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Bankruptcy Law

Automatic Stay

The “Police Power” Clash Continues: The United States District Court for the Eastern District of Virginia Reverses the Bankruptcy Court and Holds that § 362(b)(4) Applies in *ITC v. Jaffé*

Article contributed by: Brett H. Miller, Alexandra Steinberg Barrage, and Samantha Martin of Morrison & Foerster LLP

The “police and regulatory power” exception to the automatic stay in [11 U.S.C. § 362\(b\)\(4\)](#)¹ and its application to [19 U.S.C. § 337](#)² investigations by the U.S. International Trade Commission (“ITC”) has recently yielded conflicting results, both within federal courts and the ITC. This article illustrates the current legal landscape and offers a way to reconcile this conflict in a manner that is consistent with the plain meaning of § 362, public policy, and applicable precedent.

On June 3, 2009, the ITC permitted an ITC investigation to continue against chapter 11 debtor Spansion, Inc. (hereinafter “Spansion”) on the basis that “[p]reventing violation of domestic industries’ intellectual property rights falls squarely within the ‘regulatory power’ of a ‘governmental unit’” and therefore, “[s]ection 337 falls within the exception of section 362(b)(4).”³ Conversely, approximately one month later, the bankruptcy court in the Qimonda AG (“QAG”) chapter 15 bankruptcy case held that litigation initiated by a private party under § 337 before the ITC did not meet the requirements of the police power exception, rendering such actions subject to the automatic stay.⁴ In an apparent break from the ITC’s earlier opinion, an ITC Administrative Law Judge Order gave effect to the bankruptcy court’s memorandum opinion, staying the ITC action against QAG.⁵

In October 2009, the bankruptcy court in *In re Spansion, Inc.*⁶ held, among other things,⁷ that the automatic stay applied to an ITC action to adjudicate pre-petition patent infringement claims of private parties for the benefit of private parties, and that the ITC action only incidentally served the goal of preventing unfair competition.⁸ Four months later, in a separate QAG memorandum opinion (referred to herein as *Jaffé I*), the bankruptcy court explained why the police power exception did not apply, finding that the ITC action was not being prosecuted by the ITC—as required by the plain terms of § 362(b)(4)—nor

was the action an enforcement of the ITC's police and regulatory power.⁹

Most recently, on June 28, 2010, in *U.S. Int'l Trade Comm'n v. Jaffé* (referred to herein as *Jaffé I*),¹⁰ Judge T.S. Ellis III of the Eastern District of Virginia reversed *Jaffé I*, finding that the police power exception applied to the § 337 ITC investigation. In *Jaffé II*, the court held, among other things, that “where a private party files a complaint upon which a government agency chooses independently to commence an investigation, the government agency’s investigation is an action brought by a governmental unit.”¹¹

Underlying Policy and Application

The policy underlying the police power exception is to permit, in spite of § 362, regulatory, police, and criminal actions to proceed and to allow the enforcement of resulting judgments or orders, other than money judgments.¹² A governmental unit may pursue actions against the debtor or the estate, but it may not enforce a money judgment or seize or seek control over property of the estate without first obtaining relief from the automatic stay.

Congress intended for the police power exception to apply to stop violations of a law that would cause various types of harm:

Paragraph (4) excepts commencement or continuation of actions and proceedings by governmental units to enforce police or regulatory powers. Thus, where a governmental unit is suing a debtor to prevent or stop a violation of fraud, environmental protection, consumer protection, safety or similar police or regulatory laws, or attempting to fix damages for violation of such a law, the action or proceeding is not stayed under the automatic stay.¹³

To qualify under the police power exception, the action or proceeding must be commenced or continued by a governmental unit to enforce the governmental unit’s police or regulatory power. A plain reading of the “or” following “commencement” in § 362(b)(4)—in conjunction with [11 U.S.C. § 362\(a\)\(1\)](#)—indicates that the exception applies only where a governmental unit is either *commencing* or *continuing* an action or proceeding that was or could have been brought pre-petition.¹⁴

Once a determination has been made that the entity commencing or continuing an action is a “governmental unit,” the police power exception applies only if the government’s action meets the: (1) pecuniary interest test (where the governmental unit pursues a matter of public safety and welfare rather than a governmental pecuniary interest); and (2) public policy test (where the governmental action is designed to effectuate public policy rather than to adjudicate private rights).

Case Analysis

Factual Background

On April 18, 2008, LSI Corporation and Agere Systems, Inc. (together, “Complainants”) filed a complaint (“Complaint”) with the ITC against numerous respondents, alleging that the importation into the United States and the subsequent sale of certain property infringed on one of LSI’s patents in violation of § 337. The ITC instituted an investigation based upon the Complaint on May 14, 2008 (“337 Action”) and added QAG as an additional respondent on September 18, 2008.¹⁵

Jaffé I

On April 1, 2009, QAG instituted insolvency proceedings in Germany (“German Proceeding”) and appointed Dr. Michael Jaffé as the insolvency administrator. Dr. Jaffé sought recognition of the German Proceeding in the United States and sought provisional injunctive relief pending recognition of the foreign main proceeding, including preliminary application of § 362(a) to stay the 337 Action as to QAG.¹⁶

At the recognition hearing, the Complainants argued that if QAG were severed from the 337 Action, the Complainants would lose the benefit of an exclusionary order as to QAG, and, therefore, some of the protection of their patent. Furthermore, the Complainants argued that the automatic stay did not apply to the 337 Action because the 337 Action fell within the police power exception.¹⁷ Nevertheless, in a memorandum opinion prior to *Jaffé I*, the bankruptcy court found that the 337 Action did not fall within the police power exception:

The ITC did not initiate the actions before it. [The Complainants] initiated them. The Complainants [have] settled with several respondents who are no longer parties to the action. The ITC reviewed the settlements just as this court approves settlements in bankruptcy cases.... In the [337 Action, the ITC] is acting in its judicial capacity, not its enforcement capacity.... The case was commenced by individual private parties against individual private parties. The private parties are the real parties in interest; they have their own attorneys and are litigating the case in their own interests. In its judicial capacity, the [ITC] acts fairly, objectively and impartially. It is the forum for the litigation.... It is not the instigator or the prosecutor.¹⁸

Judge Mayer stayed the 337 Action as against QAG, but provided that QAG would be bound by the ITC’s ruling on the validity of the LSI patent.¹⁹ The court subsequently entered an order recognizing the German Proceeding as the foreign main proceeding, which gave rise to the automatic stay.

In *Jaffé I*, dated February 16, 2010, Judge Mayer held that the police power exception was inapplicable to the 337 Action because the ITC was not a party to the 337 Action or acting

as the governmental unit enforcing the patents; rather, “the ITC is the forum before which private litigants are enforcing their patents.”²⁰ Furthermore, as the court held, the ITC did not satisfy the pecuniary interest and private rights tests. Citing *Spansion*:

[w]hile there is no pecuniary gain for the government in an ITC action, there is also no significant public policy advanced by the ITC action presented in this case. [The Complainants’] objectives were to enforce their patent rights against private parties for their own benefit. The ITC action furthers the goal of preventing unfair competition at best only incidentally. If the action were brought *by* the ITC—which it is not—the ITC would be doing so for the private benefit of [the Complainants].²¹

Jaffé II

QAG argued that the Complainants’ appeal was moot because: (1) the patent at issue was expiring on July 13, 2010; (2) shortly after the entry of *Jaffé I*, the ITC resolved the 337 Action, finding that LSI’s patent was invalid for obviousness; and (3) the Complainants would not be able to obtain a ruling on appeal of the ITC’s final determination prior to the expiration of the patent. In addition, QAG was no longer importing any goods into the United States due to its liquidation in the German Proceeding, so the remedy of excluding infringing articles against QAG would be of limited value to the Complainants. For these reasons, and in the interest of preserving QAG’s limited resources, QAG chose not to substantially participate in the appeals process, only submitting a two-page brief on appeal and waiving oral argument.

On June 28, 2010, District Court Judge Ellis reversed Judge Mayer’s ruling and held that the 337 Action “was an action brought by a governmental unit to enforce the governmental unit’s police and regulatory power within the meaning of section 362(b)(4).”²² Judge Ellis examined the statutory and regulatory framework and noted that the filing of a complaint before the ITC results in a “preinstitution proceeding,” in which the ITC “examine[s] the complaint for sufficiency and compliance,” and performs a preliminary investigation. After evaluating whether the complaint was properly filed and an investigation is warranted, the ITC may then “commence” an investigation.²³

Judge Ellis first determined that the 337 Action was “commenced” by a governmental entity because, although the information forming the basis of the investigation was initially provided by the Complainants, the ITC, an independent federal agency created by Congress, instituted the investigation by providing official notice by publication in the Federal Register.²⁴ Judge Ellis countered the bankruptcy court’s determination that the private parties who instituted the complaint were in control of the litigation and the negotiation of settlements with various respondents who were subsequently dismissed from the case

without ITC or ALJ involvement. Here, the court noted that the ITC: (1) controls whether the 337 Action should commence in the first instance, and (2) “controls the investigation through the Federal Register notice defining the scope of the investigation.”²⁵ Judge Ellis did not, however, address the fact that the ITC *must* assume jurisdiction of any complaint that, on its face, meets the jurisdictional requirements.²⁶

In determining that the 337 Action fit “squarely” within the police power exception, Judge Ellis relied on his earlier decision in *U.S. ex rel. Jane Doe 1 v. X, Inc.*,²⁷ where he held that the automatic stay did not bar a False Claims Act action because the suit was “in essence brought ‘by a governmental unit’ within the meaning of § 362(b)(4), notwithstanding the fact that the government had yet to intervene in the suit.”²⁸ The court stated that if a qui tam action falls within the § 362(b)(4) exception because the United States is the real party in interest, “it follows *a fortiori* that where, as here, a private party files a complaint upon which a government agency chooses independently to commence an investigation, the government agency’s investigation is an action brought by a government unit.”²⁹

Second, the court held that the 337 Action sought to vindicate the public’s interest rather than a specific individual’s or entity’s rights. The court noted that the ITC does not have any pecuniary interest in QAG’s estate and held that the 337 Action was an action that promoted public safety and welfare and effectuated public policy. In support of its conclusion, the court asserted that the ITC, in consultation with various other federal agencies, is required by statute to consider the effect that its determinations will “have upon the public health and welfare, competitive conditions in the U.S. economy, the production of like or directly competitive articles in the United States, and U.S. consumers.”³⁰

The court also acknowledged that ITC proceedings are adversarial in nature, but refuted Judge Mayer’s contention that the public policy purported to be advanced is belied by the fact that respondents were dismissed from the ITC action after entering into a private settlement and that “the result in the patent infringement case and an ITC action are essentially the same.”³¹ Judge Ellis distinguished ITC actions from patent infringement actions: “[t]he ITC provides a forum in which to ensure the protection of the public interest, while patent infringement suits afford patent-holders the opportunity to vindicate their intellectual property rights and seek monetary damages.”³² The ITC only offers the remedy of excluding the infringing article from entry into the U.S. and does not award damages for patent infringement.³³

Discussion

Commencement or Continuation

One of the chief differences between *Jaffé I* and *Jaffé II* turns on each court’s interpretation of “commencement or continuation of an action or proceeding by a governmental

unit” under [11 U.S.C. § 362\(d\)\(4\)](#). Where the bankruptcy court read the plain language of § 362(d)(4) strictly to require commencement by a governmental unit, the district court found that even if a private party files a complaint before a government agency, the government agency’s investigation is nevertheless the commencement of an action brought by a governmental unit, as the governmental unit is the real party in interest. Similarly, where the bankruptcy court deemed “commencement” to occur upon the filing of the Complaint by the Complainants, the district court looked to the ITC’s own definition of “preinstitution proceeding” and determined that “commencement” occurred only once the ITC “[chose to] independently [] commence an investigation.”³⁴

In addition, *Jaffé I* analyzed “commencement” within the context of who controlled the litigation—in its view, the Complainants. “The closest that the ITC comes to controlling the litigation is the standing rules of procedure it promulgated...[The ITC and administrative law judges] do not influence the substantive rights of the parties and are not [sic] control over the litigation.”³⁵ In response, *Jaffé II* understood the ITC to control the litigation and commence the action as “it is the ITC that controls the investigation through the Federal Register notice defining the scope of the investigation...and the initial determinations of ALJs, which may be reviewed by the six-member Commission.”³⁶

Notwithstanding the courts’ varying approaches to the meaning of the term “commencement,” both courts might have agreed that irrespective of who commenced the 337 Action, the ITC’s function is clearly to *continue* the 337 Action, consistent with the plain language of § 362(d)(4) and the ITC’s own statutory and regulatory framework. Various courts have held that § 362(b)(4) should be given a narrow construction.³⁷ Yet neither decision appears to have analyzed the facts through the prism of “continuation,” despite the fact that but for the ITC’s involvement—as both courts implicitly acknowledged—the 337 Action could not have been sustained.

The focus on continuation of an action by a governmental unit also comports with applicable precedent. Regarding questions of statutory interpretation, the analysis appropriately begins with the text of the statute.³⁸ In the absence of any indication to the contrary, such as an explicit statutory definition, “words in a statute are assumed to bear their ordinary, contemporary, common meaning.”³⁹ And where “the statutory language is clear and unambiguous, [the] inquiry ends there as well; [a court] neither resort[s] to an examination of the statute’s legislative history nor appl[ies] the traditional rules of statutory construction.”⁴⁰

As a corollary, the timing of the 337 action could be of critical importance in determining the scope of the police power exception. When a private party files a complaint *pre-petition* to institute a 337 proceeding, the distinction between “commencement” and “continuation” ought to be insignificant from a bankruptcy perspective—either one may be a potential trigger for the invocation of the police power exception by

the ITC. In contrast, when a private party files a 337 action *post-petition*, the distinction between “commencement” and “continuation” could determine whether the action falls within the police power exception. Although Judge Ellis did not address the difference between 337 actions filed pre-petition and post-petition, his decision could be read to suggest that the police power exception applies regardless of when a private party initiates a 337 action—i.e., that the ITC “commences” an action each time it pursues an investigation based on a 337 complaint. If Judge Ellis had held that the ITC’s investigation was a “continuation” of the 337 Action, the ITC’s continuation of the action arguably would be valid only with respect to a pre-petition action because “continuation” of a post-petition action may itself be a violation of the automatic stay.⁴¹

Pecuniary Interest and Public Policy

The remaining inquiry is whether the facts meet the pecuniary interest and public policy tests. Here, the chief differences between *Jaffé I* and *Jaffé II* stem primarily from each court’s interpretation of the primary purpose of the Tariff Act of 1930. Where the bankruptcy court found that its primary purpose “is to protect patent holders,”⁴² the district court held that the statutes and regulations governing the 337 Action “plainly evidence an objective purpose of protecting the public interest at each stage of the ITC investigation.”⁴³ In turn, the bankruptcy court found that the 337 Action was primarily for the benefit of private parties,⁴⁴ whereas the district court found that “the public health and welfare and the assurance of competitive conditions in the United States economy must be the overriding considerations in the administration of this statute.”⁴⁵

Future courts analyzing the varying approaches to this issue may look to the legislative history underlying the police power exception and to the Supreme Court’s decision in *Board of Governors v. MCorp Financial, Inc*⁴⁶ for additional guidance. First, the ITC’s controlling regulations in approving settlements and terminating investigations require administrative law judges to “consider and make appropriate findings in the initial determination regarding the effect of [a] proposed settlement on the public health and welfare...and U.S. consumers.”⁴⁷ This language appears to be consistent with Congress’ intent in enacting the police power exception, which was, in part, to “prevent or stop a violation of...consumer protection, safety or similar police or regulatory laws.”⁴⁸ To the extent that the ITC’s ultimate purpose is to protect U.S. consumers (despite the role of private litigants), the ITC’s statutory mandate and the applicable legislative history underlying § 362(d)(4) appear to be aligned.

Second, in *MCorp*, the Supreme Court recognized the distinction between prosecution of an administrative or regulatory action, which is permitted, and enforcement of a resulting judgment or order, which may be stayed if it affects control over property of the estate. By extension, the ITC does not have the power to award damages for patent infringement; rather, exclusion of the infringing article is the

only available remedy.⁴⁹ Therefore, to the extent that the ITC does not maintain the power to enforce any resulting judgment or order, the application of the police power exception as to such governmental unit may well be in keeping with controlling precedent.

Conclusion

Although applicable law on the police power exception and its applicability to ITC actions may remain in conflict for some time, future invocations of 362(b)(4) by governmental units—including those like the ITC, whose statutory and regulatory framework arguably renders them closer to facilitators and adjudicators than private parties filing a complaint—may benefit from: (1) a statutory argument that clearly emphasizes a governmental unit's *continuation* of an action commenced by a private litigant, and (2) a public policy argument that underscores applicable precedent and legislative history.

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¹ Bankruptcy Code [§ 362\(b\)\(4\)](#) provides, in relevant part, that the “filing of a chapter 11 petition does not operate as a stay [] of the commencement or continuation of an action or proceeding by a governmental unit or any organization exercising authority...to enforce such governmental unit's or organization's police and regulatory power.” 11 U.S.C. § 362(b)(4) [hereinafter the “police power exception”]. The term “governmental unit” is defined separately in [11 U.S.C. § 101\(27\)](#).

² Section 337 of the Tariff Act of 1930 (hereinafter “§ 337”) makes unlawful “[t]he importation into the United States, the sale for importation, or the sale within the United States after importation by the owner, importer, or consignee, of articles that...infringe a valid and enforceable United States patent.” [19 U.S.C. § 1337\(a\)\(1\)\(B\)](#).

³ See *In the Matter of Certain Semiconductor Chips with Minimized Chip Package Size and Products Containing Same*, Inv. No. 337-TA-605 (U.S. I.T.C. June 3, 2009).

⁴ See *Order Issuing Preliminary Injunction*, July 2, 2009, [No. 09-14766](#) (RGM); see also *In re Qimonda AG*, [No. 09-14766, 2009 BL 152756](#) (Bankr. E.D. Va. July 16, 2009).

⁵ *In the Matter of Certain Semiconductor Integrated Circuits Using Tungsten Metallization and Products Containing Same*, Order No. 110, No. 337-TA-648 (U.S. I.T.C. July 15, 2009).

⁶ *In re Spansion, Inc.*, [418 B.R. 84](#) (Bankr. D. Del. 2009) (Carey, J.).

⁷ For a detailed description of *Spansion's* holding, see Alexandra Steinberg Barrage and Yuichi Haraguchi, *Police Power Exception and § 959(a) Deemed Inapplicable in In re Spansion*, Am. Bankr. L. J., (December/January 2010), at 40, 57.

⁸ *Spansion*, 418 B.R. at 94–95.

⁹ See *In re Qimonda AG*, [425 B.R. 256, 258](#) (Bankr. E.D. Va. 2010) (emphasis in original) (Mayer, J.), cited with approval by *In re Nortel Networks Corp.*, [426 B.R. 84, 92–93](#) (Bankr. D. Del. 2010) (Gross, J.).

¹⁰ [No. 10-cv-00367](#) (E.D. Va. June 28, 2010).

¹¹ *Jaffé II*, [No. 10-cv-00367, 2010 BL 146860, at *9–*10, *14](#) (E.D. Va. June 28, 2010), rev'g *Jaffé I*.

¹² [11 U.S.C. § 362](#).

¹³ S. Rep. 95-989 at 52, S. Rep. No. 989, 9th Cong. 2d Sess. 1978, 1978 U.S.C.C.A.N. 5787.

¹⁴ 11 U.S.C. § 362(b)(4) (emphasis added).

¹⁵ See *Opening Brief of ITC at 2, ITC v. Qimonda A.G. (In re Qimonda AG)*, [No. 10-cv-367](#) (E.D. Va. May 3, 2010).

¹⁶ *Jaffé I*, 425 B.R. at 258.

¹⁷ *Qimonda AG*, No. 09-14766, 2009 BL 152756, at *9.

¹⁸ *Id.* at *10.

¹⁹ *Id.* at *7–*9.

²⁰ *Jaffé I*, 425 B.R. at 260.

²¹ *Id.* at 263 (emphasis in original).

²² *Jaffé II*, at *14.

²³ See *id.* at *4 (internal citations omitted).

²⁴ *Id.*

²⁵ *Id.* at *9.

²⁶ See *Opening Brief of ITC at 2, ITC v. Qimonda A.G. (In re Qimonda AG)*, [No. 10-cv-367](#) (E.D. Va. May 3, 2010) (citing *Amgen, Inc. v. USITC*, [902 F.2d 1532, 1536](#) (Fed. Cir. 1990)) (emphasis added).

²⁷ [246 B.R. 817](#) (E.D. Va. 2000) (Ellis, J.).

²⁸ *Jaffé II*, at *9 (internal citation omitted).

²⁹ *Id.* at *9–*10.

³⁰ *Id.* at *11 (internal citations omitted).

³¹ *Id.* at *12.

³² *Id.* at *13.

³³ *Id.* at *12 (citations omitted).

³⁴ *Id.* at *9–*10.

³⁵ See *Jaffé I*, 425 B.R. at 259 (“LSI and Agere have controlled the litigation from the beginning.”).

³⁶ *Jaffé II*, at *9 (internal citations omitted).

³⁷ See *Grayson v. Worldcom, Inc. (In re Worldcom, Inc.)*, [No. 05-cv-5704, 2006 BL 86527](#) (S.D.N.Y. Aug. 4, 2006); *In re Stringer*, [847 F.2d 549, 552 n.5](#) (9th Cir. 1988).

³⁸ *United States v. Midgett*, [198 F.3d 143, 145–46](#) (4th Cir. 1999).

³⁹ *Walters v. Metro Educ. Enters. Inc.*, [519 U.S. 202, 207](#) (1997) (quoting *Pioneer Inv. Servs. Co. v. Brunswick Assocs. Ltd. P'ship*, [507 U.S. 380, 388](#) (1993)).

⁴⁰ *Faircloth v. Lundy Packing Co.*, [91 F.3d 648, 653](#) (4th Cir. 1996).

⁴¹ *C.f.*, *In re Spansion, Inc.*, 418 B.R. at 91–92. The *Spansion* court held that the ITC's investigation could not be excepted from the automatic stay where the initial action was brought post-petition because the action could have (and in fact was) brought pre-petition. But the *Spansion* decision has since been vacated for mootness. See *Spansion*, 418 B.R. at 84, vacating as moot [No. 09-cv-0836, 2010 BL 147147](#) (June 29, 2010).

⁴² *Jaffé I*, 425 B.R. at 263.

⁴³ *Jaffé II*, at *10.

⁴⁴ *Jaffé I*, 425 B.R. at 263.

⁴⁵ *Jaffé II*, at *11.

⁴⁶ [502 U.S. 32](#) (1991).

⁴⁷ *Jaffé II*, at *12.

⁴⁸ S. Rep. 95-989 at 52, S. Rep. No. 989, 95th Cong. 2d Sess. 1978, 1978 U.S.C.C.A.N. 5787.

⁴⁹ *Jaffé II*, at *12 (citations omitted).