



## Creditors' Rights & Bankruptcy Section Newsletter

Greetings:

Summer is almost over!!!

This month we examine whether a settlement agreement which calls for a distribution scheme which contradicts the distribution scheme under the Bankruptcy Code is permitted. Then we examine two student loan actions which explore issue relating to age, ability to produce income, health, and "certainty of hopelessness," as justifications to discharge student loan obligations

Hope you enjoy this issue. As always, let us know how we can assist you in your credit and collection needs. If you have any ideas for future article or questions that need addressing, give us a call. Best regards.

Bruce W. Akerly  
Chair, Creditors' Rights & Bankruptcy Practice Group  
Cantey Hanger LLC, Dallas



Bruce W. Akerly leads the firm's Creditors' Rights & Bankruptcy Practice Group. He has extensive experience in commercial litigation, bankruptcy, financial restructuring, and creditors' rights.

### Quote of the Month:

"Better to keep your mouth shut and appear stupid than to open it and remove all doubt."

-Mark Twain

### Latin Word of the Month:

Magnum Opus – A masterpiece; large debt; or giant squid.

### Self-Deprecating Lawyer Joke of the Month:

"A lawyer returns to his parked BMW to find the headlights broken and considerable damage. There's no sign of the offending vehicle but he's relieved to see that there's a note stuck under the windshield wiper. "Sorry. I just backed into your Beemer. The witnesses who saw the accident are nodding and smiling at me because they think I'm leaving my name, address and other particulars. But I'm not."



### What's On Your Mind?

If you have an issue or question you would like addressed in a subsequent e-newsletter, please let us know and we will attempt to do so.

[Contact Us Today!](#)



### Can A Settlement Distribution Scheme Violate The Bankruptcy Code's Priority Scheme?

Authored by Bruce W. Akerly, Partner

Section 507 of the Bankruptcy Code provides for a priority payment scheme for unsecured claims, including claims for wages and employee benefits earned before an employer's bankruptcy filing. As a general rule, priority claims must be paid before other general unsecured claims. What happens if a Chapter 11 debtor strikes a settlement of a cause of action, like a fraudulent conveyance or other avoidance action and it is proposed that the proceeds of the settlement will be paid not through a confirmed plan but through a structured dismissal of the cause of action? The United States Supreme Court has agreed to review a lower court decision involving this situation.

In *Czywski v. Jevic Holding Corp.*, the parties reached a settlement whereby the settlement proceeds would go to pay off the debtor's and unsecured creditor committee fees and other administrative expenses, tax and administrative claimants would receive payment, followed by general unsecured creditors on a pro rata basis. The case would then be dismissed. Certain wage claimants whose claims had yet to be determined, through litigation or otherwise, objected arguing that the settlement and proposed payment scheme violated the priority scheme in section 507 of the Bankruptcy Code, allowing unsecured creditors to be paid ahead of priority wage claimants. The Bankruptcy Court and District Court (Del.) approved the settlement. The Third Circuit Court of Appeals affirmed the decision on the theory that the Bankruptcy Code did prohibit structured dismissals of the type contemplated in this case and a bankruptcy court may order results different that those intended by the Bankruptcy Code for cause.

The Third Circuit reasoned that the bankruptcy court could approve such structured dismissal absent a showing that the settlement was contrived for the purpose of avoiding the procedural and safeguards ordinarily accorded in a plan for payment under a proposed plan of reorganization. The Third Circuit found that the bankruptcy court had a credible and specific basis for approving a deviation from the Bankruptcy Code's priority scheme. These included that the debtor no longer had an operating business, was rapidly losing funds, had no ability to confirm a Chapter 11 plan, and conversion to a proceeding under Chapter 7 would be a "bridge to nowhere." The decision has been appealed to the US Supreme Court which has granted the petition for review.



### Is "Certainty of Hopelessness" Required To Discharge A Student Loan?

Authored by Bruce W. Akerly, Partner

In a recent case out of the bankruptcy court in Alabama, *In re Johnson*, the debtor sought to discharge her student loan debt obligation. Section 523(a)(3)(8) requires that the debtor establish undue hardship. The debtor lacked a college degree, her income was below the poverty line, and her only funds were an IRS tax refund that would be soon exhausted. Notwithstanding these relatively harsh fact, the bankruptcy court determined that the debtor had failed to demonstrate "a certainty of hopelessness" that the debtor would be able to repay her student loan debt which approximated \$24,000. This is characterization of the proof requirement parallels the second prong of the *Brunner* test for undue hardship. Weighing against the debtor were the fact that she was in relatively good health, was articulate, would soon have no dependents to take care of, and had qualifications that were desirable in the current job market. The bankruptcy court concluded that, in light of these facts, the record demonstrated that debtor was capable of employment that would exceed the poverty level and would be sufficient to pay her student loan and certainly not an insurmountable burden.

### Along the Same Line – Old Age Does Not Always Equate to Undue Hardship

Authored by Bruce W. Akerly, Partner

In *In re Hurst*, the Bankruptcy Appellate Panel for 8th Circuit Court of Appeals, recently held that a 66 year old Chapter 7 debtor who stated that she planned to work until she was 70 years old, had low monthly expenses of \$1,482.02, with income averaging around \$1,800 per month, had sufficient income to make \$42 per month payments on her student loan and, therefore, would not be entitled to an undue hardship finding to justify discharge of her Student loan. The debtor had also failed to make any payments voluntarily on the loan. And, the court noted that although she had hearing and vision Problems, those disabilities did not appear to affect her ability to achieve her income potential. One judge on the panel dissented contending that the majority took an overly narrow approach to the "totality of circumstances" test. The dissenting jurist felt the debt should be discharged based on the fact that the debtor was facing retirement in the near future, was working a minimum wage job and had significant health issues. This is a good case for why development of facts and effective argument of counsel can win the day.



If you enjoyed this E-Newsletter or found the information helpful, please let us know and feel free to pass it along to your colleagues and friends.

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