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# GENERAL QUESTIONS RAISED (IF NOT ANSWERED) BY RECENT CASES

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## Part 1: FINDING ANSWERS TO "OLD" CLAIMS QUESTIONS IN NEW CASES

### 1. What is a claim?

**Section 101(5)**

11 U.S.C. § 101(5) states:
(5) The term "claim" means-
(A) right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured; or
(B) right to an equitable remedy for breach of performance if such breach gives rise to a right of payment, whether or not such right to an equitable remedy is reduced to judgment, fixed, contingent, matured, unmatured, disputed, undisputed, secured, or unsecured.

The hardest cases involve covenants not to compete which raise the question whether the debtor's right to enforce a covenant not compete "gives rise to a right to payment." See generally 3 Norton Bankr. L & Prac.3d section 48.6 (October 2010) *In re Gilpin*, 391 B.R 210 (BAP 6th Cir 2008), holds that the right to enforce a covenant not to compete breached prepetition was not a "claim." Before filing for chapter 7 relief,
-- As part of his employment contract with MCS, Gilpin executed a covenant not to compete;
-- Gilpin breached that covenant not compete;
-- State court awarded damages against Gilpin and "permanently enjoined" Gilpin from violating the covenant not compete for two years.

When Gilpin filed, MCS moved for relief from stay. In denying MCS's motion, the bankruptcy court concluded "this claim can be reduced to money damages."

The Sixth Circuit BAP reversed, concluding that MCS' right to enforce the covenant not to compete "did not constitute a claim under 11 USC section 101(5)(B)." This conclusion was based in substantial part on a earlier decision by the Sixth Circuit, *In re Kennedy*, 267 F.3d 493 (6th Cir. 2001), which is described as the "majority rule." And, here is the BAP's statement of that rule: "a right to an equitable remedy does not give rise to right to payment under section 101(5)(B) when the right to equitable relief is an **alternative** (court's emphasis) to a right to payment."

A federal district court in California dealt with the same question in a less-transparent way *In re Ortiz, 400 B.R. 755*(USDC C.D. Cal. Jan. 21, 2009).

-- Ortiz is a professional boxer http://www.boxrec.com/list_bouts.php?cat=boxer&human_id=257314

-- In 2005, Ortiz entered into a five year exclusive promotional agreement with Top Rank;

-- In January 2008, Ortiz filed a chapter 7 petition;

-- Neither the trustee nor Top Rank took any action with respect to the promotional agreement;

-- In April 2008, Ortiz filed an adversary proceeding against Top Rank seeking a declaration that (1) the contract was rejected by operation of law and (2) he was no longer required to perform his obligations under the exclusive promotional agreement. Ortiz also asked the bankruptcy court to enjoin Top Rank from interfering with fight promotion negotiations between Ortiz and third parties.

-- The bankruptcy court ruled for Ortiz on both the declaratory and injunctive relief.

The district court reversed and remanded in a lengthy opinion on the effect of section 365 rejection that extensively discusses and relies on Mike Andrews 20 year-old law review article on executory contracts. Then, in a two and half page footnote, the court also addresses Ortiz's argument that section 707(b)(3)'s addresses the effect of rejection of a personal services contract.

More important, the court, first looks to a Third Circuit decision, In re Ben Franklin Hotel Associates, 186 F.3d 301, 305 (3d Cir. 1999) for the standard: "The inquiry for the court is 'whether' monetary payment is a viable alternative for the proposed equitable remedy." Compare this quotation with the language quoted from *Gilpin*, and with later language in

*Ortiz*. In summarizing its conclusion on the application of section 101(5), the court states: "To determine whether any provisions of the contract remain enforceable against the debtor, rather than as claims against the estate, courts must assess whether the right to an equitable remedy is a 'claim' dischargeable in bankruptcy. This in turn requires an inquiry as to whether an equitable remedy is available under state law."

There is a fairly recent First Circuit case that might provide some indirect help. *Rederford v. U.S. Airways, Inc.*, 589 F.3d 30 (1st Cir. December 14, 2009) held that a claim for reinstatement under the American with Disabilities Act is a section 101(5) "claim." The court first discusses "several obvious purposes" served by treating a right to an equitable remedy as a section 101(5) "claim."

-- "avoid distinctions among creditors depending on whether the right to payment stems from an equitable source, a legal source, or an equitable remedy that can be reduced to payment;"

-- "treats creditors evenhandedly;"

-- "provides debtors with a fresh start."

The court then distinguishes between "abatement of ongoing conduct that is causing harm" and "remediation of past harms." Finally, and most important to the resolution of the specific question in this case, the court points out that Title I of ADA "explicitly" provides for front pay as an alternative to reinstatement.

Reconsider this point when considering the other fact pattern that periodically raises the question of whether the debtor's obligation can be reduced to a "right to payment" involves an EPA order to remediate prepetition pollution. In *United States v. Apex Oil Co.*, 59 F.3d 734 (7th Cir. August 25, 2009), the United States Court of Appeals for the Seventh Circuit dealt with that fact pattern recently and held that the EPA's right to injunctive relief was not a "claim" and so was not discharged. Two portions of Judge Posner's opinion are important.

First, Posner's response to the debtor's argument that it did not have in-house capability to do the clean up itself and would have to pay an independent contractor more than $150,000,000 to do the work:

> The Resource Conservation and Recovery Act, which is the basis of the government's equitable claim, does not entitle a plaintiff to demand, in lieu of action by the defendant that may include the hiring of another firm to perform a clean up ordered by the court, payment of clean-up costs. It does not authorize *any* form of monetary relief. . . [T]he cost to Apex is not a

"right [of the plaintiff] to payment." See generally Shari Haider, After Apex, Must Debtors Clean Up After Themselves, 29 ABI Journal 48 (Dec-Jan 2010)

Second, Posner's treatment of the Supreme Court's *Kovacs* opinion: "It is true that in *Ohio v. Kovacs,* 469 U.S. 274, 105 S.Ct. 705, 83 L.Ed.2d 649 (1985), the Supreme Court allowed the discharge in bankruptcy of an equitable obligation to clean up a contaminated site owned by the debtor. An injunction ordering the clean-up had been issued before the bankruptcy. The debtor had failed to comply with the injunction and a receiver had been appointed to take possession of his assets and obtain from them the money needed to pay for the clean-up. The receiver thus was seeking money rather than an order that the debtor clean up the contaminated site. That was a claim to a "right to payment." The plaintiff in our case (the government) is not seeking a payment of money and the injunction that it has obtained does not entitle it to payment."

More recently, in In re Mark Industries, Inc., 438 B.R. 460 (Bankr. S.D.N.Y 2010) Judge Bernstein addressed this same question and provided the same answer. Judge Bernstein looked primarily to Kovacs and In re Chateaugay Corp., 944 F.2d 997 (2d Cir. 1991): "*Kovacs* and *Chateaugay* require the Court to weigh three factors in determining whether a cleanup obligation is dischargeable. First, is the debtor capable of executing the equitable decree, or can he only comply by paying someone else to do it? * * * Second, is the pollution "ongoing"? * * * Third, if the pollution is not ongoing, or if the order imposes discrete obligations to cleanup accumulated waste, does the environmental agency have the "option" under the statute giving rise to the equitable obligation to remove the waste and seek reimbursement from the debtor?" The opinion twice cites to and quotes from Judge Posner's Apex Oil opinion to support the proposition that the mere fact that the debtor must spend money does not make the obligation a "claim.: 438 B.R. 468, 469.

### 2. When does a claim arise?

The Bankruptcy Code provides an "answer" to the question of "what is a claim" with its section 101 definition of claim. That definition does not, however, answer the question of "when does a claim arise", a question that is important in applying section 1141(d)("that arose before the date of such confirmation"), section 362(a)(1) ("that arose before the commencement of the case") and confirmation orders.

*In re Grossman's* Inc*.,* 389 B.R. 384 (Bk Del , 2008), affirmed in part, reversed in part, 2009 WL 273323 (Del. 5, 2009) provides a an answer to that question. The court holds that an asbestos-based disease diagnosed in

2007 was not a claim "arising prior to the effective date" as that phrase was used in a 1997 confirmation order).

In 1997, the confirmation order for Grossman's, a home improvement products retailer bars creditors from asserting "claims and interests arising prior to the effective date." In 2007, Mary Van Brunt was diagnosed with an asbestos-related disease and sued Grossman's in state court, alleging, inter alia, that (1) her illness was caused by products containing asbestos that she purchased from Grossman's in 1977 and (2) Ms Van Brunt had no symptoms of her disease and was unaware of her disease at the time of the Grossman's confirmation order.

The Delaware bankruptcy court reopened the bankruptcy case to decide whether Ms Van Brunt's state court claims are barred by the 1997 confirmation order, i.e., to decide if Ms Van Brunt's claim arose prior to the effective date. Following the Third Circuit's decision in *In re Frenville*, 744 F.2d 332 (3d Cir. 1984), Judge Walsh held that (1) state law determines when a section 101 claim arises and (2) New York state law controls; and (3) under New York state law, asbestos personal injury claims do not arise until manifestation, i.e., when the injury was discovered or should have been discovered. In so holding, Judge Walsh acknowledges a substantial body of case law to the contrary in other circuits. Judge Walsh also points out that not only did the Grossman's plan not contain a section 524(g) channeling injunction, it could not have: "The use of a section 524(g) channeling injunction is limited to cases involving companies that have actually been sued for damages related to asbestos prior to the date of the bankruptcy petition." 389 B.R. at 386

On appeal, the district court affirmed stating that it is "compelled by the Third Circuit decision in *Frenville".* Then, on further appeal, the Third Circuit, in In re Grossman's Inc., 607 F.3d 1114 (3d Cir. 2010), overruled Frenville, sating**:** "there seems to be something approaching a consensus among the courts that a prerequisite for recognizing a "claim" is that the claimant's exposure to a product giving rise to the "claim" occurred pre-petition, even though the injury manifested after the reorganization. We agree and hold that a "claim" arises when an individual is exposed pre-petition to a product or other conduct giving rise to an injury, which underlies a "right to payment" under the Bankruptcy Code.. Applied to the Van Brunts, it means that their claims arose sometime in 1977, the date Mary Van Brunt alleged that Grossman's product exposed her to asbestos.

"That does not necessarily mean that the Van Brunts' claims were discharged by the Plan of Reorganization. Any application of the test to be applied cannot be divorced from fundamental principles of due process.***

"Whether a particular claim has been discharged by a plan of reorganization depends on factors applicable to the particular case and is best determined by the appropriate bankruptcy court or the district court. In determining whether an asbestos claim has been discharged, the court may wish to consider, inter alia, the circumstances of the initial exposure to asbestos, whether and/or when the claimants were aware of their vulnerability to asbestos, whether the notice of the claims bar date came to their attention, whether the claimants were known or unknown creditors, whether the claimants had a colorable claim at the time of the bar date, and other circumstances specific to the parties, including whether it was reasonable*128 or possible for the debtor to establish a trust for future claimants as provided by § 524(g)."

The Grossman cases involved an asbestos claim.  A  recent Florida decision involving the same fact pattern, In re Evans-Products Co.,2009 WL 2448145 (Bankr. S.D.Fla 2009) distinguished asbestos cases from other products liability proceedings:   Previously, in In re Piper Aircraft Corp., 58 F.3d 1573 (11th Cir. 1995), the Eleventh Circuit had adopted a test for future claims different from the Third Circuit's *Frenville* test. Emphasizing the "unique nature of asbestos related illnesses Judge Cristol concluded" The court does not find the analysis in *Piper Aircraft* to be useful in asbestos cases. . . . the extremely long latency period for asbestos-related illness means that, while many victims may know of their exposure, if not their illness, at the time the tortfeasor files for bankruptcy and will decidedly have prepetition claims, others will have no knowledge of their exposure or their illness, and cannot be said to have had any cognizable relationship with the debtor, or any identifiable injury at the time of the bankruptcy.

"The end result of strictly applying the ruling in *Piper Aircraft* would essentially deny personal injury asbestos claimants (due to the extremely latent nature of their injuries) recovery from debtors, absent the debtor's choice to channel its asbestos liabilities to a trust pursuant to section 524(g) or its common-law predecessors or to otherwise provide for such claimants in a confirmed plan. Congress and the courts did not intend that asbestos claimants should have no ability to recover from a bankruptcy debtor simply because the debtor did not avail itself of the mechanisms for obtaining a channeling injunction or because, at the time it confirmed its plan, the debtor saw no need to otherwise provide for such asbestos claims by payment or other form of compensation."

For a discussion of the possible impact of Grossman's on product liability claims, see Joel S. Moss, *Frenville:  Dead and Buried in the Third Circuit*, 39 ABI J 1 (Sept. 2010) and the memorandum set out below prepared by Chris Towery, an outstanding third year law student at the University of Richmond Law School:

### II. How have subsequent court decisions interpreted *Grossman's*?

Several courts have perfunctorily cited *Grossman's* for the simple proposition that the term "claim" should be interpreted broadly. *In re Kane*, No. 09-4254, 2010 WL 5157162 (3d Cir. Dec. 21, 2010); *In re Jadczak*, No. 10-11804, 2011 WL 13612 (Bankr. E.D. Pa. Jan. 4, 2011); *In re Bath*, No. 09-14724, 2010 WL 4118109 (Bankr. E.D. Pa. Oct. 19, 2010); *In re Hutchinson*, No. 04-40835, 2010 WL 3218588 (Bankr. W.D. Ky. Aug. 13, 2010).

A panel of the Third Circuit conducted a slightly more substantive application of the *Grossman's* standard in *In re Rodriguez*, No. 09-2724, 2010 WL 5191428 (3d Cir. Dec. 23, 2010). In that case, Chapter 13 debtors claimed that their mortgage lender violated the automatic stay by seeking to recoup unpaid pre-petition escrow payments outside the bankruptcy proceedings.

At the time the petition was filed, the debtors were $5,657.60 behind on the amount due to the mortgage escrow account dedicated to costs paid by the lender, such as insurance and taxes. Of the total arrearage, $1,787.69 was not directly attributable to such costs. Instead, the $1,787.69 represented part of the one-sixth reserve that RESPA allows lenders to collect as a cushion on the total expected costs to be paid from the escrow account. Countrywide did not seek to recoup the reserve amount in the bankruptcy case. Instead, it recalculated the debtor's post-petition escrow payments on their mortgage account to include certain pre-petition escrow arrears.

Countrywide argued successfully to the bankruptcy court and the district court that it had no "claim" to the unpaid escrow amounts because a claim only accrued when Countrywide actually paid an escrow expense.

The Third Circuit reversed. The court held that the terms of the loan documents established an enforceable obligation to make the designated monthly payments into the escrow account. "*Grossman's* instructs that our focus should not be on when the claim accrues (with disbursement of Countrywide's own funds), but whether a claim exists." 2010 WL 5191428, at *18 (citing *Grossman's*, 607 F.3d at 121) (emphasis added).

## III. To what extent, if any, was the holding in *Grossman's* limited to asbestos-related cases?

In *Grossman's*, the court never explicitly limited the decision to asbestos-related cases. There are several indications that the standard set forth in *Grossman's* should be applied whenever the existence of a claim is at issue:

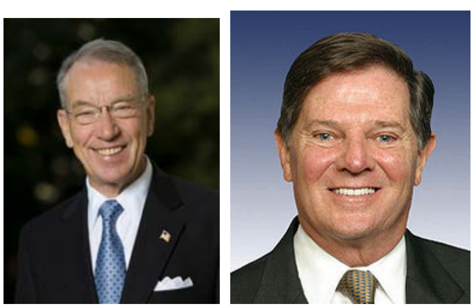
- *Grossman's* expressly (and without qualification) overruled *Frenville*, which was not an asbestos-related case: "We are persuaded that the widespread criticism of *Frenville*'s accrual test is justified, as it imposes too narrow an interpretation of a 'claim' under the Bankruptcy Code. *Accordingly, the Frenville accrual test should be and now is overruled*." 607 F.3d at 121.
- The language of the *Grossman's* holding seems to imply broad application: "a claim arises when an individual is exposed pre-petition to a product *or other conduct* giving rise to *an injury*." 607 F.3d at 125.
- Many of the cases cited in the *Grossman's* decision are not asbestos-related cases. 607 F.3d at 122-23.
- None of the cases which have cited or applied *Grossman's* have been asbestos-related cases:
    - *In re Rodriguez*, No. 09-2724, 2010 WL 5191428 (3d Cir. Dec. 23, 2010) (claim for arrearage on mortgage escrow account)
    - *In re Hutchinson*, No. 04-40835, 2010 WL 3218588, *2 (Bankr. W.D. Ky. Aug. 12, 2010) ("This Court fully concurs with the Third Circuit's approach in *Grossman's*.") (claim for negligence in preparation of mortgage)
    - *In re Kane*, No. 09-4254, 2010 WL 5157162 (3d Cir. Dec. 21, 2010) (claim related to equitable distribution)
    - *In re Jadczak*, No. 10-11804, 2011 WL 13612 (Bankr. E.D. Pa. Jan. 4, 2011) (claim for breach of contract related to auto sale)
    - *In re Bath*, No. 09-14724, 2010 WL 4118109 (Bankr. E.D. Pa. Oct. 19, 2010) (claim based on breach of contract and fraud)

A definitive answer on the application of *Grossman's* outside asbestos-related cases may be forthcoming. In *Wright v. Owens Corning*, No. 09-01567, 2010 WL 4546277 (W.D. Pa. Sept. 7, 2010), products liability plaintiffs who were allegedly injured post-petition argued in their opposition to summary judgment, *inter alia,* that *Grossman's* does not apply outside asbestos-related cases. However, there has not been a reported decision in the case.

# Part 2: FINDING ANSWERS TO BANKRUPTCY QUESTIONS IN THE UNIFORM COMMERCIAL CODE

Law professors generally give credit to Professor Llewellyn for the Uniform Commercial Code and to Professor Gilmore for Article 9 of the Uniform Commercial Code.

Law professors (and a lot of judges and lawyers) generally give blame (and worse) to Senator Grassley and former Congressman Delay for BAPCPA



While possible, it is unlikely that Tom Delay or Chuck Grassley ever met Grant Gilmore or Karl Llewellyn. Even less likely that Delay or Grassley ever had a conversation with Gilmore or Llewellyn.

Nonetheless many of the words used in Tom and Chuck's BAPCPA were also used in Karl and Grant's Uniform Commercial Code. Let's call words used in both the Bankruptcy Code and the Uniform Commercial Code "BUC" words.

Some of those BUC words are expressly defined in the Bankruptcy Code. Obviously, courts applying the Bankruptcy Code should and do look to those Bankruptcy Code definitions -- even if the Bankruptcy Code's definitions of the BUC words is different from the UCC's definition.

More of those BUC words are not defined in the Bankruptcy Code. The meaning of those BUC words not expressly defined in the Bankruptcy Code can be the key to answering important in both business bankruptcy proceedings and consumer bankruptcy proceedings.

*In re Erving Industries, Inc*., 432 B.R. 354 (Bankr. Mass. 2009) and *In re Penrod, 611 F.3d 1158 (9th Cir. 2010)* are just two examples of recent cases in which the meaning of a BUC term not defined in the Bankruptcy Code determined an important bankruptcy question.[1] *Erving* and *Penrod* are the most appropriate cases to consider because appeals are pending in both *Erving* and *Penrod*.

In *Erving*, the question was whether a provider of electricity was entitled to administrative priority claim for electricity that it has provided pre-petition. The answer turned on the meaning of the term "goods" in section 503(a)(9)

In *Penrod*, the question was whether a secured claim based on financing the debtor's acquisition of a car could be stripped down because a part of the financing was used to pay off the lien on the debtor's trade in. The answer turned on the meaning of the term "purchase money security interest" in section 1325.

Neither the term "goods" nor the phrase "purchase money security interest" is defined in the Bankruptcy Code. Both the terms "goods" and the term "purchase money security interest" are defined in the Uniform Commercial Code.[2] And so both cases provide an opportunity to consider the extent to which courts in determining the meaning of BUC terms not expressly defined in the Bankruptcy Code should rely on Uniform Commercial Code definitions.

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1 In re Circuit City Stores, Inc., 432 B.R. 225 (Bankr. E.D. Va. 2010("received"/"receipt") and In re Las Vegas Monorail, Inc., 429 B.R. 317 (Bankr. Nev. 2010)("proceeds") are other examples.

2. The Uniform Commercial Code, however, is not the only statute with a definition of goods. For example, the Fair Labor Standards Act, a federal statute, contains a definition of "goods." And, the Uniform Commercial Code contains similar but not identical definitions of "goods" in Article 2 and Article 2A.

### *1.* *Erving* and Electricity as Section 503(b)(9) "Goods"

Section 503(b)(9), a BAPCPA amendment to the Bankruptcy Code, grants an administrative priority claim for the value of "goods" received by the debtor within 20 days prior to the commencement of the bankruptcy case. NewEnergy timely filed a section 503(b)(9) claim for electricity. The Debtor objected to the NewEnergy section 503(b)(9) claim, contending that electricity is not "goods" as the term "goods" is used in section 503(b)(9).

The bankruptcy court rejected the Debtor's contention. In determining that electricity is "goods" for purposes of BAPCPA section 503(b)(9), the bankruptcy court was "primarily informed by the meaning of goods under Article 2 of the UCC ."

In the *Erving*, opinion, Judge Boroff was wonderfully candid in stating the reason for relying the Uniform Commercial Code definition of goods: "Given the wide usage and acceptance of the definition of goods found in the UCC at 2-105[3], it is hardly plausible that Congress expected bankruptcy judges to roll up their sleeves and set to work re-inventing the proverbial wheel and diving a more amorphous 'common understanding' of the term." Judge Boroff does not, however, explain what he means by "wide usage and acceptance."

Obviously, the statutory definition of "goods" in the Uniform Commercial Code should be (and has been) widely applied in deciding whether a particular transaction is a "transaction in goods" so that, under UCC section 2-102, "this Article [Article 2 of the Uniform Commercial Code] applies." However, prior to *Erving* and other cases applying BAPCPA, there has not been "wide usage and acceptance" of the Uniform Commercial Code definition of goods in resolving issues governed by the Bankruptcy Code.[4]

[4] The term "goods" appears in other sections of the Bankruptcy Code – 101(4)(A), 522(f), 523(a)(3), 546, 547, 1104.

The only such reported[5] case that I could find is *In re GIC Government Sec.* 64 B.R. 161 (Bankr. M.D. Fla. 1986) in which Judge Paskay dismissed a seller of securities' motion to reclaim securities under section 546(c), stating: §546© applies only to "goods" and § 2-105(1) of the Uniform Commercial Code . . . expressly excludes investment securities such as the one in issue here from the definition of goods." Id at 162

And, there has not been "wide usage" of the Uniform Commercial Code's definition of goods to determine whether electricity is "goods" as defined in the Uniform Commercial Code. I can find only 12 opinions on Westlaw[6] – all trial court or intermediate appellate court opinions that even consider the question of whether electricity is a goods under the Uniform Commercial Code.[7] And, not surprisingly, these cases are divided on the question of whether electricity is a "good" as that term is defined by section 2-105(1) of the Uniform Commercial Code.

As Dean Gregory Maggs explains, " Section 2-105(1) says that goods includes "things" that are "movable" at the time of identification to the contract. Nothing in the UCC, however, defines the words "things" or "movable." These terms may be sufficiently clear to exclude certain subjects, like services (which are not things) and real estate (which is not movable). Providing definitions of these terms, however, might have helped to resolve **ambiguity** about their application to other items, like electricity."[8] (emphasis added)

And, so, notwithstanding "the wide usage and acceptance of the definition of goods found in the UCC at 2-105", Judge Boroff still had to "roll up his sleeves." Indeed, Judge Boroff's lengthy opinion includes a four

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[5] Perhaps there are more unreported decisions under section 546(c) that apply section 2-105 (or even reported decisions that I did not find) Judge Huennekens in one of the Circuit City opinions states: " Indeed, bankruptcy courts have generally applied the definition of the word 'goods' contained in the UCC in determining the application of section 546(c) of the Bankruptcy Code. See, e.g., *In re GIC Government Sec.*, 64 B.R. 161, 162 (Bankr. M.D. Fla. 1986)." *In re Circuit City Stores, Inc.*, 416 B.R. 531, 536 (Bankr. E.D. Va 2009)

[6] I did a September 7, 2010, search for cases that used the word "electricity" and "2-105" in the same paragraph.

[7] And, one pre-UCC case, Fickesen v. Wheeling Electrical Co., 67 S.E. 788 (W.Va. 1910) concluding that sales law should govern a sale of electricity.

[8] Gregory E. Maggs, *Patterns of Drafting Errors in the Uniform Commercial Code and How Courts Should Respond to Them*, 2002 U.Ill.L.R 81, 101

paragraph explanation of what electricity is[9] , two more paragraphs distinguishing electricity from communication signals[10] and 43 footnotes.

Footnote 22 is especially interesting. "The Court further agrees that the UCC definition is 'consistent with the ordinary, non-legal meaning of the word' and the adoption of the Debtor's proposed alternative definition would have made no difference to the outcome of the case."

*Erving* is neither the last nor the only reported decision to look to the Uniform Commercial Code definition of "goods" in applying Bankruptcy Code section 503(b)(9). Most recently, GFI Wisconsin, Inc. v. Reedsburg Utility Comm'n, 2010 WL 4595508 (Bankr. W.D. Wisc., 2010), the court stated:

"It is possible that the meaning of goods for purposes of § 503(b)(9) of the Bankruptcy Code is different from the meaning of goods under the UCC because the laws have different purposes. Section 503(b)(9) is a priority provision, unique to federal law. Presumably, one of the reasons § 503(9)(b) was enacted was to prevent debtors from stockpiling "goods" in the days leading up to their bankruptcy filings.. The UCC uses the term "goods" to delineate the scope of all of Article 2 and to determine whether the UCC applies to a particular transaction. UCC § 2-102 ("[T]his Article applies to goods....").

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[9] Almost as clear as Mr. Wizard's. http://www.archive.org/details/IfYouWannaBeHappy but not nearly as interesting as Dave Barry's: " the greatest Electrical Pioneer of them all was Thomas Edison, who was a brilliant inventor despite the fact that he had little formal education and lived in New Jersey. Edison's first major invention in 1877 was the phonograph, which could soon be found in thousands of American homes, where it basically sat until 1923, when the record was invented. But Edison's greatest achievement came in 1879 when he invented the electric company. Edison's design was a brilliant adaptation of the simple electrical circuit: The electric company sends electricity through a wire to a customer, then immediately gets the electricity back through another wire, then (this is the brilliant part) sends it right back to the customer again.

This means that an electric company can sell the customer the same batch of electricity thousands of times a day a never get caught, since very few customers take the time to examine their electricity closely. In fact, the last year any new electricity was generated in the United States was 1937; the electric companies have been merely re-selling it ever since, which is why they have so much free time to apply for rate increases." Dave Barry, "Socket To 'Em" http://www.jimpoz.com/jokes/electricity.html

[10] But cf Dave Barry, Dave Barry in Cyberspace 31 et seq (1996) http://books.google.com/books?id=xM47GawJyOoC&pg=PA31&lpg=PA31&dq=dave+barry+and+sam+the+sham&source=bl&ots=SZnwJA3E8V&sig=vsdqSOVnkQjM9eyAXmIUREG0pi8&hl=en&ei=1JiGTKu5DsOBlAeuq9XYDw&sa=X&oi=book_result&ct=result&resnum=3&ved=0CBsQ6AEwAg#v=onepage&q&f=false

However, the bankruptcy court below and the parties in this case assume that the UCC definition applies. Absent a different definition in the Bankruptcy Code or controlling case law, I conclude that it is reasonable to apply the definition provided by the UCC, as courts often do when interpreting Bankruptcy Code provisions, *In re Peaslee,* 547 F.3d 177, 184 n. 13 (2d Cir.2008). The UCC has been accepted by nearly all of the states and governs the sale of goods. Thus, most participants in the marketplace would not be surprised that the definition of "goods" that applies to ordinary transactions governed by the UCC would govern the meaning of the term in bankruptcy."

A similar statement can be found one of the Circuit City opinions, In re Circuit City Stores, Inc., 416 B.R. 531 (Bankr. E.D. Va. 2009).

Because the *Circuit City* proceeding did not involve a specific transaction, we do not know whether in *Circuit City* as in *Erving,* the court's adoption of the "UCC definition of goods made no difference to the outcome of the case." What will make a difference to the outcome of other cases was the court's adoption of the UCC's "primary purpose test."

Many of the section 503(b)(9) claims in the Circuit City case were based on "hybrid transactions involving contracts for the delivery of goods and services." 416 B.R. 537. There is a substantial body of case law that deals with the question of whether Article 2 of the Uniform Commercial Code or common law or both should govern a transaction that involves both goods and services. The new edition of the White & Summers Uniform Commercial Code hornbook summarizes this case law as follows: "In such hybrid cases, a minority of courts apply Article 2 to the sale of goods aspects to the transactions only, whereas a majority apply Article 2 if the 'predominant purpose' of the whole transaction and in that event the majority usually applies Article 2 to the whole. If a sale of goods is not the 'predominant purpose', then Article 2 does not apply at all." James J. White & Robert S. Summers, Uniform Commercial Code 28 (6th ed 2010).

This "predominant purpose test" makes sense when the question is the Uniform Commercial Code question of whether Article 2 of the Uniform Commercial Code or common law or both should govern a transaction that involves both goods and services. Assume, for example, that S and B contract for the sale and installation of light fixtures, a contract that covers both goods and services. Under the predominant purpose test, questions such as the admissibility of parol evidence will be governed by either section 2-202 of the Uniform Commercial Code or common law parol evidence rule but not both.

The rationale for the "predominant purpose test" is less obvious when the question is the Bankruptcy Code question of whether section 503(b)(9) requires that the Debtor pay not only the "value" of the light fixtures, i.e., the goods, but also for the related services. The services provided by S in installing the light fixtures in my hypothetical, unlike the electricity in the Erving case, are not "consistent with the ordinary, non-legal meaning of the word" goods. *Circuit City,* nonetheless, looked to this UCC caselaw to answer the bankruptcy law question of how to apply section 503(b)(9) to a hybrid transaction: "the predominant purpose test . . . should be used to determine whether a claim is for the selling of 'goods' and hence correctly classified as a section 503(b)(9) claim or for the selling of services and should be classified as a general unsecured claim." Id at 539.

In so ruling, *Circuit City* cites to and relies on a recent decision by the United States Court of Appeals, *In re Price*, 562 F.3d 618 (4th Cir. 2009) and an earlier Supreme Court decision, *Butner v. United States*, 440 U.S. 48 (1979)

### *2.* Price, Peaslee, Penrod, "Negative Equity" and "Purchase Money Security Interest"

The recent decision by the United States Court of Appeals for the Fourth Circuit in *In re Price*, 562 F.3d 618 (4th Cir. 2009) cited in *Circuit City,* like the still more recent decision by the United States Court of Appeals for the Ninth Circuit in *In re Penrod*, 611 F. 3d 1158 (9th Cir. 2010) and the earlier decision by the Second Circuit in Peaslee, 585 F.3d 53 (2d Cir. 2009) involved the BUC term "purchase money security interest" as used in section 1325. More specifically, in both Price and Penrod the debtor had (i) bought a car on credit, (ii) using a trade in with negative equity (i.e., the amount the debtor owed on that trade in was greater than the value of the trade in) (iii) which was financed by a loan secured by the new car (iv) in an amount sufficient to cover not only the cost of the new car less the amount of trade in but also the balance owed on the trade in.

To illustrate, B owes X $10,000 on her station wagon. B wants to buy a new convertible from Y for $24,000. Y is willing to take the station wagon as a trade in and reduce the price from $24,000 to $20,000. B borrows $30,000 from Z, grants Z a security interest in the new convertible and uses $10,000 of the Z loan proceeds to pay X and the other $20,000 of the loan proceeds to pay Y.

If within 910 days thereafter, B files for bankruptcy, then it will be important to determine whether Z's security interest in the convertible is a "purchase money security interest" as that term is used in section 1325. As a part of BAPCPA sweeping changes of consumer bankruptcy law, a Chapter

13 debtor cannot modify the terms of Z's car financing if Z's security interest is a "purchase money security interest."

The facts in both Price and Penrod were basically the same as the facts of the hypothetical in the preceding paragraph. A security interest in a car financing with a negative equity component. In Price, our own Judge Wilkinson writing for a unanimous Fourth Circuit panel concluded that Z's (Wells Fargo Financial Acceptance) security interest resulting from the negative equity car financing was a purchase money security interest and so was protected by section 1325 from modification. In *Penrod,* Judge Mills, writing for a unanimous Ninth Circuit panel, concluded that Z's (Americredit Financial Services, Inc) security interest resulting from a car financing with a negative equity component was not a purchase money security interest and so was not protected by section 1325 from modification.

Prior to the litigation generated by the BAPCPA amendments, there were no reported cases considered whether a security interest resulting from a car financing was a "purchase money security interest" as that term is used in Article 9. Not just no UCC reported cases on whether a car financing with a negative equity component was a purchase money security interest – no UCC reported cases questioning whether any car financing was "purchase money."

Under the Uniform Commercial Code, the question of whether a security interest is "purchase money" arises only when the question is there a dispute between a purchase money security interest and an earlier in time security interest that includes after-acquired property or a question of whether a security interest in consumer goods in automatically perfected. Neither of these questions arises in connection with car financings.[11]

With no UCC case law on whether a car financing with a negative equity component is a "purchase money security interest" as that term is defined in the UCC, both the Fourth Circuit and the Ninth Circuit, as have all other circuits, looked only to the definition of that "purchase money security interest": in U.C.C. § 9-103. U.C.C. § 9-103(b) provides that "[a] security interest in goods is a purchase money security interest... [t]o the extent that the goods are purchase money collateral with respect to that security interest." The term "purchase money collateral" is defined in U.C.C. § 9-103(a)(1) to mean "goods or software that secures a purchase money obligation." Under § 9-103(a)(2), "purchase money obligation" means "an

[11] Prior to BAPCPA, the use of the UCC definition of "purchase money security interest" in bankruptcy cases was limited largely to cases under section 522(f) which reflects a Bankruptcy Code policy against a creditor having a security interest in household goods that it did not enable the debtor to obtain. Section 522(f) does not apply to automobile financing.

obligation of an obligor incurred as all or part of the price of the collateral or for value given to enable the debtor to acquire rights in or the use of the collateral if the value is in fact so used." (emphasis added)

Both the Fourth Circuit and the Ninth Circuit, like all other circuit courts that have addressed the issue, focused on the word "price" and then looked to Official Comment 3 to U.C.C. § 9-103 where there is a definition of "price." The Official Comment says:

"As used in subsection (a)(2), the definition of "purchase-money obligation," the 'price' of collateral or the "value given to enable" includes obligations for expenses incurred in connection with acquiring rights in the collateral, sales taxes, duties, finance charges, interest, freight charges, costs of storage in transit, demurrage, administrative charges, expenses of collection and enforcement, attorney's fees, and other similar obligations." (emphasis added)."

In both the Fourth Circuit *Price* case and the Ninth Circuit *Penrod* case, the secured party argued that negative equity is an "expense[ ] incurred in connection with acquiring rights in the collateral" and/or that negative equity is an "other similar obligations." These arguments were accepted by the Fourth Circuit, rejected by the Ninth Circuit.

As the attorney who "won" the Price appeal to the Fourth Circuit, I am not the appropriate person to address the question of whether the Fourth Circuit or the Ninth Circuit found the correct answer. As a law professor who is constantly urging my students to question not just the result but the reasoning in the cases they read, I am an appropriate person to question where both the Fourth and Ninth Circuits are looking the wrong place for answers.

In sum, the question of whether a car financing transaction with a negative equity component, i.e., most car financings by debtors who file for Chapter 13 relief within 910 days thereafter,[12] can be modified by Chapter 13 plans is being decided by words in Official Comments that are not in any sense "official" to a UCC definition that do not use the words "negative equity" and have never been used and were never intended to be used in car financing cases under the UCC. Why? Why are courts trying to figure out what Karl and Grant and their colleagues might have intended had they intended to cover car financings instead of what Tom and Chuck and their colleagues intended when they decided to cover car financings?

[12] Cf In re Pajot, 371 B.R. 139, 153 (Bankr. E.D.. Va. 2007)(estimating that half of the vehicle financing transactions in Chapter 13 cases involve negative equity)

### *3.* But Butner

In *Price*, Judge Wilkinson's answer for looking to Karl and Grant instead of Tom and Chuck was "We apply this state-law definition because, when determining the substance of property rights and security interests in bankruptcy, "the basic federal rule is that state law governs." *Butner v. United States,* 440 U.S. 48, 57, 99 S.Ct. 914, 59 L.Ed.2d 136 (1979). Because Congress did not provide its own definition of "purchase money security interest," no federal law prevents our use of North Carolina's [UCC] definition of that term here."

*Butner* is frequently cited, frequently quoted in support of use of state law in bankruptcy cases: "Property interests are created and defined by state law. Unless some federal interest requires a different result, there is no reason why such interest should be analyzed differently simply because an interested party is involved in a bankruptcy case." In *Butner*, a secured party was arguing that it should have the same rights in bankruptcy as it had under state law. In *Price* and *Penrod*, the underlying question was whether a secured party should have the same or lesser rights in bankruptcy as it had under state law. In *Erving* and *Circuit City*, the underlying question was whether a vendor has the same or greater rights in bankruptcy as it had under state law. In both situations, why not focus on whether some "federal interest" created by Tom or Chuck requires a different result instead of looking to Karl and Grant's definitions?

### *4.* Nature of the General Question

In both *Erving* and in *Penrod* the question for the court was the application of undefined terms in the Bankruptcy Code to a specific fact pattern. Simply a question of statutory interpretation.

I understand that questions of statutory interpretation are not simple. Reasonable people differ as to how statutes in general and BAPCPA in particular should be interpreted. There are continuing debates over methods of statutory interpretation and considerable confusion as to how the "plain meaning" and "new textualism" approaches differ.

I will leave such debates for law review articles written by scholars and judges.[13] For my discussion of *Erving* and *Penrod* let me simply suggest that the courts were (1) asking "harder" questions that they needed to ask to

[13] See, e.g., Jean Braucher, *A Guide to the Interpretation of the 2005 Bankruptcy Law*, 16 Am. Bankr. Inst. L,. Rev. 349 (2008); Hon. Thomas F. Waldron & Neil M. Berman, *Principled Principles of Statutory Interpretation: A Judicial Perspective After Two Years of BAPCPA*, 81 Am. Bankr.L.H. 195 (2007)

decide the case before them and (2) looking only in the "easiest" place for the answer.

Judge Boroff was not being asked to amend section 101 of the Bankruptcy Code by adding a definition of "goods." He was being asked to decide whether Tom, Chuck and their Congressional colleagues intended for BAPCPA section 503(a)(9), an amendment to supplement (if not supplant) section 546(c), to require Chapter 11 debtors to have pay for prepetition electricity as an administrative expense.

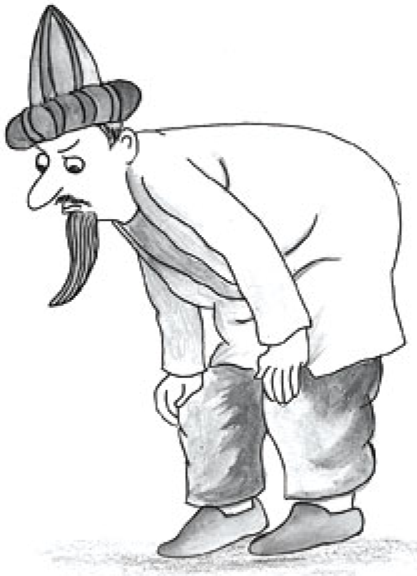
Similarly, Judge Mills and his panel member colleagues were not being asked to amend section 101 of the Bankruptcy Code by adding a definition of "purchase money security interest."[14] They were being asked to decide whether Tom, Chuck and their Congressional colleagues intended for BAPCPA 1325, an amendment to protect car financings from strip down in their new consumer bankruptcy regime, to leave most car financings unprotected from strip down.

I am not suggesting that Uniform Commercial Code definitions is not one of the places to look for an answer to these questions. It's just that there are statements in _*Erving*_ and _Penrod_ (and _*Price*_ and _*Circuit City*_) that can be read as stating that UCC definitions are the only place to look in applying BUC terms

Those statements bring to mind the story of the Mullah Nasrudin and his lost key[15]:

[14] But cf In re Price, 624 (4th Cir. 2009)(" Wells Fargo nonetheless argues that we can construct a federal definition of 'purchase money security interest' for purposes of the hanging paragraph. We disagree.") Hopefully, I have been more effective in explaining my suggestion to you than I was in explaining my argument to Judge Wilkinson.

[15] See generally http://mullanasrudinjokes.blogspot.com/



One night, a friend sees Mullah Nasrudin looking for something next to a lamp post in the street and asks what he is doing. The Mullah responds: "I am looking for my keys which I have lost. The friend says that he will help and for more than an hour they two of them search the ground under the lamp post. Finally, the friend asks "Are you sure that this where you lost your keys." When the Mullah says "no", the exasperated friend shouts: Then why are we only looking under the lamp post." Nasrudin smiles and says "There is much more light here,"

With all due respect to all "Mullahs", there is much more light in (1) looking to the ordinary and natural meaning of words[16], (2) considering the statutory context,[17] and (3) choosing a meaning that effectuates congressional intent[18].

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[16] See Rux v. Republic of Sudan, 461 F.3d 461, 470 (4th Cir. 2006)

[17] See Circuit City Stores, Inc, v, Adams, 532 U.S. 105, 118 (2001) As Judge Markell recently wrote in In re Shat, 424 B.R. 854, 868 (Bankr. Nev. 2010):: " Our goal in interpreting a statute is to understand the statute 'as a symmetrical and coherent regulatory scheme' and to 'fit, if possible, all parts into a ... harmonious whole.' " *Am. Bankers Ass'n v. Gould,* 412 F.3d 1081, 1086 (9th Cir.2005) (quoting *Food & Drug Admin. v. Brown & Williamson Tobacco Corp.,* 529 U.S. 120, 133, 120 S.Ct. 1291, 146 L.Ed.2d 121 (2000)). As the Court said in a nonbankruptcy context, "statutory language cannot be construed in a vacuum. It is a fundamental canon of statutory construction that the words of a statute must be read in their context and with a view to their place in the overall statutory scheme." *Davis v. Mich. Dep't of Treasury,* 489 U.S. 803, 809, 109 S.Ct. 1500, 103 L.Ed.2d 891 (1989)."

[18] See United Hosp. Ctr. Inc. v. Richardson 757 F,.2d 1445, 1453 ((4th Cir. 1985).