CBA Business Law Section; The Many Sides of Bankruptcy Law
"The Intersection of Securities and Bankruptcy"
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I. Stay of Litigation

a. Automatic Stay Under 11 U.S. Code § 362

The filing of a bankruptcy immediately operates as an automatic stay of all actions against a debtor and his or her property. 11 U.S.C. §362(a). If the debtor files for bankruptcy under Chapter 13, the automatic stay extends to any individual who is liable on a consumer debt with the debtor. 11 U.S.C. §1301.

The scope of the protection of the automatic stay is broad, but it only stays actions against the debtor. The protections of the bankruptcy stay do not extend to entities such as, "sureties, guarantors, co-obligors, or others with a similar legal or factual nexus to the ... debtors." *McCartney v. Integra Nat'l Bank N.,* 106 F.3d 506, 509–510 (3rd Cir.1997) *quoting Maritime Elec. Co. v. United Jersey Bank,* 959 F.2d 1194, 1204 (3rd Cir.1991).

Any action taken in violation of the automatic stay is void and without effect. *Franklin Sav. Ass'n v. Office of Thrift Supervision*, 31 F.3d 1020 (10th Cir. 1994). Importantly, the automatic stay does not stop a debtor's actions or claims against creditors or third parties. *Victor Foods, Inc. v. Crossroads Economic Development of St. Charles County, Inc.,* 977 F.2d 1224 (8th Cir. 1992); *Martin-Trigona v. Champion Federal Sav. and Loan Ass'n,* 892 F.2d 575 (7th Cir. 1989). A debtor may continue to pursue claims and/or counterclaims against a creditor in a non-bankruptcy forum even while the creditor is prohibited from continuing its claims against the debtor.

Creditors beware: violations of the automatic stay are sanctionable. *In re Skinner*, 917 F.2d 444 (10th Cir. 1990); *In re Aspen Limousine Svc., Inc.*, 198 B.R. 341 (D. Colo. 1996). Individual debtors have a cause of action for damages for violations of the automatic stay, including attorney's fees. 11 U.S.C. §362(k). Entities can seek sanctions for stay violations under 11 U.S.C. §105(a). *Standard Indus., Inc., v. Aquila, Inc. (In re C.W. Mining Co.)*, 625 F.3d 1240 (10th Cir. 2010).

One important exception to the automatic stay is that bankruptcy does not stop an action or proceeding against a debtor brought by a governmental unit to enforce the police and regulatory power. 11 U.S.C. §362(b)(4). This exception includes enforcement of a money judgment obtained in such governmental action or proceeding. *Id.*

Question: When should a debtor anticipating or defending claims file?

b. Discretionary Stay in Cases of Alleged Criminal Conduct.

The Fifth Amendment provides "no person . . . shall be compelled in any criminal case to be a witness against himself." However, while "[p]arties are free to invoke the Fifth Amendment in civil cases, but the court is equally free to draw adverse inferences from their failure of proof." *S.E.C. v. Colello*, 139 F.3d 674, 677 (9th Cir. 1998). Therefore, parties under criminal prosecution or investigation for securities violations may seek a stay of parallel civil litigation. *See Steiner v. Minnesota Life Insurance Co.*, 85 P.3d 135 (Colo. 2004) ("The appropriate remedy will of course depend upon the facts and circumstances of each case. In some instances, courts have found it proper to impose a stay of the civil proceeding until the parallel criminal proceeding has completed.").

II. Resolving Claims Through Bankruptcy Court

a. Filing Proof of Claim

Whether the debtor files Chapter 7 or Chapter 13, a creditor should always file a proof of claim in the case. Typically, Chapter 7 cases are "no asset" cases and unless the Trustee recovers property, there may not be a distribution. The deadline to file a claim is 90 days after the first date set for the meeting of creditors. Fed.R.Bankr.P. 3002(c). In a "no asset" case, the creditor will not initially receive the form for the proof of claim. The creditor should pay attention to further notices it receives from the Bankruptcy Court as there may be a later date to file the claim. In a Chapter 13 case, a form will be mailed with the notice of the meeting of creditors. In a Chapter 11 case, if the debtor has listed the creditor as not disputed, not contingent, and liquidated, then the creditor need not file a proof of claim if the creditor agrees with the amount listed by the debtor. 11 U.S.C. §1111(a). If the debtor lists the creditor as disputed, contingent or unliquidated, or if the creditor disagrees with the amount listed by the debtor, the creditor should file a proof of claim with the court.

The filing of a proper proof of claim is *prima facie* evidence of the debt. Fed.R.Bankr.P. 3001(f). There are very specific rules on the information that must be contained in the proof of claim. Fed.R.Bankr.P. 3001(c). If the claim is based on a writing, the creditor must attach a copy of the document. Fed.R.Bankr.P. 3001(c)(1). Moreover, the creditor must attach supporting information, including an itemization if the claim includes interest, fees, expenses or other charged. Fed.R.Bankr.P. 3001(c)(2). Failure to provide this documentation and information, may preclude the creditor from introducing such information in a contested hearing. Fed.R.Bankr.P. 3001(c)(2)(D). *See In re Reynolds*, 470 B.R. 138 (Bankr.D.Colo. 2012).

The form may be obtained from the Bankruptcy Court, and is also attached to these materials. http://www.cob.uscourts.gov/forms.asp. The deadline for filing proofs of claim (known as the "bar date") cannot be extended under the excusable neglect standard. *Jones v. Arross*, 9 F.3d 79 (10th Cir.1993). However, if the claim is allowed, the creditor will receive a

pro rata distribution of assets, following payment of administrative expenses and the Trustee's fee.

Practice note: If your client owes or will owe fees, consider making your trust account the payee on the proof of claim.

b. Fraudulent Transfer Litigation

Under the Uniform Fraudulent Transfer Act, a fraudulent transfer occurs when the debtor makes a transfer (1) "with actual intent to hinder, delay, or defraud any creditor of the debtor" or (2) "without receiving a reasonably equivalent value" where the debtor has "unreasonably small" remaining assets to conduct business or the debtor knew or should have known he would soon incur debts "beyond his ability to pay." C.R.S. § 38-8-105. Normally, the creditor can pursue her statutory remedies, for example, to avoid the transfer or to attach the asset. C.R.S. § 38-8-108. However, when a debtor in bankruptcy has made the transfer, the bankruptcy trustee may claim that the creditor is recovering or has recovered an asset of the bankruptcy estate and may seek to avoid the creditor's recovery as a preference. 11 U.S.C. §§ 541 & 547. The Bankruptcy Code also gives the trustee special powers to void fraudulent transfers (11 U.S.C. §§544 & 548), to recover fraudulently transferred assets (11 U.S.C. §§550 & 551), and to sell property (11 U.S.C. §363). *See Larson v. Munoz (In re Munoz)*, 111 B.R. 928, 930 (D. Colo. 1990) (creditor lacks standing claims under § 544 because the Code specifically limits the §544 powers to the trustee.); *but see also Starzynski v. Sequoia Forest Indus.,* 72 F.3d 816, 821 (10th Cir. 1995) (allowing creditor to obtain court-approved "derivative standing" to bring avoidance actions on behalf of the estate where the trustee fails to do so); *Hill v. Akamai Technologies, Inc. (In re MS55, Inc.)* 477 F.3d 1131, 1139 n.9 (10th Cir. 2007) (questioning whether creditor may obtain derivative standing).

Practice note: Creditors take a risk when they pursue assets that a bankruptcy estate may claim. Creditors should consider whether it is in their best interest to encourage the trustee to bring these claims.

Question: What happens when a broker-dealer closes its doors, but doesn't file a bankruptcy?

c. Adversary Proceedings

1. Exception to Discharge: Section 523(a)(19)

Under § 523(a)(19) an individual debtor cannot obtain a discharge of any debt that:

(A) is for—

(i) the violation of any of the Federal securities laws (as that term is defined in section 3(a)(47) of the Securities Exchange Act of 1934), any of the State securities laws, or any regulation or order issued under such Federal or State securities laws; or

(ii) common law fraud, deceit, or manipulation in connection with the purchase or sale of any security; and

(B) results, before, on, or after the date on which the petition was filed, from—

(i) any judgment, order, consent order or decree entered in any Federal or State judicial or administrative proceeding;

(ii) any settlement agreement entered into by the debtor; or

(iii) any court or administrative order for any damages, fine, penalty, citation, restitutionary payment, disgorgement payment, attorney fee, cost, or other payment owed by the debtor.

Section 523(a)(19) does not require that a judgment be entered on securities fraud prior to the defendant's bankruptcy filing. In *In re Chan*, 355 B.R. 494 (Bankr.E.D.Pa. 2006), the Court discussed whether to grant relief from stay. The Court in *Chan* noted that the changes to Section 523(a)(19) under the BAPCPA amendments to Section 523(a)(19) were "added to the statute to remove a temporal limitation from the elements of the §523(a)(19) discharge exception." *Id.* Specifically, "Congress added the phrase, 'before, on, or after the date on which the petition was filed," clarifying that a plaintiff whose claim had not been reduced to judgment may still seek an exception to discharge.'" *In re Lichtman*, 388 B.R. 396, 409 (Bankr. M.D. Fla. 2008). Accordingly, no pre-bankruptcy judgment is necessary for a finding of non-dischargeability. Rather, the determination can be made post-bankruptcy. *In re Jafari*, 401 B.R. 494, 496 (Bankr.D.Colo. 2009) (Brown, J.).

However, the bankruptcy courts are divided on whether they may enter the securities judgment to establish non-dischargeability under Section 523(a)(19). The leading case in Colorado, *In re Jafari*, holds that securities fraud liability must be determined by a non-bankruptcy forum before determination of dischargeability. 401 B.R. 494 at 496 (lifting bankruptcy stay to permit the non-bankruptcy forum to decide whether the securities violation occurred), *see also In re James, slip op., Adv. Proc. No. 11-1837-MER* (Bankr.D.Colo. Oct. 11, 2012) (Romero, J.) (following *Jafari*); *In re: Larry Ivan Behrends*, 14-CV-03247-REB-AP, 2015 WL 5728825, at *4 (D. Colo. Sept. 30, 2015) (appeal pending) (bankruptcy court granted relief from automatic stay so that adversary plaintiffs could obtain confirmation of FINRA arbitration award in state court); *In re Zimmerman*, 341 B.R. 77 (Bankr.N.D.Ga. 2006) (holding Section 523(a)(19) "expressly contemplates a post-petition determination of liability by a nonbankruptcy forum"); *McGraw v. Collier* (*In re Collier*), 497 B.R. 877, 894 (Bankr.E.D.Ark.2013) (adopting *Jafari*); *Terek v. Bundy (In re Bundy),* 468 B.R. 916, 921 (Bankr.E.D.Wash.2012) (ruling that allowing a bankruptcy court to decide liability for securities violations renders section 523(a)(19)(B) superfluous); *Voss v. Pujdak (In re Pujdak)*, 462 B.R. 560, 574 (Bankr.D.S.C.2011) (stating nonbankruptcy tribunals must decide securities law violations); *Cutcliff v. Reuter* (*In re Reuter*), 427 B.R. 727, 760 (Bankr.W.D.Mo.2010), aff'd, 443 B.R. 427 (8th Cir. BAP 2011), aff'd, *807 686 F.3d 511 (8th Cir.2012) (stating in dicta that if the issue were before it, the court would likely agree with *Jafari* that a non-bankruptcy forum is required to determine liability under section 523(a)(19)(B)).

Other courts, outside Colorado, have held that that the bankruptcy court itself may enter the securities judgment. *See, e.g., In re Chui*, 538 B.R. 793, 806-07 (Bankr. N.D. Cal. 2015) (holding bankruptcy court may enter judgment in satisfaction of section 523(a)(19)(B)); *Floyd v. Hill* (*In re Hill*), 495 B.R. 646 (Bankr.D.N.J.2013); *Gelber v. Jensen–Ames* (*In re Jensen–*

Ames), 2011 WL 1238929, at *7–8, 2011 Bankr. LEXIS 1207, at *21 (Bankr.W.D.Wash. Mar. 29, 2011); *Williams v. Sato (In re Sato)*, 512 B.R. 241, 252 (Bankr.C.D.Cal.2014); *One Longhorn Land I, L.P. v. Presley,* 529 B.R. 755, 761 (C.D.Cal.2015).

2. Exception to Discharge: Fraud, Section 523(a)(2) & (4)

Question: when does issue preclusion from nonbankruptcy proceedings apply?

The determination of non-dischargeability due to fraud is a federal question. *In re Sawyer*, 112 B.R. 386 (D.Colo. 1990); *See also Rishell v. Davis (In re Davis)*, 115 B.R. 346 (Bankr.N.D.Fla.1990); *see also Merchants Nat'l Bank & Trust v. Pappas (In re Pappas)*, 661 F.2d 82 (7th Cir.1981) ("Bankruptcy Court has exclusive jurisdiction to determine the meaning of false pretenses and false representations, without having to look to ... state law...."). [1] Similarly, whether a debtor qualifies as a "fiduciary," within meaning of Section 523(a)(4), is question of federal and not state law. *In re Stout,* 123 B.R. 412 (Bankr.W.D.Okla. 1990); *In re Weber*, 99 B.R. 1001 (Bankr.D.Utah 1989). A registered investment advisor qualifies as a fiduciary within the meaning of Section 523(a)(4). *In re Peterson*, 96 B.R. 314 (D.Colo. 1988).

In *Hartford Fin. Holdings, Inc. v. Singer*, 2010 U.S. Dist. LEXIS 45045, 2010 WL 1838843 (S.D.N.Y. May 3, 2010), the court considered whether a pre-petition arbitration award collaterally estopped the debtor from re-litigating the fraud issues. The findings of the FINRA Arbitration Panel included a finding of liability, a determination and award of an amount damages and interest. *Hartford Fin. Holdings, Inc. v. Singer*, 2010 WL 1838843 *1. The Court in *Singer* reserved the determination of whether a debt is dischargeable under 11 U.S.C. §523(a)(4), because such determination was within the sound jurisdiction of the Bankruptcy Court. *Id.*, * 5. The Court further noted that the Federal Arbitration Act precluded the Bankruptcy Court from altering the Arbitration Award or making a determination on the merits of the award. *Id.* (*citing* 9.U.S.C. §11(c) and *LLT Int'l, Inc. v. MCI Telecomms. Corp.*, 69 F.Supp.2d 510, 517 (S.D.N.Y.1999).

The doctrine of collateral estoppel "may be invoked to bar relitigation of the factual issues underlying the determination of dischargeability." *Wallace v. Klemens (In re Wallace)*, 840 F.2d 762, 764 (10th Cir. 1988). *See Grogan v. Garner*, 498 U.S. 279, 285, n.11 (1991). To determine whether to apply collateral estoppel—or as it is presently known, issue preclusion—courts apply a four-factor test, asking whether "(1) the issue precluded is identical to an issue actually litigated and necessarily adjudicated in the prior proceeding; (2) the party against whom estoppel was sought was a party to or was in privity with a party to a prior proceeding; (3) there was a final judgment on the merits in the prior proceeding; (4) the party against whom the doctrine is asserted had a full and fair opportunity to litigate the issues in the prior proceeding. *Bebo Constr. Co. v. Mattox & O'Brien,* P.C., 990 P.2d 78, 84-85 (Colo. 1999).

Moreover, the *Rooker-Feldman* doctrine prevents state-court aggrieved parties from collaterally attacking state court judgments in the federal courts. *Exxon Mobil Corp. v. Saudi Basic Industries Corp.*, 544 U.S. 280 (2005); *Colonial First Properties, LLC v. Henrico County*

[1] Note that claims falling within § 523(a)(3) fall into a different jurisdictional analysis.

Virginia, 236 F.Supp.2d 588, 595 (E.D.Va.2002); *see also Marshall v. Lauriault*, 372 F.3d 175, 180 (3rd Cir.2004).

For the purposes of securities litigation, a claimant will be required to proceed either in the United States District Court or in a state court of general jurisdiction to obtain a finding of a securities law violation. *In re Jafari*, 401 B.R. at 499-500 ("the bankruptcy courts and non-bankruptcy courts share concurrent jurisdiction to determine the dischargeability of a § 523(a)(19) claim.) Creditors must seek relief from the automatic stay ***prior*** to commencing or continuing non-bankruptcy litigation on the securities law issues while the bankruptcy case is still open. *See In re Curtis,* 40 B.R. 795, 799-800 (Bankr.D.Utah 1984).

<u>Examples of the application of collateral estoppel.</u>

In one case, the debtors stipulated to a judgment with a creditor. *Martin v. Hauck (In re Hauck)*, No. 13-1180, 2013 WL 6069271 (10th Cir. 2013). The creditor's claims were (1) Deceit Based on Fraud, and (2) Civil Theft. When the debtors filed for bankruptcy protection, the creditor filed an adversary proceeding and moved for summary judgment on collateral estoppels grounds from the prior stipulation. The debtors contended that since the claims were not actually litigated, that collateral estoppel did not apply. The Bankruptcy Court granted summary judgment for the creditor finding that the debtors had admitted culpability and manifested an intent to be bound by the judgment. On appeal, the 10th Circuit held that the debtors failed to preserve their waiver or duress defenses and therefore the bankruptcy court's granting summary judgment based upon the debtors' admitted fraud was proper.

In another case, a creditor obtained a state court judgment for civil theft against a debtor. *Steward Software Company, LLC v. Kopcho, (In re Kopcho)*, No. 11-35850 HRT (Bankr.D.Colo. August 12, 2014). After the debtors filed bankruptcy, the creditor filed an adversary proceeding and sought summary judgment using the state court judgment under the principles of collateral estoppel. The bankruptcy court found that the jury's findings in the state court judgment met all of the elements for embezzlement under 11 U.S.C. §523(a)(4), and for willful and malicious injury under 11 U.S.C. §523(a)(6). As a result, the bankruptcy court granted summary judgment for the creditor.

Recently, the Tenth Circuit found that a default judgment in a securities case could be the basis for a finding of non-dischargeability. *Tripodi v. Welch*, 810 F.3d 761, 766-67 (10th Cir. 2016).

3. Exception to Discharge: Criminal Restitution, Section 523(a)(7)

Criminal restitution is non-dischargeable in bankruptcy under 11 U.S.C. 523(a)(7). *Kelly v. Robinson* 479 U.S. 36 (1986).

4. Jurisdictional Issues in Bankruptcy Court

In *Stern v. Marshall*, the Supreme Court held the Bankruptcy Court lacked authority under Article III of the Constitution to enter a final judgment on a Debtor's counterclaims

brought in response to a creditor's proof of claim in the case. 131 S.Ct. 2594 (2011). The Supreme Court found that Congress overstepped its authority in authorizing bankruptcy judges, under Article I of the U.S. Constitution, to hear and decide "non-core" matters, essentially private-right controversies. The counterclaims in *Stern* were state law claims that did not implicate a public right under the Bankruptcy Code. Thus, the Supreme Court found that only Article II courts (or state courts of general jurisdiction) could decide private-right disputes.

When a claim for relief invokes "plenary" jurisdiction, the claim is outside the jurisdiction granted to the Bankruptcy Court. *In re Ball Four, Inc.*, slip op., Case No. 12-1036 EEB, Docket No. 80 at 6 (Bankr.D.Colo., Sept. 30, 2013)(Brown, J.). In other words, when a claim seeks to bring assets from outside into a bankruptcy estate, the Bankruptcy Court lacks jurisdiction to fully adjudicate such claims. *Id.* at 8. State law claims of breach of contract and implied duty of good faith and fair dealing claims are "related to," non-core matters. *Id*

Following *Stern*, the Supreme Court again weighed in the morass of bankruptcy jurisdiction in *Executive Benefits Insurance Agency v. Arkison*, 134 S.Ct. 2165 (2014). In *Arkinson*, the Chapter 7 bankruptcy trustee filed a complaint asserting both federal and state law claims, including fraudulent transfers claims. The question in *Arkinson* was whether the bankruptcy judge's submission of proposed findings of fact and conclusions of law to the U.S. District Court for *de novo* review was sufficient under *Stern.* The Supreme Court said that since the bankruptcy court could not enter a final judgment, de novo review by the District Court comported with Article III jurisdiction and *Stern*. The Supreme Court however did not decide the question of whether a party's actions during litigation resulted in an implied consent to bankruptcy court jurisdiction over the non-core claims.

Recently, in *Wellness International Network v. Sharif*, 135 S.Ct. 1932 (2015), the Supreme Court held that bankruptcy courts may enter final judgments on non-core claims if a litigant consents, either express or implied. The Court found that the consent must be knowing and voluntary. In doing so, the Court adopted the functional approach set forth in *Commodity Futures Trading Comm'n v. Schor*, 478 U.S. 833 (1986). Thus, litigants may waive their right to a determination by an Article III court and have their cases decided by the Article I bankruptcy judges.

5. Concurrent Jurisdiction of Federal Bankruptcy Courts and State Courts

Question: If a debtor fails to list a creditor with a fraud claim that could be non-dischargeable in bankruptcy, what court has jurisdiction over that dispute?

Pursuant to 11 U.S.C. §23(a)(3), a discharge in bankruptcy does not discharge a debt under Sections 523(a)(2)[fraud], (a)(4)[fiduciary fraud, embezzlement, larceny],or (a)(6)[willful and malicious injury], if the debt was not listed in the bankruptcy case and the creditor did not have actual notice of the case. If a creditor then commences an action in state court, a debtor may argue that the action violates the bankruptcy stay (or injunction), or assert the bankruptcy discharge as an affirmative defense. *See* 11 U.S.C. §§362(a); 524(a); C.R.P.C. 8(c);

Fed.R.Civ.P. 8(c). This issue was addressed in *In re Manning*, Case No. 10-23188-HRT (Bankr. D. Colo. June 19, 2012). *Manning* overruled the earlier *In re Padilla* decision to hold that:

> Moreover, even if the Herbs' State Court Complaint made no claim to post-petition damages, it does make claims of nondischargeability that are cognizable under § 523(a)(3)(B). The State Court enjoys jurisdiction, concurrent with the federal courts, to determine if any of those obligations are nondischargeable under 11 U.S.C. § 523(a)(3)(B).

In another case, *In re Everly*, 346 B.R. 791 (B.A.P. 8th 2006), the Court notes:

> In short, the penalty to the debtor for failing to schedule a [debt under § 523(a)(2)(4) or(6)] or otherwise inform the creditor of the bankruptcy is forfeiture of the right to enjoy exclusive federal jurisdiction and loss of the sixty-day limitations period applicable in the exclusive jurisdiction actions." In re Jenkins, 330 B.R. 625, 631 (Bankr.E.D.Tenn.2005)(quoting First Nat'l Ins. Co. of Am. v. Bartomeli (In re Bartomeli)), 303 B.R. 254, 269 797*797 (Bankr.D.Conn.2004); Fed. R. Bankr.P. 4007(b).

Likewise, *In re Massa*, 217 B.R. 412 (Bankr. W.D.N.Y. 1998), holds:

> [C]oncurrent jurisdiction to determine that an unscheduled debt is nondischargeable pursuant to Section 523(a)(3)(B) exists from the moment a debtor files the schedules required by Section 521 and Rule 1007 and they fail to list a prepetition debt "of a kind specified" in Section 523(a)(2), (4), (6) or (15) with the name of the creditor holding the debt, and continues until either: (a) the schedules are amended so that a timely request for a determination of dischargeability is reasonably possible; or (b) the bankruptcy court or a state court with concurrent jurisdiction makes a determination of dischargeability pursuant to Section 523(a)(3)(B), notwithstanding that the creditor holding the unscheduled debt may have received notice or had actual knowledge of the debtor's bankruptcy case; and (2) once the state court assumes and exercises its concurrent jurisdiction to determine that an unscheduled debt is nondischargeable pursuant to Section 523(a)(3)(B), the *Rooker-Feldman Doctrine* is applicable and the bankruptcy court can no longer assume jurisdiction, pursuant to Section 524(a) or otherwise, to correct any erroneous determination.

So, the applicable court will have to decide at least four things:

a. Is the debt of a kind described in § 523(a)(2), (4), or (6)?

b. Was the debt listed or scheduled (as that term has been interpreted) under § 521(1) of the Bankruptcy Code with the name of the plaintiff?

c. Did the plaintiff have actual knowledge of the case in time to timely file an adversary proceeding in the bankruptcy court under § 523(a)(2), (4), or (6)?

d. Does the plaintiff's case have merit?

III. Public Disclosures: Perils & Opportunities

> "Bankruptcy is a sacred state, a condition beyond conditions, as theologians might say, and attempts to investigate it are necessarily obscene . . . ." John Updike.

Every debtor must list all assets, liabilities, and creditors in the schedules to the bankruptcy petition. The debtor is then examined at the meeting of creditors. The trustee for the bankruptcy estate will permit, within limits, creditors and their counsel to ask questions. Creditors may also take a "2004 Examination," which is overtly described as a "fishing expedition:" *In re M4 Enterprises, Inc.*, 190 B.R. 471, 474 (Bankr. N.D. Ga. 1995) (the examination can "legitimately be in the nature of a fishing expedition."); *In re Valley Forge Plaza Assocs.*, 109 B.R. 669, 674 (Bankr. E.D. Pa. 1990) ("Rule 2004 permits a party invoking, it to undertake a broad inquiry of the examiner, in the nature of a fishing expedition"); *In re Frigitemp Corp.*, 15 B.R. 263, 264 n. 3 (Bankr. S.D.N.Y. 1981) (noting that predecessor to Rule 2004 examinations have been likened to "fishing expeditions"). Absent a properly invoked privilege against self-incrimination, the debtor must answer all material questions to qualify for a discharge of debt under the Code. 11 U.S.C. § 727(6).

Practice tip: a debtor's disclosures may carry consequences for securities litigation. Listing all creditors means those impacted by securities violations may find one another. Disclosing all assets may untangle a complex web of entities.

IV. Registration Exception for Bankruptcy Plans

Under 11 U.S.C. §1145, securities issued as a result of a Chapter 11 bankruptcy plan are exempt from the securities laws and registrations. Section 1145 provides that:

> (a) Except with respect to an entity that is an underwriter as defined in subsection (b) of this section, section 5 of the Securities Act of 1933 and any State or local law requiring registration for offer or sale of a security or registration or licensing of an issuer of, underwriter of, or broker or dealer in, a security do not apply to--
>
> (1) the offer or sale under a plan of a security of the debtor, of an affiliate participating in a joint plan with the debtor, or of a successor to the debtor under the plan--
>
> (A) in exchange for a claim against, an interest in, or a claim for an administrative expense in the case concerning, the debtor or such affiliate; or
>
> (B) principally in such exchange and partly for cash or property;
>
> (2) the offer of a security through any warrant, option, right to subscribe, or conversion privilege that was sold in the manner specified in paragraph (1) of this subsection, or the sale of a security upon the exercise of such a warrant, option, right, or privilege;
>
> (3) the offer or sale, other than under a plan, of a security of an issuer other than the debtor or an affiliate, if--

(A) such security was owned by the debtor on the date of the filing of the petition;
(B) the issuer of such security is--

(i) required to file reports under section 13 or 15(d) of the Securities Exchange Act of 1934; and

(ii) in compliance with the disclosure and reporting provision of such applicable section; and

(C) such offer or sale is of securities that do not exceed--

(i) during the two-year period immediately following the date of the filing of the petition, four percent of the securities of such class outstanding on such date; and

(ii) during any 180-day period following such two-year period, one percent of the securities outstanding at the beginning of such 180-day period; or

(4) a transaction by a stockbroker in a security that is executed after a transaction of a kind specified in paragraph (1) or (2) of this subsection in such security and before the expiration of 40 days after the first date on which such security was bona fide offered to the public by the issuer or by or through an underwriter, if such stockbroker provides, at the time of or before such transaction by such stockbroker, a disclosure statement approved under section 1125 of this title, and, if the court orders, information supplementing such disclosure statement.

The goal of Section 1145 is to promote creditors' acceptance of reorganization plans by allowing certain creditors to accept a reorganization with view to reselling securities obtained under plan. *In re Kenilworth Systems Corp.*, 55 B.R. 60 (Bankr.E.D.N.Y.1985). The distribution of new promissory notes and new common stock of an entity surviving reorganization to holders of the allowed unsecured claims against the surviving debtor and its affiliate participating in joint plan was "sale of securities" consistent with Section 1145 and thus exempt from securities laws. *In re Eagle Bus Mfg., Inc.*, 134 B.R. 584, affirmed 158 B.R. 421 (Bankr.S.D.Tex.1991).

V. Standing

In general, the assets of the debtor on the date the petition is filed become the assets of the bankruptcy estate. However, some assets, like retirement plans, are exempt. In addition, the trustee may opt to abandon property that is burdensome to the estate or of inconsequential value and benefit to the estate. 11 U.S.C. § 554 (a) & (b). Any "scheduled" property that is not otherwise administered at the time of closing of a case is also abandoned to the debtor. 11 U.S.C. § 554(c).

Question: What happens when a plaintiff who has lost everything files a bankruptcy?

See, e.g., Brumfiel, v. U.S. Bank, 2013 U.S. Dist. LEXIS 142648 (Colo. Bankr. 2013) ("[B]ecause Plaintiff's claims for monetary damages were not disclosed during her bankruptcy proceeding, those claims are the property of the bankruptcy estate. Therefore, the bankruptcy trustee is the real party in interest with respect to those claims, and Plaintiff lacks standing to bring them.").

Can a debtor gain standing by purchasing a claim in his bankruptcy case in order to oppose a trustee's motion to sell assets? No. The debtor must show (1) a reasonable possibility of a surplus where the debtor previously alleged insolvency; and, (2) assignment of a valid proof of claim. *In re Morreale*, Case No. 13-27310 MER, 2015 WL 3897796 (Bankr.D.Colo. Jun. 22, 2015). Notwithstanding the debtor's inability to prove a surplus, the bankruptcy court held that a debtor cannot be a creditor in his own case. *Id.* The assignment of the creditor's claim to the debtor nullified the debt. *Id.*

VI. Anticipating Insolvency

Because bankruptcy-related issues can so heavily impact securities litigation (and your ability to get paid), it may be important to evaluate the financial capacity of the parties to the litigation.

Practice tip: Broker-dealers file FOCUS Reports (Form X-17A-5) publically available on Edgar at http://www.sec.gov/edgar/searchedgar/companysearch.html. Banks must file Uniform Bank Performance Reports available at https://cdr.ffiec.gov/public/ManageFacsimiles.aspx.