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STATE LAW AND BANKRUPTCY

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1. WHY DOES THE ROLE OF STATE LAW IN BANKRUPTCY MATTER?

Every bankruptcy case presents three fundamental questions: (1) what property of the debtor should be liquidated or reorganized for the benefit of creditors, and (2) who are creditors who should participate in and be bound by the bankruptcy case--that is, who has a claim that arises before the bankruptcy case begins and (3) how should those claims be treated in bankruptcy. These bankruptcy questions require judges and lawyers to determine the relative roles of bankruptcy policy and state law.

2. WHERE DO WE LOOK FOR GUIDANCE?

A. Erie Doctrine in Bankruptcy

1. Alfred Hill, *The Erie Doctrine in Bankruptcy*, 66 Harv. L. Rev. 1013 (1953)
2. Vern Countryman, *The Use of State Law in Bankruptcy Cases*, 47 NYU L. Rev. 407, 631 (1972)
3. Thomas E. Plank, *The Erie Doctrine in Bankruptcy*, 79 Notre Dame L. Rev. 633 (2004)

No reported case in 2003 or the first part of 2004 discusses the Erie Doctrine in bankruptcy.

B. Butner doctrine

In *Butner v. United States*, 440 U.S. 48 (1979), Butner acquired a second mortgage on real estate of a bankrupt real estate developer, but did not acquire a direct security interest in the rents collected on the real estate. Under applicable state law, Butner would not have been entitled to a security interest in the rents until he had taken certain steps, such as appointment of a receiver or foreclosure of the mortgage. Nevertheless, Butner asserted a perfected security interest in the rents under a federal bankruptcy rule of equity adopted by courts of appeals in two federal circuits that gave the mortgagee a security interest in the rents upon the filing of the bankruptcy petition regardless of state law. Resolving a conflict among the federal circuits on whether to apply the relevant state law or the federal bankruptcy rule of equity, the Supreme Court held that federal courts in bankruptcy should apply the relevant state law and not the federal rule. The Court enunciated what has come to be known as the *Butner* principle: "Property interests are created and defined by state law. **Unless some federal interest requires a different result**, there is no reason why such interests should be analyzed differently simply because an interested party is involved in a bankruptcy proceeding." (Emphasis added)

C. United States v. Craft, 535 U.S. 274 (2002)

Craft, a federal tax lien case, held that property titled as tenancy by the entirety could be levied by the Government. The Supreme Court began its analysis by using the common idiom of a “bundle of sticks” to describe property interests. It described the relationship between state and federal law in the following terms “State law determines only which sticks are in the person’s bundle. Whether those sticks qualify as ‘property’ for purposes of the federal tax lien statute is a question of federal tax law.” The Court then held that “despite the state law fiction that a tenant by the entirety has no separate interest in the entireties property, each tenant possesses individual rights in the estate sufficient to constitute property or ‘rights to property’ for the purposes of the lien.”

D. In re Wise, 346 F.3d 1239 (10th Cir. 2003)

In a Chapter 7 case, the spousal maintenance payments to a Colorado debtor within 180 days after the filing of her bankruptcy case is a “personal statutory right” and not property of the estate. In so ruling the court cited to *Butner* and then stated “Once property rights are determined by state law, however, the federal bankruptcy law determines the extent to which the property interest is property of the estate.”

3. WHAT ARE SOME CURRENT PROBLEM AREAS?

A. When will a transaction structured as a lease be treated as a security interest in bankruptcy

In re Pillowtex, 349 F.3d 711 (3d Cir. 2003)

In re UAL Corporation, 2004 WL 632866 (Bankr. N.D. Ill. 2004)

B. When will a transaction structured as a sale of accounts be treated as a security interest in bankruptcy

Reaves Brokerage Co., Inc. v. Sunbelt Fruit & Veg. Co., Inc., 336 F.3d 410 (5th Cir. 2003)

Carter v. Four Seasons Funding Corp. 97 S.W.3d 387 (Ark. 2003)

C. Does the term “proceeds” in section 552 refer to federal law or state law at the time that section 552 was enacted or Revised Article 9's expanded definition of proceeds

9-102(64); see generally Lois Lupica, *Circumvention of the Bankruptcy Process: The Statutory Institutionalization of Securitization*, 33 Conn. L. Rev. 199 (2000).

D. Are the debtor’s domain names property of the estate

Network Solutions, Inc. v. Umbro International, Inc., 529 SE.2d 80 (Va. 2000)

E. When will bankruptcy courts recognize right of recoupment

In re Communications Dynamics, Inc., 300 B.R. 220 (Bankr. Del. 2003)

F. When will bankruptcy courts recharacterize debt as equity

In re Airwalk International, LLC, 305 B.R. 34 (Bankr. Colo. 2003)