

# Case Law Update: Equitable Consideration in Bankruptcy Cases

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Among laypersons not extensively schooled in the law who observe the administration of justice in our country, it may go unnoticed that there are actually two sides of the court system in the United States. In some states courts are named law courts and others chancery courts. Conversely, there are states where these two types of court systems are unified and the judge may sit in law or in equity, depending on the nature of the relief sought. The origins of this distinction are found long ago in the structure of the church in old England. Accordingly, the scope of the equitable powers of the bankruptcy court is derived from English Court of Chancery, which had jurisdiction over matters of equity. The courts of equity were established to combat harsh results of common law and provide a flexible and evolving form of relief beyond monetary damages. Equity courts focus on principles of fairness and creating solutions that are just and reasonable under specific sets of circumstances.

Generally, bankruptcy courts are referred to as courts of equity, though this has become more restricted. The equitable nature of bankruptcy is well illustrated by two recent decisions in a Michigan bankruptcy court. These opinions rendered by former bankruptcy attorney and newly appointed bankruptcy court judge, Joel Applebaum, demonstrate fair and just reasoning when defining certain statutory terms.

In *In re Neubert*, No. 20-30771-jda, 2020 WL 6950396 (Bankr. E.D. Mich. Nov. 25, 2020), Neubert filed her Chapter 7 case in a Michigan bankruptcy court, which was fully administered and closed. After the case was closed, but within 180 days of the original filing, Neubert's mother died. Being named beneficiaries of their mother's IRA, the debtor and her siblings each became entitled to one-fourth share of the account.

Pursuant to Section 541(a)(5)(A) and (C) of the Bankruptcy Code (the "Code"), a debtor's estate is comprised of "[a]ny interest in property that would have been property of the estate if such interest had been an interest of the debtor on the date of the filing of the petition, and that the debtor acquires or becomes entitled to acquire within 180 days after such date – (A) by bequest, devise, or inheritance; or (C) is a beneficiary of a ... death plan."

The outcome of *In re Neubert* depended upon how the terms, "bequest," "devise," and "inheritance," as well as "beneficiary of ... a death benefit plan," were defined, which would establish whether Neubert's share of the IRA belonged to the estate.

Judge Applebaum relied upon numerous sources to define these terms, including *Black's Law Dictionary*. Based upon these definitions, Judge Applebaum did not force the debtor to turn over funds received from her deceased-mother's IRA because that money was distributed by contract, not through bequest, devise or inheritance, and could not be considered "property of the estate" under Section 541 of the Code.

Another example of Judge Applebaum's sensitivity to ensuring equity in the bankruptcy system is found in *In re Richardson*, No. 20-30790-jda, 2020 WL 6038893 (Bankr. E.D. Mich. Aug. 13, 2020). That case focused on the definitions of the terms, "provisions" and "comfortable subsistence" in the Michigan exemption statute. The Michigan exemption statute provides that a debtor "may exempt from property of the estate ... (b) provisions and fuel for comfortable subsistence of each householder and his or her family for 6 months."

Over the objections of the Chapter 7 Trustee, Judge Applebaum allowed the debtor to exempt the cash on hand and funds from her personal bank accounts as "provisions and fuel for comfortable subsistence." Similar to his reasoning in *In re Neubert*, Judge Applebaum relied upon numerous sources to define these terms. Judge Applebaum also considered what the Michigan exemption statute sought to accomplish and how the definitions of these terms impact this case, finding that "the ordinary meaning of the key terms ... is consistent with the intention of Michigan's exemption statutes generally."

Judge Applebaum criticized two prior court decisions that defined these terms of the Michigan exemption provision because those courts' interpretations diverted from the ordinary meaning of "the key statutory times at the time of

enactment.” Ultimately, Judge Applebaum applied the Michigan exemption provision in *In re Richardson* broadly and determined that the debtor could exempt the cash on hand and funds in her bank accounts.

In another recent decision, a South Carolina bankruptcy court also demonstrated an equitable result derived from the way the judge defined terms of the statute. In *In re Wright*, C/A No. 20-01035-HB, 2020 WL 2193240 (Bankr. D. S.C. Apr. 27, 2020), Judge Helen Burris allowed the debtor to qualify as a “small business debtor” pursuant to Section 101(51D) of the Code, which would allow him to take advantage of certain benefits through the bankruptcy process.

When evaluating Section 101(51D) of the Code, Judge Burris focused on defining the relevant terms pursuant to their ordinary and plain meaning. By doing so, Judge Burris focused on both the language of the statutory provision and the context that the language was being used with the broad context of the statute as a whole.

Judge Burris emphasized that Bankruptcy provisions were designed to provide relief from debt in various forms and Section 101(51D) to broaden relief available to address small business debt. Judge Burris did not interpret the defining language of “small business debtor” to limit its application to debtors that are only currently engaged in business or commercial activities, which extended the application to the debtor here.

Although not cited by either Judge Applebaum or Judge Burris, in the case of *United States v. Ron Pair Enterprises, Inc.*, 489 U.S. 235 (1989) (where one of the authors herein represented a debtor against the Internal Revenue Service), Judge Antonin Scalia used the often quoted phrase “plain meaning of the law” to guide us on how to interpret ambiguous or equivocal expressions in statutes.

“The plain meaning of legislation should be conclusive, except in the ‘rare cases [in which] the literal application of a statute will produce a result demonstrably at odds with the intentions of its drafters.” *Ron Pair Enterprises, Inc.*, 489 U.S. at 242.

Our clients, whether holders of secured debt or unsecured trade creditors, are counseled to be aware that the judgment of the court when adjudicating claims in the bankruptcy context may be heavily impacted by equitable considerations.

Further, our clients should be aware of different ways in which judges may interpret a statute. It is important to understand that the plain meaning of a term may not be uniform among every court and that the application of certain statutory provisions is not always black-and-white.

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