruptcy laws and non-bankruptcy laws generally.
Sharing Fees with Nonprofit Attorney Referral Programs

The ABA also supports Section 326 of the Act, titled “Sharing of Compensation,” which amended Section 504 of the Bankruptcy Code to allow bankruptcy attorneys to pay referral fees to bona fide public service attorney referral programs. See 11 U.S.C. § 504. These nonprofit attorney referral programs, many of which are affiliated with state and local bars around the country, provide a valuable and highly visible service to the community by serving two critical functions: providing information to consumers about their legal concerns and, if appropriate, making a referral to an attorney who is capable of providing appropriate legal services to the consumer. Most of these referral programs in the U.S. support their operations by charging a percentage fee to each attorney who receives a case from the service, and this system has been very effective in the roughly 34 states that currently utilize this system.

Prior to the passage of the Act, the language of Section 504 of the Bankruptcy Code inadvertently prohibited bankruptcy attorneys from sharing their fees with these nonprofit lawyer referral programs. In particular, previous Section 504 of the Code prohibited fee-splitting arrangements except where (1) a person is a partner or otherwise associated with an individual compensated from an estate or (2) an estate-compensated attorney for a creditor who filed an involuntary case under Section 303 is assisted by another attorney. But this prohibition was similar to the general fee splitting prohibition applicable to all other types of lawyers contained in the ABA Model Rules of Professional Conduct, for which an exception had been made specifically for public service lawyer referral programs. By eliminating this irrational distinction between bankruptcy and non-bankruptcy lawyers and allowing the former to pay referral fees to nonprofit attorney referral programs, Section 326 of the Act has made a substantial contribution to the financial health of these nonprofit referral programs. As a result, this provision in the Code has benefited—and will continue to benefit—many thousands of consumers around the nation every year.

Bankruptcy Attorney Liability Provisions

The ABA and over 25 state and local bars throughout the country strongly oppose those provisions in the new law that require debtor bankruptcy attorneys to: (1) certify the accuracy of the debtor’s bankruptcy schedules, under penalty of harsh court sanctions [see Section 102, codified at 11 U.S.C. § 707(b), et al., and Section 319]; (2) certify the ability of the debtor to make future payments under reaffirmation agreements [see Section 203(a), codified at 11 U.S.C. § 524]; and (3) identify and advertise themselves as “debt relief agencies” subject to a host of new intrusive regulations that interfere with the confidential attorney-client relationship [see Sections 227-229, codified at 11 U.S.C. §§ 526-528]. The ABA believes that these attorney liability provisions in the Act, discussed in greater detail below, have been highly detrimental to the nation’s bankruptcy system and should be repealed.

(1) Certification of Bankruptcy Schedules and Related Attorney Sanctions

The ABA strongly opposes the language in Sections 102 and 319 of the Act that requires the debtor’s attorney to certify the accuracy of all factual allegations in the debtor’s schedules of assets and liabilities and subjects the attorney to harsh court sanctions if any factual inaccuracies result in the dismissal of the debtor’s Chapter 7 bankruptcy petition or in its conversion to a Chapter 13.
During House-Senate conference committee negotiations in 2002 on a previous version of the legislation (i.e., H.R. 333), the provision requiring the court to impose sanctions against attorneys for inaccurate bankruptcy schedules was replaced with a discretionary standard. Although that change was a significant improvement, the final language contained in Sections 102 and 319 of the Act still has had a significant negative impact on bankruptcy attorneys, debtors, and the bankruptcy system.

Prior to enactment of Sections 102 and 319, the debtors themselves were solely responsible for the accuracy of the schedules they filed with the bankruptcy court, and they were required to sign and certify these schedules under penalty of perjury. If the debtor filed false schedules, he or she was subject to strict sanctions and criminal penalties, including stiff fines and up to five years in prison. In addition, Bankruptcy Rule 9011 required both debtor and creditor bankruptcy attorneys, like all other attorneys appearing in federal courts, to certify that pleadings and other items that they prepare are supported by the facts before they are filed with the court. This rule, which was identical in form and substance to Federal Rule of Civil Procedure 11, applied to all pleadings and motions filed with the bankruptcy court. By its own terms, however, Rule 9011 did not apply to the bankruptcy schedules listing the debtor’s financial information. Because those schedules are prepared almost entirely with information supplied directly by the debtor, Rule 9011 allowed bankruptcy attorneys to rely in good faith upon the accuracy of this information provided by the client. Therefore, the debtor alone was held responsible for the truthfulness and accuracy of the schedules.

Sections 102 and 319 of the Act changed existing law by creating a new and higher standard for debtor bankruptcy attorneys that goes well beyond the standards imposed upon other attorneys. By creating new subsections 4(A) – (D) to 11 U.S.C. § 707(b) and modifying Rule 9011, Sections 102 and 319 for the first time began to hold the debtor’s attorney—instead of the debtor—financially responsible for any factual errors contained in the debtor’s bankruptcy schedules. Therefore, if even innocent errors in the schedules result in the dismissal of the petition or in its conversion to a Chapter 13 proceeding, the debtor’s attorney now can be held financially responsible unless it is proven that the attorney conducted a time-consuming and costly investigation of these factual allegations before the filing.

In addition, while previous Bankruptcy Rule 9011 held all bankruptcy attorneys to the same standards, Sections 102 and 319 of the Act unfairly discriminate between debtor and creditor attorneys. These sections provide that if the debtor’s schedules are found to violate Rule 9011 and the debtor is denied a discharge under the means test outlined in the Act, the debtor’s attorney will be subject to harsh court sanctions and could be held personally liable for the attorneys’ fees of the trustee or bankruptcy administrator who contested the discharge, as well as civil penalties. Because malpractice carriers have indicated they will exclude this new liability from coverage under their policies or charge substantially higher rates and/or deductibles, the debtor attorney’s exposure will be even greater. In contrast, attorneys representing creditors were not required to certify the accuracy of their clients’ factual information and were not subjected to any comparable new sanctions under the new law.

The new standards outlined in Sections 102 and 319 of the Act also have fundamentally altered the attorney-client relationship in bankruptcy cases. It has transformed the attorney from an advocate
to a detective and informer. The legislation created an unwavitable conflict of interest because the
attorney is unable to accept information provided by the client at face value without risking liability
if the information later proves to be inaccurate. Further, the debtor’s attorney now is required to
independently verify the client’s factual representations.

Requiring the debtor’s attorney to verify all of the client’s representations has raised significantly
the cost to the debtor of filing for bankruptcy. As a result of the new obligations and liability
imposed on attorneys by Sections 102 and 319, many bankruptcy lawyers will no longer agree to
accept debtors’ cases because they are not willing to become their client’s insurer. In addition,
those bankruptcy lawyers who continue to represent debtors now are forced to charge substantially
higher fees (which many debtors are unable to afford). Therefore, the practical effect of these
provisions has been to deny many debtors timely, effective, and affordable representation just when
they need it most. For all of these reasons, the ABA believes that Section 319 and new subsections
4(A), (B), and (D) contained in Section 102 are counterproductive and should be repealed.

(2) Certification of Reaffirmation Agreements

The ABA also opposes those provisions in Section 203(a) of the Act that require attorneys to certify
the debtor’s ability to make future payments under reaffirmation agreements.

Under previous law, a debtor was not required to accept the discharge of all outstanding debt.
Instead, the debtor could choose to reaffirm certain debts—and retain liability for these debts—if
the attorney certified that the decision was voluntary and would not create undue hardship for the
debtor or the debtor’s dependants. Section 203(a) changes these procedures by again imposing new
burdens on the debtor’s attorney. Unlike the previous law, which simply required the debtor’s
attorney to certify in writing that the reaffirmation agreement was voluntary and would not cause
the debtor undue hardship, the new provisions require the attorney to certify that “the debtor is able
to make the [reaffirmation] payment,” in cases where there is a presumption of undue hardship
under the debtor’s budget (i.e., if the debtor’s monthly income is less than monthly expenses,
including the reaffirmation payments).

Bankruptcy attorneys are not accountants and are neither trained nor equipped to conduct extensive
audits of their clients’ finances, nor do they make financial or household budgeting decisions for
their clients. Indeed, this is not the attorney’s proper role, and any attempt to force the attorney to
assume these duties will substantially increase the cost of representing a debtor in bankruptcy.
Therefore, this certification requirement, like the certification requirement in Sections 102 and 319,
has discouraged many attorneys from representing debtors, while forcing the remaining debtors’
attorneys to charge higher fees to cover the substantial additional costs and risk.

The new certification requirement contained in Section 203(a) of the Act also creates strong
conflicts of interest between the debtor and the attorney in those instances when the debtor wants to
reaffirm a debt and instructs the attorney to certify the debtor’s ability to make payments. If the
attorney follows the client’s directive, the attorney may become subject to sanctions under
Bankruptcy Rule 9011—or to a lawsuit by the creditor—if the debtor later proves unable to pay the
reaffirmed debt. This new mandate is particularly unfair because creditor’s attorneys are not
subject to sanctions under Rule 9011 for their clients’ false disclosures or illegal collection practices
even if they acted in bad faith for vexatious purposes. For all of these reasons, the ABA believes that the provisions in Section 203(a) requiring debtors’ attorneys to certify their clients’ ability to make reaffirmation payments are inappropriate and should be repealed.

(3) “Debt Relief Agency” Provisions

The ABA also strongly opposes those provisions in Sections 227-229 of the Act that require bankruptcy attorneys to identify and advertise themselves as “debt relief agencies” and then comply with a host of new intrusive and burdensome regulations. These provisions confuse the public, seriously interfere with the attorney-client relationship, and impose unfair additional burdens and liability on debtors’ attorneys that constitute an unjustified government invasion of the relationship between private attorneys and their clients.

Under these provisions, any “person”—including both bankruptcy attorneys and non-attorney “bankruptcy petition preparers”—who assists individual debtors with their bankruptcies in return for compensation is deemed to be a “debt relief agency.” Unfortunately, the provisions fail to take into account any of the important differences between attorneys and non-attorneys providing bankruptcy services. Under current law, only attorneys are permitted to give legal advice, file pleadings, or represent debtors in bankruptcy hearings. In addition, unlike non-attorney bankruptcy petition preparers, only attorneys are licensed by the state in which they practice, bound by canons of ethics, and subject to discipline by the courts in which they practice. More importantly, only those communications between the debtor and his or her attorney are protected by the attorney-client privilege. Requiring both attorneys and non-attorney bankruptcy petition preparers to advertise themselves as “debt relief agencies” obscures these important distinctions while creating substantial confusion among the public.

The “debt relief agency” provisions in the Act also interfere with the attorney-client relationship in a variety of ways. Because the definition is worded so broadly, it may be construed to apply not just to bankruptcy attorneys, but also to family attorneys, tax attorneys, criminal and civil defense attorneys, and general practitioners who, in the course of representing their clients, are compelled to advise them to consider filing bankruptcy to protect their rights. This jeopardizes the attorney’s ability to properly advise his or her client regarding their legal rights.

Any attorney who assists a client with bankruptcy is subject to a long list of new regulations under the new law. In particular, such attorneys now are required to provide lengthy written disclosure statements to potential and existing bankruptcy clients that explain the bankruptcy system and provide general, government-approved legal advice. In addition, attorneys now are required to advise the debtor in writing that the debtor need not be represented by a lawyer in the bankruptcy or in related litigation, which in many cases is bad advice.

By requiring that the debtor’s attorney provide the debtor with preprinted, government-approved legal advice on bankruptcy law, and by forcing the attorney to state in writing that the debtor need not even retain a lawyer, the Act usurps the attorney’s role as the proper legal representative of the debtor. Perhaps even more troubling, the Act also prohibits the attorney from giving certain proper pre-bankruptcy planning advice to the client, including advice to pay certain lawful obligations or to incur certain debts. In fact, these provisions are worded so broadly that the attorney could be
subject to liability merely for making an unsuccessful attempt to help the client restructure the debt to avoid bankruptcy. These provisions, which dictate the types and content of legal advice that an attorney can and cannot render to his client, are particularly destructive of the attorney-client relationship.

Sections 227-229 also require attorneys to provide the debtor with a written contract, and if the contract fails to comply with each of the detailed requirements outlined in the Act, it could become void and unenforceable. Furthermore, if the debtor’s attorney fails to follow any of the many technical requirements of the Act, the attorney could forfeit the entire fee and could be sued in state or federal court by the debtor, the trustee, or state law enforcement officials for actual damages, civil penalties, attorneys’ fees, and costs. Although pre-existing law and ethical rules already required all attorneys to provide quality legal representation to their clients, Sections 227-229 go well beyond those general standards and unfairly subject just one type of attorney—debtors’ bankruptcy attorneys—to a far stricter standard than attorneys in any other field of practice.

In addition, Section 229 also seeks to micromanage the bankruptcy attorney’s advertising by requiring the attorney to include a conspicuous—and awkward—statement in all its advertising stating that “We are a debt relief agency. We help people file for bankruptcy relief under the Bankruptcy Code.” No such requirements apply to creditors’ attorneys under the Act. These new advertising regulations could conflict with the well-established advertising rules that have already been established by many state supreme courts and state bars and will confuse the public. In addition, requiring attorneys to label themselves as “debt relief agencies” will discourage general practitioners and bankruptcy professionals who have a consumer and business, debtor and creditor practice from advertising the availability of bankruptcy services, thus limiting consumer bankruptcy representation to attorneys with narrower practices. For all of these reasons, the ABA believes that the Act should be amended to exempt attorneys—who are already heavily regulated by their respective state courts, state bars, and federal courts—from the coverage of the “debt relief agency” provisions contained in Sections 227-229.

In recent months, the constitutionality of certain “debt relief agency” provisions in the Act has been called into serious question by the federal courts. Several different U.S. District Courts have held that as a matter of law, the portion of the debt relief agency provisions in the new statute prohibiting the rendering of certain legal advice violates the attorney’s First Amendment rights. See Susan B. Hersch v. United States, 347 B.R. 19 (N.D. Tex. 2006) and Olsen v. Gonzales, 350 B.R. 906 (D. Or. 2006). In addition, a number of courts have held that the term “debt relief agency” does not apply to licensed attorneys, but that if it did apply, it would violate the attorneys’ First Amendment rights. See, e.g., Milavetz, Gallop & Milavetz P.A. v. United States, 355 B.R. 758 (Minn. 2006); and In Re Reyes, 2007 WL 136934 (Bankr. S.D. Fla.). Meanwhile, on May 11, 2006, the Connecticut Bar Association and the National Association of Consumer Bankruptcy Attorneys filed suit in U.S. District Court in Connecticut challenging the constitutionality of the Act’s debt relief agency provisions. See Connecticut Bar Association v. United States, No. 3:06-cv-00729 (D. Conn.) The suit seeks a preliminary injunction prohibiting application of these provisions to attorneys, but the court has not yet set a hearing date.

All three attorney liability provisions outlined above, taken together, have been highly detrimental to the nation’s bankruptcy system and substantially reduced the availability of pro bono legal
representation. These provisions have discouraged many attorneys from agreeing to represent debtors at all and are making bankruptcy representation unaffordable for countless numbers of Americans. In addition, these provisions already have discouraged many attorneys from providing essential *pro bono* bankruptcy services to the nation’s poor. Indeed, since the Act became law, many large law firms that previously encouraged its lawyers to provide *pro bono* bankruptcy representation to the poor are now instructing their lawyers that because of the new attorney-liability provisions in the Act, they may not accept any more such cases. With fewer attorneys available to represent debtors, many more debtors have been forced to file their bankruptcies *pro se*, without first obtaining adequate advice regarding the necessity or advisability of filing for bankruptcy. Unless these provisions are remedied, they will continue to have an adverse effect on debtors, creditors, and the bankruptcy system as a whole.

The ABA has prepared a draft “technical corrections” bankruptcy bill that would correct the problems created by the bankruptcy attorney liability provisions in P.L. 109-8, and the text of the draft bill is attached as Appendix A. Instead of unfairly punishing attorneys who provide legal services to debtors in bankruptcy, the draft bill would replace the harmful attorney liability provisions in P.L. 109-8 with new language instructing the courts to more vigorously enforce existing Bankruptcy Rule 9011 when misconduct by any attorney or party in the case is shown. The draft bill would also amend the definition of "debt relief agency" in the Act to exclude attorneys (who are already licensed and heavily regulated by their state supreme courts, state bars, and federal courts) while leaving these new regulations in the bill in place for the non-attorney bankruptcy petition preparers (who are now largely unregulated). The draft bill would reduce fraud and abuse in a far more effective and equitable manner, and we urge all members of the Subcommittee to support this or similar legislation.

**Partnerships in Bankruptcy**

The ABA also believes that the Bankruptcy Code could be further improved by enacting legislation that would add a partnership bankruptcy structure to the Code.

Partnerships are a popular vehicle for doing business. Partnerships include the two person small business, the single asset real estate venture, and the large professional service firm. By its nature, the general partnership does not afford limited liability to its members. Rather, the liability of general partners for partnership debt is determined by state law and the partnership agreement. Consequently, the determination and enforcement of liability for the debts of an insolvent partnership involves a multitude of difficult and seemingly unanswerable questions.

The complexities of the intersection between partnership and insolvency laws have defied resolution. The result is that currently only one provision of the Bankruptcy Code—11 U.S.C. § 723—addresses a partnership bankruptcy. This section authorizes the trustee of a partnership in a Chapter 7 liquidation to claim and collect a deficiency of the partnership estate from a general partner and does not apply to Chapter 11 reorganizations.

In 1996, the ABA adopted policy recommending that Congress enact legislation providing for the administration and resolution of partnership cases under the Bankruptcy Code. The proposed
amendments to the Bankruptcy Code, and the ABA resolution endorsing these amendments, are attached as Appendix B.

The estate of many partnerships, especially professional or service partnerships, can be preserved only by the Chapter 11 process. This fact has been exemplified by a number of bankruptcies involving insolvent professional partnerships, all of which involve remarkably similar facts. Each involved either a large law or accounting firm which sought Chapter 11 bankruptcy relief to wind up its affairs. In each case, the bankruptcy court was forced to formulate a remedy that would encourage voluntary contribution by general partners to maximize the distribution of property of the estate and simultaneously avoid unnecessary bankruptcy filings by partners and unnecessary litigation. It also became clear in each case that the issuance of an injunction or its equivalent to bar future actions against contributing partners was the sine qua non of the confirmed plan.

The ABA has carefully evaluated the problems and solutions set forth in the foregoing cases in formulating the proposed amendments to the Bankruptcy Code. The extended stay, which is analogous to a permanent injunction, is a key factor of the amendments. Although the foregoing cases involve large professional partnerships, the problems encountered and the resolutions embraced are equally applicable to all partnership bankruptcy cases.

The ABA believes that the Bankruptcy Code should be amended so that a partnership bankruptcy will trigger an automatic stay of a limited duration of sixty days. Although general partners may be liable for some or all of the debts of the partnership under non-bankruptcy law, the courts have generally given heed to the literal language of the Bankruptcy Code and its legislative history negating the argument that the property of a partnership includes the property of its member general partners. Thus, the automatic stay has been generally held not to bar actions, proceedings, or acts directed against a general partner or its property.

Experience in the administration of partnership cases has demonstrated the crucial importance in Chapter 11 partnership cases of the issuance of an injunction against the enforcement of partnership creditors’ rights against general partners and their property. The automatic stay will prohibit partnership creditors from exercising their collection efforts against partners or partners’ property. The purpose of the automatic stay is to preserve the partners’ property for distribution in the partnership case. By obviating the necessity for the partnership trustee or the partnership as a debtor-in-possession to seek and obtain an injunction against actions, proceedings and acts by partnership creditors directed against general partners, the extended stay accomplishes the same purpose and result for the benefit of the partnership creditors, insofar as the general partner’s assets liable for the partnership debts are concerned, as the automatic stay of Section 362 does with respect to the partnership assets.

Further, the American Bar Association proposes an amendment that would allow the stay to be extended to non-debtor partners as a part of the confirmation of a plan. Courts should be permitted to issue an extended stay of actions, proceedings and acts against a general partner in a partnership

1 These bankruptcy cases studied by the ABA include the following: (1) Finley, Kumble, Wagner, Heine, Underberg, Manley, Myerson & Casey (Bankr. S.D.N.Y.); (2) Myerson & Kuhn (Bankr. S.D.N.Y.); (3) Laventhol & Horwath (Bankr. S.D.N.Y.); (4) Heron, Burchette, Ruckert & Rothwell (Bankr. D.D.C.); and (5) Gaston & Snow (Bankr. S.D.N.Y.).
case when the general partner has made a contribution to the payment of the partnership’s debts, or assumed a commitment to make such a contribution in accordance with the provisions of a confirmed plan or order confirming a plan. Experience has demonstrated that recoveries by partnership creditors may be significantly enhanced if general partners can be persuaded to contribute to a recovery pool, post-petition future earnings, exempt property, and other assets not otherwise available to partnership creditors, in exchange for protection against collection suits by partnership creditors and suits for contribution and indemnification by copartners and the trustee of the partnership or the partnership as a debtor-in-possession.

Without the extended stay, individual creditors would sue individual general partners, and general partners would then cross-claim against each other for contribution and sue the debtor for indemnification. The probable result would be a costly and time-consuming web of litigation replete with attendant attachments, garnishments and executions. Personal bankruptcy would be a likely consequence for many. By preventing a haphazard scramble for the assets of general partners, and by facilitating an orderly distribution scheme, the permanent injunction under the extended stay ensures that general partners will be protected and that creditors’ recoveries will be maximized. The extended stay should not bar actions, proceedings, or acts against general partners who do not assume a commitment or fail to fulfill a commitment to pay partnership debts. The extended stay does not constitute nor may it be deemed to be a release of joint tortfeasors. Because the extended stay is tied to confirmation of a plan, compliance with the “best interests of creditors” test, which is inherent in the confirmation process, is ensured.

In sum, the ABA urges the Subcommittee to support legislation, generally in the form of the attached Appendix B, to establish a partnership bankruptcy structure in the Code. As part of this new structure, the ABA endorses an automatic stay inhibiting post-bankruptcy suits against general partners for partnership liabilities, to remain in effect for sixty days after a bankruptcy filing. The ABA also believes that such an amendment should include automatic stays of transfers outside the ordinary course of non-bankruptcy property by general partners of the filing partnership.

Thank you for considering the views of the ABA on these important bankruptcy matters. If you would like more information regarding the ABA’s positions on these issues, your staff may contact our senior legislative counsel for bankruptcy law issues, Larson Frisby, at (202) 662-1098.

Sincerely,

Denise A. Cardman
Acting Director

cc: All members of the House Judiciary Subcommittee on Commercial and Administrative Law
APPENDIX A

110TH CONGRESS
1ST SESSION

To amend title 11, United States Code, to make technical amendments relating to bankruptcy, and for other purposes.

________________________

IN THE _______ OF THE UNITED STATES

____ introduced the following bill; which was read twice and referred to the Committee on

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A BILL

To amend title 11, United States Code, to make technical amendments relating to bankruptcy, and for other purposes.

1 Be it enacted by the Senate and House of Representatives of
2 the United States of America in Congress assembled,

3 SECTION 1. SHORT TITLE.

4 This Act may be cited as the "Bankruptcy Reform Technical
5 Amendments Act of 2007".

6 SEC. 2. EFFECTIVE DATE.

7 This Act and the amendments made by this Act shall become
8 effective on the date of enactment of this Act.
TITLE I—ATTORNEY SANCTIONS

SEC. 101. SIGNATURE OF ATTORNEY

Section 707(b)(4) of title 11, United States Code, is amended to read as follows:

“(4) The signature of an attorney on a petition, pleading, or written motion shall constitute a certification that the attorney has—

(A) performed a reasonable investigation into the circumstances that gave rise to the petition, pleading, or written motion; and

(B) determined that the petition, pleading, or written motion—

(i) is well grounded in fact; and

(ii) is warranted by existing law or a good faith argument for the extension, modification, or reversal of existing law and does not constitute an abuse under paragraph (1).”

SEC. 102. GROUNDS FOR AWARD OF COSTS

Section 707(b)(5)(A)(ii)(II) of title 11, United States Code, is amended by striking “requirements of clauses (i) and (ii) of paragraph (4)(C)” and inserting “requirements of clauses (A) and (B) of paragraph (4)”.

SEC. 103. REAFFIRMATION AGREEMENT CERTIFICATIONS

Section 524(k)(5) of title 11, United States Code, is amended—

(1) by striking subparagraphs (B) and (C); and
(2) by striking “consist of” and all that follows through
“(A) The following” and inserting “consist of the following”.

SEC. 104. DEFINITION OF DEBT RELIEF AGENCY.

Section 101 (12A) of title 11, United States Code, is amended
by inserting “, other than an attorney or an employee of an attorney,“
after “means any person”.

SEC. 105. DISCLOSURES.

Section 527(b) of title 11, United States Code, is amended—

(1) by striking “AN ATTORNEY OR” each place that
term appears and inserting “A”; and

(2) by striking “THE ATTORNEY OR” and inserting
“THE”.

SEC. 106. SENSE OF CONGRESS REGARDING ENFORCEMENT
OF RULE 9011 OF THE FEDERAL RULES OF
BANKRUPTCY PROCEDURE.

Title III of the Bankruptcy Abuse Prevention and Consumer
Protection Act of 2005 (Public Law 109-8, 119 Stat. 75) is amended
by striking section 319 and inserting the following:

“SEC. 319. SENSE OF CONGRESS REGARDING
ENFORCEMENT OF RULE 9011 OF THE
FEDERAL RULES OF BANKRUPTCY
PROCEDURE.

“It is the sense of Congress that significant fraud and abuse
exists in the bankruptcy system, and that in order to curb such
fraud and abuse, Federal bankruptcy courts should vigorously enforce rule 9011 of the Federal Rules of Bankruptcy procedure (11 U.S.C. App.)."
APPENDIX B

RESOLUTION ADOPTED BY THE

HOUSE OF DELEGATES

OF THE

AMERICAN BAR ASSOCIATION

AUGUST 1996*

RECOMMENDATION

1 RESOLVED, That the American Bar Association approves the proposed amendments to
2 the Bankruptcy Code generally in the form attached as Appendix A dated May, 1996, to the
3 Report accompanying this Recommendation and urges that the proposed amendments be
4 approved and adopted by the National Bankruptcy Review Commission and Congress as the
5 basis for administration and resolution of partnership cases under the Bankruptcy Code.

*Note: The “Recommendation” and “Proposed Amendments,” but not the “Report,” constitute
official ABA policy.
REPORT

The Ad Hoc Committee is comprised of representatives from the Tax, Partnership, and Business Bankruptcy Committees. The Ad Hoc Committee has proposed amendments to the Bankruptcy Code which form the basis for administration and resolution of partnership cases under the Bankruptcy Code. The proposed amendments to the Bankruptcy Code are attached as Appendix A.

An overview of the proposed amendments is found in an article by Morris W. Macey and Frank R. Kennedy entitled "Partnership Bankruptcy and Reorganization: Proposals for Reform," which appears in Volume 50, Number 3 of The Business Lawyer. Professor Kennedy, the original Reporter for the Bankruptcy Code, has served as the Reporter for the Ad Hoc Committee.

The Ad Hoc Committee has always conducted open meetings. Consequently, there has been broad based participation in the work of the Committee.

Partnerships are a popular vehicle for doing business. Partnerships include the two person small business, the single asset real estate venture, and the large professional service firm. By its nature, the general partnership does not afford limited liability to its members. Rather, the liability of members of a partnership for debts of the partnership is determined by state law and the partnership agreement. Consequently, the determination and enforcement of liability for the debts of an insolvent partnership involves a multitude of difficult and seemingly unanswerable questions.

The complexities of the intersection between partnership and insolvency laws have defied resolution. The result is that currently only one provision of the Bankruptcy Code — 11 U.S.C. § 723 — addresses a partnership bankruptcy. This section authorizes the trustee of a partnership in a Chapter 7 liquidation to claim and collect a deficiency of the partnership estate from a general partner and does not apply to Chapter 11 reorganizations.

The estate of many partnerships, especially professional or service partnerships, can be preserved only by the Chapter 11 process. This fact has been exemplified by five recent bankruptcies involving insolvent professional partnerships: (1) Finley, Kumble, Wagner, Heine, Underberg, Manley, Myerson & Casey (Bankr. S.D.N.Y.); (2) Myerson & Kuhn (Bankr. S.D.N.Y.); (3) Laventhal & Horwath (Bankr. S.D.N.Y.); (4) Heron, Burchette, Ruckert & Rothwell (Bankr. D.D.C.); and (5) Gaston & Snow (Bankr. S.D.N.Y.).

These five cases involve remarkably similar facts. Each involved either a large law or accounting firm which sought Chapter 11 bankruptcy relief to wind up its affairs. In each case, the bankruptcy court was forced to formulate a remedy that would encourage voluntary contribution by general partners to maximize the distribution of property of the estate and simultaneously avoid unnecessary bankruptcy filings by partners and unnecessary litigation.

In each of the cases it was clear that the issuance of an injunction or its equivalent to bar future actions against contributing partners was the sine qua non of the confirmed plan. As the Court stated in Heron, Burchette, 148 B.R. 660, 667 (Bankr. D. D.C. 1992):
The injunction is also essential to provide maximum payout and fair distribution under the plan. The absence of an injunction would result in extensive litigation and personal bankruptcies for many partners. Many smaller creditors would not be able to maintain their claims as it would not be worth the cost. Thus, the entry of the permanent injunction benefits all the creditors being enjoined and is consistent with the Code's goal of maximizing return on a collective basis to all creditors.

The Ad Hoc Committee carefully evaluated the problems and solutions set forth in the foregoing cases in formulating the proposed amendments to the Bankruptcy Code. The extended stay, which is analogous to a permanent injunction, is a key factor of the amendments. Although the foregoing cases involve large professional partnerships, the problems encountered and the resolutions embraced are equally applicable to all partnership bankruptcy cases. The result of the Ad Hoc Committee's work are the amendments, which propose a new Subchapter IV of Chapter 5 of the Bankruptcy Code.

Under proposed amendment § 563, a bankruptcy of a partnership will trigger an automatic stay of a limited duration of sixty days. The automatic stay will prohibit partnership creditors from exercising their collection efforts against partners or partners' property. The purpose of the automatic stay is to preserve the partners' property for distribution in the partnership case.

Proposed amendment § 564 allows the stay to be extended as nondebtor partners as a part of the confirmation of a plan. Because the extended stay is tied to confirmation of a plan, compliance with the best interests of creditors test, which is inherent in the confirmation process, is ensured.

Proposed amendment § 565 further requires disclosure by partners of their assets and liabilities as a condition of the continuance of the stay. Proposed amendment § 566 prohibits the participating partners from disposing of their property other than in the ordinary course of business or for ordinary and usual personal purposes during the course of the stay.

Respectfully Submitted:

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Herbert S. Wander, Chair
Section of Business Law
## APPENDIX A

### PROPOSED AMENDMENTS TO THE BANKRUPTCY CODE

**RELATING TO PARTNERSHIPS**

May, 1996

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CHAPTER 1—GENERAL PROVISIONS

§ 101. Definition of a general partner

(26A) except as provided in section 561, "general partner" means an entity that as a result of an existing or former status as an actual or purported general partner in an existing, former, predecessor, or affiliated partnership, is liable under applicable nonbankruptcy law for one or more of the debts of the partnership.

Comment

When the Bankruptcy Code refers to "general partner," the reference includes any entity that is liable for the debts of a partnership by reason of a status as a "general partner" in the partnership, whether the status was coexistent with the partnership from the filing of the petition or preexisting. See Tatge v. Chandler (In re Judiciary Tower Associates), 175 B.R. 796, 802 (Bankr. D.D.C. 1994); cf., Kipperman v. Youssef (In re Miramar Mall Limited Partnership, Inc.), 152 B.R. 631 (Bankr. S.D. Cal. 1993) (general partner not personally liable for partnership debts that predated his admission to the partnership). The definition of "general partner" includes any entity liable as a general partner by estoppel, as an implied general partner, or otherwise under applicable nonbankruptcy law. A general partner does not include any entity liable solely as a guarantor of a partnership debt. It is immaterial when the status began or when or whether it was terminated so long as the entity is personally liable for debts of the partnership. The applicability of the definition of "general partner" is not affected by special characterizations in the partnership agreement, e.g., as a "contract partner" or "senior principal."

CHAPTER 3—CASE ADMINISTRATION

SUBCHAPTER I—COMMENCEMENT OF A CASE

§ 303. Involuntary cases

(b) [Delete "or" at the end of subsection (b)(3)(B), delete "(4)" at the beginning of subsection (b)(4), substitute "(5)" therefor, and add insert after subsection (b)(3)(B) the following:]

(4) by the trustee of a partnership against a general partner of such partnership if relief has been ordered under this title with respect to such partnership.

Comment

Section 303(b) of the Bankruptcy Code authorizes creditors of a general partner to file an involuntary petition against a general partner. A creditor of a partnership is eligible to be a petitioner against a general partner. In re Elsub Corp., 66 B.R. 172 (Bankr. D. N.J. 1986) (partnership creditors counted in determining whether general partner had more than 11 creditors
under section 303(b)(2)); In re Lamb, 40 B.R. 689, 692-93 (Bankr. E.D. Tenn. 1984) (trustee of partnership holding judgment against general partner held to be eligible petitioner under section 303(b)(1) & (2)). Under proposed section 562(b) and (d), derived from section 723 of the Bankruptcy Code, the trustee of a partnership debtor is a creditor of a general partner for the full amount of all the claims of creditors allowed in the partnership case. Although the partnership trustee may proceed against a general partner to enforce the general partner’s liability for partnership debts, it may be more efficient and expeditious to administer the general partner’s estate under the Bankruptcy Code. The proposed section 303(b)(4) contemplates that the requirements of section 303(h) would apply to the trustee’s petition, but the number, the amount, and the nature of the claims of the creditors of the partnership or general partner would not be in issue.

CHAPTER 5--CREDITORS, THE DEBTOR, AND THE ESTATE

SUBCHAPTER III--THE ESTATE

§ 541(a)(3).

Substitute “562” for “723.”

SUBCHAPTER IV--CASES OF PARTNERSHIPS

§ 561. Rules applicable to former partners

Notwithstanding section 101(26A), a former partner of a partnership is not, absent a specific court order to the contrary, required to consent to a voluntary petition by a partnership, to be served with a petition or summons in an involuntary case against a partnership, or to perform procedural duties imposed on a general partner of a debtor partnership.

Comment

Bankruptcy Rule 1004(a) requires all general partners to consent to a voluntary petition filed by or on behalf of a partnership, and Bankruptcy Rule 1004(b) requires a copy of an involuntary petition against a partnership and a summons to be served on each general partner. The expanded definition of “general partner” in section 101(26A) is not intended to encumber the commencement of voluntary or involuntary cases by or against partnerships by involving former partners in the pleadings and service of process. Likewise the amended definition of “general partner” is not intended to subject a former partner to duties of disclosure imposed on existing partners by Bankruptcy Rule 1007(g) absent a court order directed to the former partner.

If the changes in sections 101 and 561 proposed above are adopted, the proposed amendment of section 303 by the addition of section 303(1) would be unnecessary, and it should be withdrawn.
§ 562. Rights of partnership trustee against general partners

(a) The court in which a partnership case is pending may determine who is or may be liable as a general partner for the debts of the partnership and may determine the rights among the general partners with respect to the debts of the partnership.

Comment

Section 562(a) clarifies the jurisdiction of the court in which a partnership case is pending to determine the liabilities of the former and current general partners to the trustee (or the partnership as a debtor-in-possession) and to each other by way of contribution or indemnification. The jurisdiction extends to the determination of liabilities of former and current general partners at the time of the commencement of the case.

Section 5d of the Bankruptcy Act purported to confer on the court of bankruptcy which had jurisdiction of one of the general partners “jurisdiction of all the general partners and of the administration of the partnership and individual property.” The comprehensive implications of the provision were never tested in the courts. The subdivision literally seemed to give the bankruptcy court in which a general partner was adjudicated a bankrupt the power to draw the estates of the partnership in which he was a member and of the other general partners into custodia legis for the purpose of administration under the Bankruptcy Act. The subdivision was, however, treated only as a venue provision, depriving the partnership, any other general partner, or any creditor of either of any objection to venue for the administration of a partnership estate or the estate of a general partner if venue had been properly selected for any general partner of the firm. See Meek v. Centre County Banking Co., 268 U.S. 426, 431-32 (1925).

The entry of an order for relief by or against a partnership does not constitute a binding determination of liability of any entity as a general partner who was not notified or given the opportunity to be heard on the issue of its status. See Manson v. Williams, 213 U.S. 453 (1909); Carter v. Whisler, 275 Féd. 743 (8th Cir. 1931); Tate v. Hoover, 345 Pa. 19, 26 A.2d 665, 670, cert. denied, 317 U.S. 677 (1942).

(b) If there is a deficiency of property of the estate to pay in full all claims which are allowed in a partnership case, other than claims for contribution against partners, and with respect to which a general partner of the partnership is personally liable, the trustee shall have a claim against each general partner to the extent that under applicable nonbankruptcy law such general partner is personally liable for such deficiency, which claim shall not be reduced on account of any right of contribution or indemnity among general partners. The amount of the deficiency shall be estimated if its determination would unduly delay the administration of the case. Any action or proceeding to enforce a liability for a deficiency under this section shall be commenced no more than four years after the entry of the initial order for relief in the case concerning the partnership.
Comment

Section 562(b) is an adaptation of section 723(a) of the Bankruptcy Code, extending the right of the trustee of a partnership in a Chapter 7 case under the Code to a partnership trustee in a Chapter 11 or 12 case. The subdivision would codify the views of the rights of a Chapter 11 trustee or debtor-in-possession adopted in the following cases: *Litchfield Co. of S.C. Ltd. Ptshp. v. Anchor Bank (In re Litchfield Co. of S.C. Ltd. Ptshp.), 135 B.R. 797, 802-05 (W.D.N.C. 1992)* (under U.P.A. §§ 18(a) 40(a) and (d), partnership assets held to include “contributions of the [general] partners necessary for the payment of all liabilities,” and these provisions held to empower debtor-in-possession in a partnership case to compel each general partner to contribute to covering losses of partnership); *Tatge v. Chandler (In re Judiciary Tower Associates), 175 B.R. 796, 801-03 (Bankr. D.D.C. 1994)* (former partners held liable to trustee under section 723(a) to the extent of their liability under state law notwithstanding their prepetition withdrawal from the partnership); *Commercial Bank v. Price (In re Notchcliff Associates), 139 B.R. 361, 370-71 (Bankr. D. Md. 1992)* (Chapter 11 trustee of partnership held entitled under confirmed partnership plan to proceed against nondebtor general partners to collect partnership indebtedness pursuant to U.P.A. § 40 and sections 541(a) and 544(a) of the Bankruptcy Code to the extent of the deficiency of the general partners’ assets); *In re Finley, Kumble, Wagner, Heine, Underberg, Manley, Myerson & Casey, Case No. 88B10377(PBA) (Bankr. S.D.N.Y. 1991)* (Chapter 11 plan providing for contributions of $40.7 million by 256 of 284 general partners confirmed); *In re Myerson & Kuhn, Case No. 89B13346(PBA) (Bankr. S.D.N.Y. 1991)* (Chapter 11 plan providing for contributions of $4.4 million by 43 of 51 general partners approved); *In re Laventhal & Horwath, Case No. 90B13346(PBA) (Bankr. S.D.N.Y. 1992)* (Chapter 11 plan providing for contributions of $35 million by 500 of 636 general partners confirmed); *In re Gaston & Snow, Case No. 91B14594(CB) (Bankr. S.D.N.Y. 1993)* (Chapter 11 plan providing for contributions of $10.4 million by 107 of 148 general partners); *cf. National Tax Credit Partners L.P. v. Havlik, 20 F.3d 705, 708 (7th Cir. 1994)* (“The right to collect from the general partners is ‘property of the estate.’”); *In re Safren, 65 B.R. 566, 567-68, 575 (Bankr. C.D. Cal. 1986)* (administrative claim against estate of partnership that had been dismissed held to be a general unsecured claim against consolidated estates of general partners who were debtors-in-possession). The proposed subdivision would overrule the following cases insofar as they declined to grant relief for the benefit of partnership creditors in Chapter 11 cases: *Andrew v. Coopersmith (In re Downtown Investment Club III), 89 B.R. 59, 65 (B.A.P. 9th Cir. 1988)* (bankruptcy court’s modification of Chapter 11 plan by releasing general partner from personal liability for withholding taxes reversed); *Russett, Jarvis, Estabrook & Dashiel v. Kaveney (In re Kaveney), 60 B.R. 34 (B.A.P. 9th Cir. 1985)* (fee application of counsel for trustee of Chapter 11 partnership debtor for services rendered trustee in proceeding against estates of general partner and his wife denied on the ground that section 723 applies only in a Chapter 7 case); *In re Monetary Group, 55 B.R. 297, 298-99 (Bankr. M.D. Fla. 1985)* (section 103(b) held to preclude indemnity by general partners of liquidating partnership); *MBank Corpus Christi v. Seikel (In re I-37 Gulf Limited Partnership), 48 B.R. 647, 650 (Bankr. S.D. Tex. 1985)* (partnership creditor’s motion for turnover of general partner’s assets to partnership debtor-in-possession denied in view of inapplicability of section 723 in Chapter 11 partnership case).
Section 212 of the Bankruptcy Reform Act 1994 was intended to clarify that a general partner of a registered limited liability partnership would be liable in bankruptcy only to the extent a general partner would be personally liable for a deficiency according to the registered limited liability statute under which the partnership was formed. 140 Cong. Record 10768 (daily ed. Oct. 4, 1994). This subsection (b), when read with subsection (f) of this section, accommodates section 212 because it applies nonbankruptcy law to determine the extent of a deficiency claim against the general partner.

The case law is in disarray in dealing with the time applicable to the trustee's recovery of a deficiency under section 723. Several court opinions and commentators treat the cause of action recognized by section 723 as one of the rights accorded a trustee by section 544(a): Andrew v. Coopersmith (In re Downtown Investment Club III), 89 B.R. 59, 65 (B.A.P. 9th Cir. 1988); Marshack v. Mesa Valley Farms, I.P. (In re The Ridge II), 158 B.R. 1016, 1020, 1023-24 (Bankr. C.D. Cal. 1993); Stamps v. Knobloch (In re City Communications, Ltd.), 105 B.R. 1018, 1023-24 (Bankr. N.D. Ga. 1989); Pettigrew v. Barton (In re Barton & Ludwig), 37 B.R. 377, 379 (Bankr. N.D. Ga. 1984); 3 Daniel Cowans, BANKRUPTCY LAW AND PRACTICE § 15.4 (1989); 4 Lawrence P. King, COLLIER ON BANKRUPTCY ¶ 732.02, p. 723.2 (15th ed. 1993). The bankruptcy and district courts in Miller v. Spitz (In re CS Assoc.), 156 B.R. 755 (Bankr. E.D. Pa. 1993) and 150 B.R. 989, 905-06 (Bankr. E.D. Pa. 1993), aff'd sub nom. Silk v. Miller (In re CS Assoc.), 167 B.R. 368, 369 (E.D. Pa. 1994), questioned the coupling of the trustee's rights under section 544 with his rights under section 723. After noting that the trustee's rights under section 544 are directed against third parties and are based on prepetition acts, the bankruptcy court pointed out in 160 B.R. at 904-06 that the right of action recognized by section 723 cause of action cannot accrue until after the determination of the existence and extent of the deficiency, and the district court ultimately held that the assertion of the section 723 cause of action was subject to no statute of limitations. Since there was no lack of diligence on the part of the trustee and no prejudice to the defendant general partner, the trustee's proceeding was not barred by laches. The court in Wilson v. Vanteicher (In re Jones), 161 B.R. 180 (Bankr. N.D. Tex. 1993), applied a state statute of limitations of four years but held that the limitation period did not begin to run until entry of a final judgment for the deficiency in favor of the trustee. Two other cases deeming state limitations to apply to action grounded on section 723 are McGraw v. Betz (In re Bell & Beckwith), 112 B.R. 858, 861-63 (Bankr. N.D. Ohio 1990) and In re Golden H. Packing Co., 11 B.R. 111 (Bankr. D. Nev. 1981) (partnership trustee denied recovery against deceased general partner's estate because of failure to file a claim within applicable probate limitations).

As the court recognized in McGraw v. Betz, supra at 868-69, "[r]equiring the exact deficiency to be determined prior to allowing a trustee to file a complaint would result in § 723(a) being unavailable in all but the most uncomplicated liquidations." The section here proposed authorizes the trustee to proceed to enforce the recovery of its existence and amount and to act on an estimate as it may under section 502(c). The section does not go so far, however, as Silk v. Miller, supra, which declares that no statute of limitations applies to proceedings under section 723. The section enacts a federal cause of action subject to a federal statute of limitations. The section leaves the court free to reduce or extend the period allowable for bringing an action under section 562 when good cause is shown.
(c) Pending determination of such deficiency, the court may order any general partner (i) to provide the estate in such amount as the court shall determine to be appropriate under the circumstances with indemnity for, or assurance of payment of, any deficiency recoverable from such general partner or (ii) not to dispose of property not already subject to a stay under section 566(a) of this title.

Comment


(d) Notwithstanding section 728(c) of this title, the trustee of a partnership has a claim against the estate of each general partner in such partnership that is a debtor in a case under this title for the full amount of all claims of creditors allowed in the case concerning the partnership for which such general partner would be otherwise personally liable as a general partner under applicable nonbankruptcy law. Notwithstanding section 502 of this title, there shall not be allowed in such general partner’s case a claim on which both such general partner and such partnership are liable, except to any extent that such claim is allowable and secured only by property of such general partner and not by property of such partnership.

Comment

Subsection (d) is derived from the first and second sentences of section 723(c). Unlike under section 723(c), however, the claim of a trustee of a debtor partnership against the estate of a debtor general partner includes only the amount of allowed claims against the debtor partnership for which the general partner would otherwise be personally liable under applicable nonbankruptcy law. This provision recognizes that a general partner may not be personally liable for all claims against the partnership and is consistent with the calculation of the claim of the partnership trustee against nondebtor general partners under subsection (b).

(e) The claim of a trustee of a partnership debtor, or the claim of a creditor of a partnership that is not a debtor in a case under this title, is entitled to share in the distribution in a general partner’s case in the same manner and to the same extent as any other claim of the same or similar kind of a creditor of such general partner.

Comment

Section (e) is an adaptation and elaboration of the last sentence of section 723(c) of the Bankruptcy Code. This sentence is the basis for the overstatement in the legislative history of the Bankruptcy Code that the Code “repeals the jingle rule.” *See House Rep. No. 95-595, 95th*

The final sentence of 11 U.S.C. § 723(c) makes clear that the jingle rule is abolished with respect to the partnership creditor's rights in the assets of a partner; the trustee of the partnership is entitled to share pro rata with unsecured creditors of a partner in dividing the partner's estate. This recognizes the traditional rights of creditors of the partnership to share on an equal basis with other creditors of a partner under some nonbankruptcy laws adopted before the Uniform Partnership Act. On the other hand, the jingle rule still applies in principle with respect to the partners [sic] interest in the partnership. The partners [sic] interest is worthless until all administrative expenses and partnership claims have been paid.

The last sentence of section 723(c) does not, however, except by a strained construction, affect the applicability of the jingle rule in any cases other than Chapter 7 cases where both a partnership and one of its general partners are debtors. See Frank R. Kennedy, "Partnerships and Partners Under the Bankruptcy Code: Claims and Distribution," 40 Wash. & Lee L. Rev. 50, 59-60 (1983). The proposed subdivision would accomplish the repeal of the jingle rule in any general partner's case under Title 11 insofar as the rule accords priority to a general partner's nonpartnership creditors in the distribution of a general partner's estate, irrespective of whether the partnership is also a debtor and of whether the general partner's case is administered under Chapter 7, 11, 12, or 13.

(f) The trustee shall apply any recovery from a general partner under subsection (b), or from the estate of a general partner under subsections (d) and (e), of this section only to the payment of deficiencies for which such general partner is personally liable as a general partner under applicable nonbankruptcy law. Any property constituting recoveries under subsections (b), (d), and (e) of this section not applied to the deficiencies as herein provided shall be equitably distributed by the trustee to such general partners or general partners' estates as may be ordered by the court after notice and hearing.

Comment

The first sentence of subsection (f) further implements the policy of conforming the provisions of this section to the respective rights of creditors of a partnership and its general partners under applicable nonbankruptcy law. The provisions of subsection (f) limit the application of recoveries by the trustee from each general partner or general partner's estate under subsections (b), (d), and (e) to the claims supporting the right of each such recovery. Like existing section 723(a), proposed subsections (b), (d), and (e) recognize that a general partner may not be liable under applicable nonbankruptcy law for all of the debts of the partnership and therefore limit the right of
recovery by the trustee from general partners to such claims as to which the general partner was liable under applicable nonbankruptcy law. Under existing law developed in Chapter 7 cases, recoveries from general partners under section 723(a) and (c) are added to the bankruptcy estate of the partnership under section 541(a)(3) and included in the distributions under section 726 to creditors holding allowed claims against the partnership, which may include claims of creditors for which a general partner was not liable under applicable nonbankruptcy law.

However, adherence to the principles of partnership law generally dictates that absent some express undertaking or a partnership-by-estoppel argument, a general partner is personally liable only for the debts of the partnership incurred during his or her tenure as a general partner. Accordingly, not all general partners are necessarily liable to all creditors of the estate. The corollary from the creditors' perspective is that creditors holding claims under partnership law against greater numbers of general partners should receive from general partner contributions a greater recovery than creditors with claims against fewer general partners.

The liability of a particular general partner to a particular creditor is further complicated by the possibility of a contractual modification of the general partner's liability under partnership law. It is not uncommon for a lease of space or a loan to a partnership to be either nonrecourse or have limited recourse to the individual general partners. Similarly, if a creditor has built into its contract with the partnership a provision releasing general partners upon their retirement or withdrawal from the partnership, the effect of this provision is not abrogated by the partnership's bankruptcy filing. To avoid the result required in Chapter 7 cases which is inconsistent with the reorganization concept of Chapter 11 and the concept of marshaling, subsection (f) limits the application of such recoveries to claims for which the general partner was liable under applicable nonbankruptcy law. Thus, there must be a careful analysis of the specific contractual relationship between each creditor and each general partner and the allocation of contributions of similarly situated general partners to similarly situated creditors in each partnership case. See Alfred J. Bianco & Joseph T. Moldovan, Partnership Break-Ups: Who Pays?, February 7, 1994, N.Y.L.J., at 7, col. 1. This approach is suggested by a limited aspect of the D.C. Circuit's opinion in In re AOV Industries, Inc., 792 F.2d 1140 (D.C. Cir. 1986), where the court held that a reorganization plan subjected a creditor to unequal treatment in violation of section 1123(a)(4) of the Bankruptcy Code because it required the creditor to forego its direct claim against nondebtor/third parties who were funding the plan in order to receive a distribution under the plan.

Building on the AOV decision, and recognizing that the cornerstone to any partnership reorganization plan is a waiver by individual creditors of their direct claims against the general partners in exchange for a recovery from the fund created by the voluntary contributions of general partners, the inter-creditor allocation of general partner contributions requires (1) the development in a partnership bankruptcy of a matrix detailing the dates of service of each general partner and the effect of contractual release provisions, and (2) the allocating of creditors into similarly situated groups in accordance with the claims of each group to similarly situated general partners. See In re Gaston & Snow, Case No. 91B14594 (CB) (Bankr. S.D.N.Y. 1993) (plan of reorganization contained a classification scheme where creditors were classified differently based upon their sharing from the pool of partnership estate assets and the separate pool of voluntary
general partner contributions). The result of this methodology is that each creditor would theoretically share in two funds: (1) pro rata in the assets of the estate, or as required based upon the Bankruptcy Code's priority scheme, and (2) a percentage interest in the general partner contribution pool based upon the attribution to each creditor group of contributions to be made by all general partners liable to such group. There can be no bright-line test to determine the most appropriate method of attributing general partner contribution among various creditor groups. To some degree, such an exercise is case-and-fact specific and may require the application of relevant state law relating to the marshaling doctrine.

However, the determination of the claims subject to this allocation should not be burdensome since such claims and their deficiencies will have been identified as a basis for asserting the right of recovery under subsection (b) or (d) against each general partner or general partner's estate.

The second sentence of subsection (f) is a refinement of section 723(d) of the Bankruptcy Code and, in keeping with the provisions of the first sentence of this subsection, provides authority for the bankruptcy court to return any surplus of recoveries from general partners not applied to claims for which such general partners were liable. The allocation of such surplus is to be applied on a case-by-case basis in accordance with the court's determination of the equities of the case.

(g) Notwithstanding section 726 of this title, the trustee shall distribute property of the partnership estate not subject to distribution under subsection (f) of this section in payment of allowed claims against the partnership in accordance with the applicable provisions of this title without consideration of such recoveries or their distribution as provided in subsection (f).

Comment

The partnership estate may consist of property constituting recoveries by the trustee under subsections (b), (d), and (e) together with other property of the partnership estate. Subsection (f) provides for the distribution of property of the partnership estate constituting recoveries under subsections (b), (d), and (e). Subsection (g) deals with the distribution of other property of the partnership estate by providing for the distribution to the holders of allowed claims against the partnership (including, if applicable, creditors of the partnership entitled to distribution under subsection (f)) of such property without consideration of the recoveries provided under subsection (f).

(h) The expenses of administration of a partnership case under section 503 of this title shall be paid from the property constituting recoveries from general partners under this section and from other property of the estate in such proportions as the court shall determine are fair after reasonable notice and hearing.
Comment

This subsection is derived from section 5f of the Bankruptcy Act and adapted to accommodate the provisions of this section. In several of the larger professional partnership cases, issues have arisen concerning responsibility for payment of the costs of administration of the case. Arguments have been made by creditors that all costs of administration should be borne by those general partners who remain general partners at the time the case is filed. Conversely, general partners have argued that it is unfair to increase a general partner's contribution amount in situations where creditors' committee activity has been responsible for the high cost of the case. The provisions of subsection (h) are predicated on the presumption that the court will take into consideration the liability, if any, of a general partner or a general partner's estate for costs of administration in apportioning the costs of administration of the estate.

§ 563. Temporary stay of proceedings and acts against general partners

(a) A petition filed under section 301 or 303 in a partnership case operates as a stay of—

(1) the commencement or continuation of an action or proceeding against a general partner to recover on a claim against the partnership debtor that arose before the commencement of the partnership case;

(2) the enforcement against a general partner, or against property of a general partner, of a judgment obtained against the partnership before the commencement of the partnership case;

(3) any act by the holder of a claim against the partnership debtor to obtain possession of or from, to exercise control over, or to create, perfect, or enforce a lien against the property of a general partner for the purpose of collecting or enforcing the holder's claim against the partnership; and

(4) the commencement or continuation of any action or proceeding by any entity other than the partnership to enforce contribution or indemnification with respect to any liability arising out of the general partner's relation to the partnership and any other general partner.

Comment

Section 563 extends the automatic stay triggered by the filing of a petition by or against a partnership to actions, proceedings, and acts directed against a general partner or a general partner's property. Although general partners may be liable for some or all of the debts of the partnership under nonbankruptcy law, the courts have generally given heed to the literal language of the Bankruptcy Code and its legislative history negating the argument that the property of a partnership includes the property of its member general partners. See House Rep. No. 95-595, 95th
Cong. 2nd Sess. 200 (1978). Thus, the automatic stay has been generally held not to bar actions, proceedings, or acts directed against a general partner or its property. In re Two Appeals Arising Out of the San Juan DuPont Plaza Hotel Fire Litigation, 994 F.2d 956, 969 (1st Cir. 1993); Teachers Ins & Annuity Assn. of America v. Butler, 803 F.2d 61, 65 (2d Cir. 1986); Aboussie Bros. Constr. Co. v. United Missouri Bank of Kirkwood (In re Aboussie Bros. Constr. Co.), 8 B.R. 302 (E.D. Mo. 1981); but, cf., Litchfield Co. of S.C. Ltd. P'tshp. v. Anchor Bank (In re Litchfield Co. of S.C. Ltd. P'tshp.), 135 B.R. 797, 803-05 (W.D.N.C. 1992). Although section 723(a) recognizes the liability of the general partners for a deficiency of the partnership property to pay the debts of a partnership in a Chapter 7 case, that subdivision is only a contingent and unreliable safeguard of the partnership creditors’ rights while the general partners’ property remains unprotected from grabs by creditors of the general partners and the partnership pending a determination of the existence of a deficiency during the administration of the partnership case. Experience in the administration of partnership cases has demonstrated the crucial importance in Chapter 11 partnership cases of the issuance of an injunction against the enforcement of partnership creditors’ rights against general partners and their property. See In re Heron, Burchette, Ruckert & Rothwell, 148 B.R. 660, 686 (Bankr. D.D.C. 1992); In re Myerson & Kuhn, 121 B.R. 145,150 (Bankr. S.D.N.Y. 1990); In re Laventhol & Horwath, Case No. 90B13346 (PBA) (Bankr. S.D.N.Y. Aug. 25,1992) (sec. E, paragraphs 49-51 of the opinion); Harold C. Buschman III & Sean P. Madden, “The Power and Propriety of Bankruptcy Court Intervention in Actions Between Nondebtors,” 47 Bus. Law. 913, 942 (1992); Michael J. Crames & Joseph T. Moldovan, “Section 105 Injunctions Offer Protections to Members of Professional Partnerships,” 209 N.Y.L.J. 5 (March 29, 1993); Paul R. Glassman, “Third-Party Injunctions in Partnership Bankruptcy Cases,” 49 Bus. Law. 1081 (1994). The opinions in the cited cases emphasize that injunctions of suits against the general partners were keystones to the development and consummation of Chapter 11 plans that maximized distributions to partnership creditors. The following cases illustrate the appropriateness of the issuance of an injunction against creditors’ proceedings against partners during the administration of a Chapter 7 case. Tatge v. Chandler (In re Judiciary Tower Associates), 175 B.R. 796, 805 (Bankr. D.D.C. 1994); Jonas v. Newman (In re Comark), 53 B.R. 945, 947 (Bankr. C.D. Cal. 1985). Section 563, by obviating the necessity for the partnership trustee or the partnership as a debtor-in-possession to seek and obtain an injunction against actions, proceedings and acts by partnership creditors directed against general partners, accomplishes the same purpose and result for the benefit of the partnership creditors, insofar as the general partners’ assets liable for the partnership debts are concerned, as the automatic stay of section 362 does with respect to the partnership assets.

(b) The stay provided by this section shall terminate sixty days after the commencement of the partnership case unless, after notice and hearing, it is extended or otherwise modified by an order entered after a determination by the court that continuance of the stay is necessary to an effective reorganization that maximizes the recovery by partnership creditors of their claims against the partnership and the general partners or will be reasonably necessary to an equitable distribution of assets of the partnership and general partners to their creditors. In any hearing under this subsection, the party requesting an extension has the burden of proof.

Comment
This subdivision (b) recognizes that the stay imposed by section 562 is intended to operate only for a limited period of time. As pointed out by Buschman and Madden in 47 Bus. Law. at 940, a permanent stay of actions against nondebtor general partners may be justified in connection with partnership reorganization plans, but such relief should be conditioned as provided in section 564. For the purposes of this section, the words “effective reorganization” include a liquidation conducted by the partnership as a debtor-in-possession in a Chapter 11 case, or by an appointed trustee in a case under any chapter of the Code. All professional partnership bankruptcy cases have thus far been liquidating Chapter 11 cases.

(c) On request of a party in interest and after notice and a hearing, the court may grant relief from the stay so provided, such as by terminating, annulling, modifying, or conditioning such stay for cause.

Comment

Subsection (c), an adaptation of section 362(d), recognizes the appropriateness of according the bankruptcy court authority to grant relief from the automatic stay for cause. Relief may be granted on motion by a general partner, the partnership, or a creditor. The temporary stay may be modified with respect to any general partner, any creditor, or all the creditors. Cause for termination would include absence of any reasonable likelihood of reorganization, inability to effectuate a plan, unreasonable delay by the debtor that is prejudicial to creditors, failure to propose a plan with the time fixed by a court, denial of confirmation of every plan proposed, revocation of an order of confirmation, inability to effectuate substantial consummation of a confirmed plan, material default with respect to a confirmed plan, termination of a plan by reason of the occurrence of a condition specified in the plan, or the nonpayment of fees or charges.

§ 564. Extended stay of proceedings and acts against general partners under a confirmed plan

(a) In connection with confirmation of a plan in a partnership case, the court may, without the filing of an adversary proceeding, extend or renew a stay of proceedings and acts (i) initiated by a partnership creditor to enforce the liability of a general partner who has contributed or assumed a commitment to contribute an amount to the payment of the debts in accordance with the provisions of the plan, or (ii) initiated by a general partner or partnership or partnership trustee to enforce a liability for contribution or indemnification against a general partner.

Comment

Section 564(a) authorizes the court to issue an extended stay of actions, proceedings, and acts against a general partner in a partnership case when the general partner has made a contribution to the payment of the partnership’s debts, or assumed a commitment to make such a contribution, in accordance with the provisions of a confirmed plan or order confirming a plan. The provision recognizes that as pointed out by Buschman & Madden in 47 Bus. Law. at 942, “[t]he prospect of obtaining permanent injunctive relief from partnership creditors provides the debtor’s
general partners with an incentive to contribute to a reorganization plan.” Experience has demonstrated that recoveries by partnership creditors may be significantly enhanced if general partners can be persuaded to contribute to a recovery pool postpetition future earnings, exempt property, and other assets not otherwise available to partnership creditors, in exchange for protection against collection suits by partnership creditors and suits for contribution and indemnification by copartners and the trustee of the partnership or the partnership as a debtor-in-possession. The permanent stay has long been regarded as the *sine qua non* of the larger professional partnership bankruptcies. As Crames and Moldovan note:

The direct result of an [extended stay] is that creditors are able to receive from general partners on a consensual basis funds that would otherwise be difficult, if not impossible, for them to recover.

Without [the extended stay] individual creditors would sue individual general partners, and general partners would then cross-claim against each other for contribution and sue the debtor for indemnification. The probable result would be a costly and time-consuming web of litigation replete with attendant attachments, garnishments and executions. Personal bankruptcy would be a likely consequence for many. By preventing a haphazard scramble for the assets of general partners, and by facilitating an orderly distribution scheme, the permanent injunction under [the extended stay] ensures that general partners will be protected and that creditors’ recoveries will be maximized.

Section 524(e) provides that, except as provided in a subsection dealing with community claims, a discharge of a debtor does not affect the liability of any other entity. This section has been held, however, not to preclude the issuance of an injunction that channels creditors' claims to a fund provided by settling obligors. Menard-Sanford v. Mabey (In re A.H. Robins Co., Inc.), 880 F.2d 694, 701-02 (4th Cir.), cert denied, 110 S.Ct. 376 (1989); MacArthur Co. v. Johns-Manville Corp. (In re Johns-Manville Corp.), 937 F.2d 89, 94 (2d Cir.), cert. denied, 109 S.Ct. 176 (1988); cf. Republic Supply Co. v. Shoaf, 815 F.2d 1046, 1060 (5th Cir. 1987) (upholding release of nondebtor guarantor by plan that was confirmed without objection on appeal). The extended stay should not bar actions, proceedings, or acts against general partners who do not assume a commitment or fail to fulfill a commitment to pay partnership debts. The extended stay does not constitute nor may it be deemed to be a release of joint tortfeasors.

Inasmuch as the extended stay is to be authorized by statute and may only be obtained if embodied in a plan, it is not necessary for the plan proponent to commence a separate adversary proceeding seeking permanent injunctive relief. To this extent, the decisions of those courts that have required the commencement of an adversary proceeding are rejected.

(b) The stay may be continued or extended pursuant to this section only upon a determination by the court after notice and hearing that the plan complies with section 1129 of this title and that the stay does not discriminate unfairly or inequitably with respect to claims of creditors of the partnership and claims of general partners for contribution and indemnity.

Comment

Subsection (b) requires notice and hearing to afford creditors of the partnership and the general partners and the general partners themselves an opportunity to obtain judicial assurance that the stay is part of a plan that complies with the best-interest-of-creditots test and the other requirements of section 1129, and to object to any feature of the stay that discriminates or otherwise operates unfairly in its treatment of their rights, liabilities, and obligations. This subsection does not presume that all creditors of the partnership or all claimants for contribution and indemnity must be treated in the same way.

(c) (1) A stay with respect to any general partner under this section may be terminated only for a material failure by that general partner to meet a commitment under the plan, or

(2) On request of a party in interest at any time before four years after the date of the entry of the order of confirmation, and after notice and a hearing, the court may revoke the stay as to any general partner if the stay as to such general partner was procured by fraud.

Comment
This subsection restricts grounds for relief against the stay provided by this section to (1) material breach of a general partner’s commitment to contribute to the payment of partnership debts in accordance with the plan or (2) procurement of the stay by fraud. Paragraph (1) incorporates in a modified form the language of section § 1144 and case law generated thereunder. Under paragraph (2) discovery within four years of confirmation that the information provided by a general partner pursuant to section 565 was fraudulent would be grounds to terminate and revoke the stay.

(d) A stay under this section shall not preclude enforcement of a claim of a partnership creditor against a general partner, or against the property of a general partner, who has not contributed or assumed a commitment to contribute to the payment of debts of the partnership in accordance with the confirmed plan of such partnership.

Comment

The tension between the rights of individual creditors and of creditors generally is often resolved in the Code in favor of the rights of the collective creditor body. These amendments continue this dynamic through the imposition of the temporary stay embodied in section 563 and the permanent stay of section 564. However, the *quid pro quo* of granting the nondebtor general partners relief normally found only by recourse to a personal bankruptcy filing is that the benefit of the stay applies only to those who participate or make a commitment to participate in the debtor's plan of reorganization or liquidation. In several of the larger professional partnership cases, the debtors have reserved in their plans the right to proceed against nonparticipating general partners for some period of time after confirmation on the theory that the debtor had greater resources to fund litigation and could distribute any recovery for the benefit of all creditors. Nothing in this section precludes a plan provision reserving to the creditor a brief exclusive period to sue nonparticipants; however, the benefit of such provision is questionable in light of the requirement of section 562(f) that the debtor act merely as a conduit so that any recovery be distributed only to those creditors to whom or to which the general partner is liable under applicable nonbankruptcy law.

§ 565. Disclosure by general partner

Unless otherwise ordered by the court for cause, each general partner shall produce, within 30 days after the entry of an order for relief in a partnership case or within such time as the court shall fix, information concerning such general partner's nonpartnership assets and liabilities and personal financial affairs, and such periodic reports as may be required by the court from time to time. The information provided pursuant to this section shall be subject to examination on conditions prescribed by the court, shall be subject to the penalty of perjury, and shall be submitted in a form and with a content prescribed by rules.
Comment

Section 565 is an elaboration of Bankruptcy Rule 1007(g). When a petition is filed by or against a partnership, there is a substantial likelihood that a deficiency of partnership assets to pay partnership debts in full will occur. In light of the probabilities and in the interest of expediting administration, the section requires the submission by general partners of documents and information regarding nonpartnership assets and liabilities and personal financial affairs in every partnership case unless the court orders otherwise for cause. Bankruptcy Rule 1007(g) refers to a “statement of personal assets and liabilities,” but section 565 adopts the language of section 101(32)(B)(ii) of the Bankruptcy Code in identifying these assets and liabilities as “nonpartnership assets and liabilities.” (The Uniform Partnership Act in §§ 40(h) and 40(i) refers to “individual property” and “separate property” respectively, but both clauses refer to “separate creditors.” Section 2 of the Uniform Fraudulent Conveyance Act refers to “separate assets” and “separate creditors,” but section 67d(l)(d) of the Bankruptcy Act, modeled on the U.F.C.A., referred to “separate property” and “separate debts.” The Uniform Fraudulent Transfer Act follows the Bankruptcy Code by referring in § 2(d) to “nonpartnership assets” and “nonpartnership debts.”) The information required to be disclosed by general partners is needed to enable the partnership debtor or other plan proponent to determine the sources of payments of the deficiency of partnership assets, to allocate to the general partners their respective shares of the deficiency, and, if a plan of reorganization or orderly liquidation is to be proposed, to prepare a liquidation analysis that will assure compliance with section 1129(a)(7). In many of the professional partnership cases, the debtor or trustee has sought and been provided with copies of tax returns and loan applications. See Michael J. Crames & Joseph T. Moldovan, “Section 105 Injunctions Offer Protections to Members of Professional Partnerships,” 209 N.Y.L.J. 5, 10 (March 29, 1993). Crames and Moldovan refer to “certain specified conditions of confidentiality,” but section 107 of the Bankruptcy Code declares that generally “a paper filed in a case under this title” is a public record and “open to examination by an entity at reasonable times without charge.” Section 107(b) and Bankruptcy Rule 9018 authorize the court to protect the confidentiality of particular information, but the premise of the statute and the rule is that unless the court perceives a justification for secrecy, the papers filed in a bankruptcy case should be accessible to parties in interest. The Code and Rules do not literally cover papers filed with the trustee or debtor-in-possession, with its attorney, and with creditors’ committees, but 18 U.S.C. § 154 subjects to fine and forfeiture of office a “custodian, trustee, or other officer of the court” who “knowingly refuses to permit a reasonable opportunity for the inspection of documents and accounts relating to the affairs of estates in his charge by parties in interest when directed by the court to do so.” The provision in proposed section 564 to the effect that information filed pursuant to the section “shall be subject to examination on conditions prescribed by the court” appears to comport with the present law and policy respecting confidentiality of papers in a bankruptcy case.
§ 566. Stay of transfer of nonpartnership property

(a) A petition filed under section 301 or 303 in a partnership case operates as a stay of a voluntary transfer by a general partner of the general partner’s nonpartnership property other than (i) in the ordinary course of business in which such general partner is engaged or (ii) for ordinary and usual personal purposes.

Comment

Section 566(a) is an elaboration and implementation of section 723(b) of the Bankruptcy Code. It recognizes that during the administration of a partnership case, general partners may strip their separate estates of assets that may be required to satisfy a deficiency of partnership assets to pay partnership debts. The section does not prohibit a general partner from using, leasing, or disposing of nonpartnership assets since the general partner may be operating a separate business as an individual proprietor or may be a general partner in one or more other partnerships. In such a case the general partner should be allowed to engage in the kind of transactions involving nonpartnership property that a debtor-in-possession is authorized to conduct without notice and a hearing under section 363. Like section 363(b), the section contemplates that if the general partner desires to engage in transactions out of the ordinary course of business, permission should be requested by motion and granted only after notice and hearing. Thus, it is not intended to prevent a general partner from entering into a workout with nonpartnership creditors on a showing that the interests of the partnership and nonpartnership creditors are protected. Under this section, a general partner is prohibited from converting nonexempt assets into exempt assets. A general partner would similarly be prohibited from purchasing a new home or other extraordinary item or funding a retirement account. The burden is on the general partner to seek relief from the section. The presumption is that a large financial expense is not appropriate. However, there are always grey areas like tuition payments. Relief from the strictures of this section may not always require judicial intervention. In most of the large cases, general partners have routinely obtained permission for extraordinary expenses by seeking permission of the debtor and the creditors' committee. If a general partner proceeds to engage in a transaction involving nonpartnership property potentially detrimental to the recovery of a deficiency in the payment of partnership debts, the partnership or other party in interest may request the issuance of a protective order after notice and hearing.

(b) On request of a party in interest, including a general partner who is subject to the stay of this section, and after notice and hearing, the court may grant relief from the stay so provided, such as by terminating, annulling, modifying, or conditioning such stay for cause.

Comment

Section 566(b) authorizes the grant of relief from the automatic stay provided by the section on the request of the general partner subject to the stay or of any other party in interest. Since the stay is imposed for the benefit of the creditors of the partnership, the trustee or the partnership as debtor-in-possession would receive notice of the request for relief under this section. The court may also appropriately require notice to a creditors’ committee and other parties in
interest. The availability of the option raises the same kind of question as that presented when a trustee waives the automatic stay of section 362. See Commerzbank v. Telewide Systems, Inc, 790 F.2d 206 (2d Cir. 1986) (debtor's consent to appeal held not to waive operation of automatic stay since stay also protected creditors).

§ 567. Duty of trustee respecting information as to applicability of §§ 563, 565, and 566

The trustee of a partnership debtor shall maintain a list, accessible to creditors of the partnership, of the names and addresses of general partners that are protected by the stay under section 563, are subject to the duties of disclosure under section 565, and subject to restrictions on the disposition of nonpartnership property under section 566.

Comment

In the interest of minimizing inadvertent litigation against general partners and of facilitating negotiations and settlement of disputes involving general partners, section 567 requires the trustee of a partnership debtor to maintain an accessible record of general partners protected by the stay and subject to duties of disclosure and restrictions on disposition of nonpartnership property.

§ 568. Appointment of committee of general partners

On request of a party in interest the court may authorize the appointment by the United States trustee of a committee of general partners fairly representative of the interests of all general partners.

Comment

Section 568 authorizes the appointment of a committee of general partners in the interest of facilitating the collection of the partnership's receivables and other assets and the determination of appropriate allocations of the general partners' liability for the deficiency of partnership assets to pay partnership debts, Bankruptcy Judge Abram denied a request for such an appointment in In re Finlay, Kumble, Wagner, Heine, Underberg, Manley, Myerson & Casey, 85 B.R. 13, 17 (Bankr. S.D.N.Y. 1988), pointing out that such an appointment was not authorized by the Bankruptcy Code and that the request did not contemplate the performance by the committee of a role comparable to that of committees appointed under section 1102. The uniqueness and refractoriness of the problems arising in partnership cases involving large numbers of general partners warrant the establishment of a mechanism for facilitating the resolution of differences and disputes among the general partners, the partnership, and the creditors of the partnership and the general partners and the development of a plan for adjusting the competing and conflicting claims and interests. Judge Abrams acknowledged a concern about "the expense of continued separate legal representation of each of the Debtor's [general] partners" and expressed a hope that "through the formation of unofficial committee or dialogue groups or the offices of the Chapter 11 trustee," the general partners would reconcile their differences through compromise so that the case might promptly come to a conclusion. 85 B.R. at 18. In several other cases, informal committees of
general partners or general partners’ counsel were formed and performed the function of an unofficial general partner’s committee. The section would remove doubts as to the propriety and status of a committee of general partners in a partnership case. The bankruptcy court with the assistance of the United States trustee may exercise control over the expenses of the committee chargeable against the partnership estate.

§ 569. Denial of dischargeability because of imputed misconduct or liability of copartner

Nothing contained in section 523 shall preclude discharge of an individual general partner from any debt for which such general partner is liable solely as a result of imputing to the general partner the conduct or liability of a copartner.

Comment

The Supreme Court in Strang v. Bradner, 114 U.S. 555, 561 (1885), held that the liability of a general partner for fraudulent representations by a member of the partnership was not dischargeable notwithstanding the general partner’s innocence of any responsibility for the perpetration of the fraud. Strang v. Bradner has been followed in a substantial number of cases that apply a doctrine of imputed fraud as a basis for denying dischargeability to an innocent general partner. See Steven H. Resnicoff, “Is It Morally Wrong to Depend on the Honesty of Your Partner or Spouse?” Bankruptcy Dischargeability of Vicarious Debt, 42 Case Western Res. L. Rev. 147 (1992). The innocent general partner’s sharing in the fruits of the fraudulent conduct was emphasized as a factor in the decision in Strang v. Bradner, but under the case law constituting the progeny of the decision the denial of discharge has not depended on a showing of receipt by the general partner of the benefits of the fraud. See, e.g., Bancboston Mtg. Corp. v. Ledford (In re Ledford), 127 B.R. 175, 181-85 (M.D. Tenn. 1991), aff’d, 970 F.2d 1556 (6th Cir. 1992) (general partner’s fraud imputed to innocent general partner for the purpose of determining dischargeability of partnership creditor’s claim). The Ad Hoc Committee on Partnerships in Bankruptcy agrees with Professor Resnicoff’s conclusion that ‘[t]he Strang doctrine serves no significant public policy’ and concurs in his recommendation for legislative excision of the doctrine. This proposed section would apply in Chapter 7, 11, 12, and 13 cases. It would provide no basis for a discharge of liability of a general partner for fraud or misconduct specified in section 523.

CHAPTER 7-LIQUIDATION

SUBCHAPTER 11—COLLECTION, LIQUIDATION, AND DISTRIBUTION OF THE ESTATE

§ 723. Repeal of § 723.

Section 723 is repealed.

Comment
The repeal of section 723 is necessary to eliminate the overlap with section 562, which supersedes section 723.

As defined for this chapter under section 1112, 1208, or 1307 of this title, a claim allowed under section 502(b) of this title incurred under any other chapter of this title or under this chapter before such conversion and over any expenses of a custodian supersedes under section 543 of this title.

Comment

The rules governing distribution in Chapter 7 cases would be subject under the proposed amendment of section 726(b) to accommodate the special considerations involved in partnership cases.

CHAPTER 11—REORGANIZATION

SUBCHAPTER 11—OFFICERS AND ADMINISTRATION

§ 1111. Claims and interests

(b)

(3) Except as otherwise provided in a confirmed plan of a partnership debtor or the order confirming such a plan, a general partner is not liable on a nonrecourse claim against the partnership except to the extent the general partner is personally liable on such claim under applicable nonbankruptcy law.

Comment

Subparagraph (3) is not intended to preclude a general partner's liability on a contractual guaranty to a lender executed by the general partner or to a liability arising out of the general partner's fraud, waste, or tortious conduct. Section 1111(b) clarifies the Congressional intent that nonrecourse debt of a partnership does not become a liability of the general partners. Since the holders of nonrecourse claims are entitled to be classified as unsecured creditors of the partnership in the calculation of the deficiency of assets in a partnership case to pay all partnership debts, the nonrecourse liability of the general partners cannot be disregarded in the formulation and implementation of a partnership plan. The formulation of a confirmation plan when there are nonrecourse claims in a partnership case poses a formidable challenge to the proponents. See, e.g.,
In re Greystone III Joint Venture, 102 B.R. 560 (Bankr. W.D. Tex. 1989), aff'd, 127 B.R. 138 (W.D. Tex. 1990), where such a plan was confirmed, but a liquidation analysis was not required because all creditors other than an undersecured creditor with a nonrecourse claim supported the plan. The order confirming the plan was subsequently reversed by the court of appeals, however, on the ground that the claim of the undersecured creditor had been improperly classified in a gerrymandered plan. 995 F.2d 1274, cert. denied, 113 S.Ct. 72 (1992). See Randolph J. Haines, "Cramdown: Separate Classification and Treatment of Nonrecourse Deficiency Claims," 1990 Norton Bankruptcy Law Adviser No. 4, pp. 7-9 (April 1993), commenting on John Hancock Mut. Life Ins. Co. v. Route 37 Business Park Assoc., 987 F.2d 154 (3d Cir. 1993).