Concurrent Workshop

Chapter 7 Issues Panel

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2010 Educational Materials

CHAPTER 7 ISSUES

HON. JOHN E. WAITES
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POST–BAPCPA CASES

1. Amended §330 interpreted to allow Lodestar analysis of Trustee compensation

A Pennsylvania Bankruptcy Court has analyzed the effect of amended §330, and concluded that Trustee compensation remains subject to a reasonableness determination based on the Trustee's efforts in the case, including a Lodestar analysis, prior to consideration of the commission fee structure of §326. *In re Ward*, 366 B.R. 470 (Bkrtcy.W.D.Pa. 2007).

In this case the Trustee requested the §326 maximum fee, based on funds disbursed in the case. Initially the Trustee submitted no time records to support his fee request, citing amended §§330(a)(3) and 330(a)(7). He argued that these amended sections, when read together, indicate that the commission structure of §326 now trumps §330(a)(3), which no longer applies to Chapter 7 Trustees. Upon hearing, the Court requested time records, and asked the Trustee to brief the issue. A Memorandum by the United States Trustee and an Amicus Brief by the Chapter 7 Panel Trustees from the district, both in support of the Trustee's position, were also filed.

Judge Bentz cited *In re Clemens*, 349 B.R. 725 (Bkrtcy.D.Utah 2006), where the Court found that after the §330 amendments it "must still apply the Lodestar analysis in reviewing Chapter 7 Trustee compensation but now must supplement that analysis with a consideration for the provisions of §326." The Pennsylvania Court further cited Collier on Bankruptcy, which opined: "…It will continue to be necessary for trustees to present detailed fee applications, …" after the amendments to §330. The Court found that a "typical Lodestar analysis" would render an appropriate fee in the "$2,000.00 range", and that the maximum compensation under §326 was $9,188.64; then allowed compensation in the amount of $5,000.00, plus reimbursement of expenses of $584.66, recognizing that "trustees often perform services in cases where they end up with an estate of little or no value and receive little or no compensation, …."

Editor's Note: There is absolutely no way to read amended §330(a)(3) to do anything other than remove the Lodestar analysis from factors to be evaluated in determining reasonable compensation for Chapter 7 Trustees. While the component of "reasonableness" remains, the Lodestar analysis does not. A Trustee's fee might be unreasonable in the exceptional situation where it amounts to a windfall, but not based on the Lodestar approach. Hopefully, Courts will eventually be able to distinguish the no-longer applicable Lodestar analysis, from the "windfall analysis" that should apply post-BAPCPA. In other words, the §326 commission structure should apply except in the extraordinary circumstance where it would amount to an unconscionable windfall to the Trustee. That is post-BAPCPA "reasonableness".

2. Under BAPCPA, Chapter 7 Trustee compensation is commission based, and lodestar is no longer a method for fee computation

A Texas Bankruptcy Court has analyzed the BAPCPA amendments to §330, and concluded that the omission of "Chapter 7 Trustee" from subsection (a)(3), combined with the addition of the "commission language" of subsection (a)(7) "must mean" that the calculation under §326 "*shall be permitted to be regarded as the reasonable compensation*

to be paid to him in the Chapter 7 case, and the Court *shall not be required to undertake the Johnson-type analysis contemplated in §330(a)(3)."* (Emphasis included in text). *In re Coyote Ranch Contractors, LLC*, 400 B.R. 84 (Bkrtcy.N.D.Tex. 2009).

In this case the Trustee requested $340,913.11 in compensation, computed under §326(a). The largest creditor objected to the fee as unreasonably high. The Trustee had expended 461.7 hours of time, which translated to $174,420.00 under a "lodestar" computation. Judge Jernigan looked to the plain language of the BAPCPA amendments to make his ruling. He noted that amended subsection (a)(3) specifically omits consideration of lodestar and certain other factors in computing the fee. He further noted that subsection (a)(7) requires "a commission-style approach, based on the parameters set forth in §326." Thus, "courts may start and end with the cap (in other words, there is no obligation to consider the factors described in §330(a)(3))". However, the Court acknowledged that the §326 computation still represents the maximum compensation, subject to a reasonableness component. The Court found that the (a)(3) factors, including lodestar, "may" be used to assess the reasonableness of the fee, after computation under §326. Here, the Trustee's services brought an identifiable, tangible and material benefit to the bankruptcy estate, in a complicated case. Objection denied and maximum fee approved.

Comment: This is the first post-BAPCPA case holding that the §330 amendments require courts to start with the §326 compensation cap as reasonable, and work backwards. It is also the first case to find that lodestar is not to be applied directly to fee computation, though it remains a factor as to reasonableness. This is very close to what NABT has said all along, and it will hopefully advance this interpretation far beyond the great state of Texas.

3. Disbursements by escrow agent included in Trustee's commission base

During case administration, the Trustee sold numerous properties. The majority of the sale proceeds were disbursed by escrow agents when the sales were closed. These disbursements paid the secured claims of mortgage holders, and other obligations of the Debtor. The Trustee included all of these disbursements as part of his commission base in calculating his compensation under §326. The Debtor objected, arguing that the funds were not disbursed by the Trustee, and could not therefore be included in the calculation. *In re McMaster*, 396 B.R. 266 (Bkrtcy.M.D.Pa. 2008).

Judge Thomas noted that actual monies were disbursed, though not directly by the Trustee. That was distinguished from a "constructive disbursement" such as a credit bid, where no money is actually paid. The Court then held that where funds are disbursed to creditors, either directly or by an agent of the Trustee, they are included as part of the amount from which the §326 maximum fee can be calculated.

4. Debtors allowed to dismiss cases under §521

Two recent cases confront the troublesome issue of Debtors manipulating the requirements of §521 to force case dismissal, when a Trustee has begun administering assets that were not disclosed by the Debtor. In the case of *In re Hall*, 368 B.R. 595 (W.D.Tex. 2007), a Chapter 13 Trustee sought dismissal of a case in which the Debtor, among other improper activities, had secretly conveyed real estate to an entity he controlled. At the urging of the U.S. Trustee, the case was converted instead of dismissed,

and Judge Monroe "reluctantly" allowed the case to proceed. The Debtor then filed a motion to reflect that the case had already been automatically dismissed on the 46th day under §521(i). Rejecting the previously reported cases of *In re Parker*, 351 B.R. 790 (Bkrtcy.N.D.Ga. 2006) and *In re Withers*, 2007 WL 628078 (Bkrtcy.N.D.Cal. 2007), the Court found nothing in the statute that restricts the use of §521(i) to non-debtors, and noted that §521(i)(2) allows "any party in interest" to request an order reflecting dismissal. Therefore, the Debtor had the right to file such a request. The Court further found that the filing requirement in §521(a)(2) could only be waived by the Court during the applicable 45-day period. It could not happen after day 46 because the case was already dismissed at that point. However, citing *Marrama v. Citizen's Bank of Massachusetts*, 127 S.Ct. 1105 (2007), the Court ruled that this Debtor's bad faith justified the imposition of a condition on the dismissal, and imposed a two-year prohibition on future bankruptcy filing by the Debtor.

The second case on this issue, which was filed to avoid the freezing of a $93,000.00 bank account to pay past-due child support, involved another Debtor's attempt to "escape" estate administration. Here, the Debtor stated that he had not obtained pre-petition counseling under §109, and had not filed pay advices under §521(a). The Bankruptcy Court sustained the Trustee's objection to dismissal, finding that the Debtor "want[ed] out of Chapter 7 based on his own fraudulent misconduct." In so holding, the Court relied on the reasoning of the *Parker* and *Withers* cases. Specifically, the Bankruptcy Court held that (1) §109 is not jurisdictional, such that the Debtor can be judicially estopped from using that section as a basis for dismissal, and (2) the requirement to file pay advices can be "waived" by the Court. Appeal was taken to the District Court. *Warren v. Weirum*, 378 B.R. 640 (N.D.Cal. 2007).

The District Court agreed that the §109 requirement was not jurisdictional, and that judicial estoppel could be imposed in that regard. However, following the *Hall* Court, the District Court held that the requirement to file pay advices under §521(a)(2) could not be waived after the initial 45-day period expired. The Court acknowledged that "debtors who seek to manipulate the bankruptcy process by intentionally withholding documents required under §521, … are provided with an undeserved opportunity to 'test the waters' of bankruptcy and thereby minimize their exposure to creditors." Unfortunately, the Court found this problem could only be resolved by Congress. *See also,* accord *Rivera V. Miranda*, 376 B.R. 382 (D.Puerto Rico 2007); but see 7 and 8 below, reversing *Warren* and *Rivera*.

Editor's Note: We all know that certain interests were favored in BAPCPA. Specific provisions were designed to positively affect groups as disparate as DSO claimants, car lenders, warehousemen and pawn brokers. While it might be argued that such interests should not be favored, there is at least an honest argument that such interests might need some deference or protection. Section 521 specifically favors dishonest Debtors by allowing them to manipulate the bankruptcy process. What argument can be made that dishonest Debtors need favored treatment, deference and/or protection in bankruptcy?

5. First Circuit denies §521(i) dismissal sought by debtor in asset case

After the case was converted from Chapter 13, the Chapter 7 Trustee proposed settlement of a discrimination suit which the Debtors had belatedly disclosed in a second amendment to their schedules. The Debtors did not agree with the settlement; and moved to dismiss their case for failure to file payment advices and a statement of monthly net

income within the requisite 45 days under §521. The Trustee objected and the Bankruptcy Court "excused" the Debtors' failure to file under these circumstances. The District Court reversed, finding no authority to do anything other than dismiss after the 45-day deadline. Appeal was taken to the First Circuit. *In re Acosta Rivera*, 557 F.3d 8 (1st Cir. 2009).

The Circuit Court noted the two opposing views. On one side, *In re Parker*, 351 B.R. 790 (Bkrtcy.N.D.Ga. 2006); *In re Jackson*, 348 B.R. 487 (Bkrtcy.S.D.Iowa 2006); *In re Bonner*, 374 B.R. 62 (Bkrtcy.W.D.NY 2007), finding that special circumstances can warrant *nunc pro tunc* relief. On the other side, *Warren v. Wirem*, 378 B.R. 640, (Bkrtcy.N.D.Cal. 2007) and *In re Hall*, 368 B.R. 640 (Bkrtcy.W.D.Tex. 2007), holding that the Court must dismiss the case after expiration of the 45 days. The First Circuit found that neither approach "satisfies both head and heart in equal measure." Acknowledging that the stricter reading might appear to address a congressional effort to reduce the escalation of bankruptcy filings, the Court also found that Congress, through the enactment of BAPCPA, "was not bent on placing additional weapons in the hands of abusive debtors." Thus, the Court held that "where…there is no continuing need for the information or a waiver is needed to prevent automatic dismissal from furthering a debtor's abusive conduct, the Court has discretion to take such action… The great divide in §521 is between information that is required and information that is not. The Act allows courts to do the sifting suggested by that divide without rigid adherence to the 45-day deadline."

Comment: This is the initial circuit court case decided on this issue. Hopefully it will have a precedential impact far beyond the First Circuit.

6. Ninth Circuit reverses District Court allowance of Debtor's §521 case dismissal motion

Following the First Circuit case of *In re Acosta Rivera*, 557 F.3d 8 (1st Cir. 2009), the Ninth Circuit has held that §521 automatic case dismissal for failing to provide information may be waived after the 45-day statutory deadline. The Circuit Court noted that §521(a)(1)(B) provides for dismissal "unless the court orders otherwise." The question of whether this discretion can be applied after the 45 day period has run was found to be ambiguous from the statutory language. The Court then agreed with the First Circuit that BAPCPA was not intended to put "additional weapons in the hands of abusive debtors". Thus, Bankruptcy Courts were found to have discretion to determine that the missing information is not required, "or that denial of dismissal is necessary to prevent a debtor from abusing and manipulating the bankruptcy system." *In re Warren*, 568 F.3d 1113 (9th Cir. 2009).

7. Confirmation of Chapter 13 Plan precludes subsequent dismissal under §521(i)

After confirmation of the Debtor's Chapter 13 Plan, the case was converted to Chapter 7. The Trustee in the converted case moved for case dismissal under §521(i), because the Debtor had failed to file copies of pay advices in the Chapter 13 proceeding, as required under §521(a)(1)(B)(iv). *In re Ober*, 390 B.R. 60 (Bkrtcy.W.D.NY 2008).

Judge Bucki found, under principles of res judicata, that confirmation of the Chapter 13 Plan precluded any further action under §521(i). In particular, the confirmation of a Chapter 13 Plan implicitly requires that a valid outstanding bankruptcy case exist, which

has not been dismissed either automatically or otherwise. Because the Chapter 13 Trustee, creditors and other interested parties were all privy to the confirmation process, and could have raised issues about whether the case was pending or had been automatically dismissed, the order confirming the Plan was res judicata as to all of those parties. Likewise, a Chapter 7 Trustee, as a subsequent representative of those same creditors, was also bound by the order.

See also In re Spencer, 388 B.R. 418 (Bkrtcy.D.DC 2008), where Judge Teel found that there can be no dismissal of a case under §521 without Court action. Rather, the proper reading of the statute is that the Court has no discretion to deny dismissal when the issue is brought before it. Further, the dismissal can only be effective from the date of the dismissal order.

8. Section 521 dismissal

A New York Bankruptcy Court has recently strictly applied §521(a), finding that a case was automatically dismissed on the 46th day after petition filing, based on the Debtor's failure to file all of the required payment advices. Here, Debtor's counsel discovered that the initially filed payment advices were incomplete. Unfortunately, when counsel attempted to correct this mistake within the 45-day period, he inadvertently and mistakenly re-filed the same incomplete set of documents he had previously filed. Thus, the 46th day came and went without the complete required filing having been made. Subsequently, after learning of his mistake, he immediately filed the missing information. Upon the Trustee's motion to dismiss, Debtor's counsel argued that he had made a good-faith effort to comply within the 45-day period, and that the missing information could not possibly affect the course of case administration. He further argued that dismissal would serve no meritorious purpose. *In re Catania*, 397 B.R. 667 (Bkrtcy.W.D.N.Y. 2008).

Judge Bucki noted "no discretion but to follow the direction of Congress." Under §521(a)(1)(B) the Debtor must make the required filing "unless the court orders otherwise", but this requires seeking a waiver prior to the effective date of automatic dismissal. The Court further noted that the Debtor offered no basis for a finding of the §521(i) "information required" from the documents which were filed. Finally, though such dismissal might provide results that strictly penalize Debtors who are otherwise deserving of a discharge, the Court found "nothing unconscionable about this, as the statute allows a window of 45 days to verify and correct the mandated information."

9. Another case restricts application of §521

This case considers the issue of whether §521(a)(1), which requires the filing of all statements and schedules, triggers §521(i) to automatically dismiss a case 46 days after the petition filing, where the statements and schedules are incomplete or inaccurate. Here, a creditor argued that such errors and omissions compel the Court to find noncompliance with the filing requirements and acknowledge automatic dismissal of the case. *In re Herrera*, 398 B.R. 490 (Bkrtcy.S.D.Fla.).

The U.S. Trustee requested that the Debtors amend their schedules to explain inconsistencies with their §341 hearing testimony. The amendments were not made, and the creditor argued the case was dismissed under §521(i). Judge Mark disagreed, finding that a challenge to the accuracy or completeness of schedules filed under §521(a)(1)

should be "framed in a complaint objecting to discharge." The Court found that §727 and adversary complaint procedures "provide a fair opportunity for both sides to litigate the issue." Although not applicable here, the Court pointed out that other cases with inaccurate disclosures could be asset cases, or become so through exemption objections or avoidance actions. In such cases, §727 would allow "an appropriate remedy and also allow administration of the case." By contrast, dismissal under §521(i) would prevent administration and deprive creditors of a potential distribution.

10. 1,215 day "look-back" limitation on homestead relates to purchase, not occupancy

A Texas Debtor inherited real property outside the 1,215 day "look-back" period of §522(p), but did not actually occupy the premises until much later, within the 1,215-day period. When she claimed all of the $359,000.00 equity as exempt under Texas law, an unsecured creditor objected, asserting the $125,000.00 limitation in §522(p). After the Bankruptcy Court overruled the objection, and the District Court affirmed, the case was appealed to the Fifth Circuit. *In re Rogers*, 513 F.3d 212 (5th Cir. 2008).

The Circuit Court noted this to be a matter of first impression. Looking to the statutory language, the Court found that "any amount of interest that was acquired by the debtor…" in §522(p) refers to the "economic value" of the property interest acquired within the 1,215-day period. The Court then reasoned that time of occupancy is irrelevant to the acquisition of an economic interest in the property, which occurred outside 1,215 days. Thus, the exemption was not limited by §522(p).

11. More cases about which exemption laws apply

When the Debtor filed his bankruptcy case in Texas he had not lived there for 730 days, having moved from Florida during that period. The Debtor claimed the federal Bankruptcy Code exemptions under the hanging paragraph following §522(b)(3)(c) ("Hanging Paragraph"). The Debtor asserted that because the applicable Florida exemptions apply only to Florida residents, he was left without any available exemptions and defaulted to the federal exemptions per the Hanging Paragraph. The Trustee objected, noting that Florida has opted out of the federal exemptions, making them unavailable in any instance. *In re Camp*, 396 B.R. 194 (Bkrtcy.W.D.Tex. 2008).

Judge Gargotta held that the Florida exemptions applied to the Texas Debtor and the Debtor's property in Texas; even though the Florida law specifically provides that it applies only to Florida residents and land in Florida. The Court further found the federal exemptions inapplicable because Florida had opted out of them. The decision was based on the Court's finding that Congress preempted state law residency requirements with the BAPCPA amendments. Therefore, Florida law could apply in Texas regardless of the Florida state law restrictions. The Court further found that Florida's opt out of the bankruptcy exemption scheme made it impossible to use the federal exemptions when Florida exemption law was made applicable under the 730-day rule. As to the Debtor's argument that the federal exemptions apply by default under the Hanging Paragraph, there was no default. The Debtor was not left with no exemptions because, under this Court's analysis, the Florida exemptions did apply to the Texas Debtor.

But see In re Brooks, 393 B.R. 80 (Bkrtcy.M.D.Pa. 2008), *contra*, where Judge France found the federal exemptions to be available, under the Hanging Paragraph, to a Debtor who was unable to use the exemption scheme of his former domicile due to residency restrictions, and unable to use the federal exemptions because the applicable state had opted out of the federal exemption scheme. *In re Brooks*, 3939 B.R. 80 (Bkrtcy.M.D.Pa. 2008).

12. How to count the days in the 730-day exemption residency requirement

Debtors filed their Chapter 7 petition in Missouri on May 30, 2007. They claimed the Nevada exemptions, including the more generous Nevada homestead exemption. The Trustee objected, asserting that the Debtors were "domiciled" in Missouri for the entire 730-day period immediately preceding their bankruptcy filing. The evidence showed that the Debtors had moved from Nevada to Missouri, arriving late in the evening on May 30, 2005. They stayed in a hotel that night. The next day they closed their home purchase and moved into their new residence. The Debtor argued that even if they became "domiciled" in Missouri on their arrival, but before they owned their residence; the filing date was still 729, rather than the required 730 days later. Thus, their prior, Nevada domicile exemption could be claimed. *In re Dufva*, 388 B.R. 911 (Bkrtcy.W.D.Mo. 2008).

Judge Federman found no case explaining how to calculate the §522(b)(3)(A) BAPCPA domiciliary period, but observed that the statute looked to where the Debtor was domiciled "for the 730 days immediately preceding the date of the filing of the petition…." Here, the date "immediately preceding" the filing date was May 29, 2007. Counting backwards from that date, the 730th day was May 30, 2005. Because the Debtors were in Missouri on that date, with the intent to remain, they were domiciled in Missouri. Accordingly, the Trustee's objection was sustained and the Debtors were limited to the Missouri exemptions.

13. Repeat filer stay termination applies to property of the estate

An Illinois Bankruptcy Court has rejected the overwhelming majority opinion that §362(c)(3)(A) applies only to property of the Debtor and not to property of the Debtor's bankruptcy estate. *In re Daniel*, 2009 WL 1133338 (Bkrtcy.N.D.Ill.).

Judge Wedoff acknowledged that the statutory language specifically provides that automatic stay relief terminates for creditors of a one-time repeat filing Debtor "with respect to the debtor." However, the Court disagreed that this language necessarily omits property of the Debtor's bankruptcy estate from its application. Rather, this language was found to limit stay relief to the property of the estate of a repeat filer whose subsequent case was filed jointly with a non-repeat filing spouse. Under this reading, the stay termination is limited to the Debtor" who is the repeat filer. Therefore, §362(a)(c)(3) applies "with respect to the debtor" who is the repeat filer, and to that debtor's property, which became estate property upon the petition filing. When read this way, the language makes sense because it differentiates between joint Debtors, and applies only to the one who is a repeat filer. In so holding, the Court further found this statutory interpretation to be more in keeping with the stated policy objectives of BAPCPA generally, and specifically as to repeat bankruptcy filings.

14. No more "retain and pay" option on secured claims

In a case where the Debtor declared the intention to "retain collateral and continue to make regular payments" on a car loan, the Court found: 1) the automatic stay expired 30 days after filing, 2) the collateral was no longer property of the bankruptcy estate, and 3) repossession of the vehicle did not violate the stay. *In re McFall*, 356 B.R. 674 (Bkrtcy.N.D.Ohio 2006).

Under §521(a)(2) a debtor has 30 days to declare an intention to reaffirm, redeem, or surrender as to personal property; and another 30 days after the 341 hearing to perform that intention. If either does not timely occur, then §362(h) provides that the stay is lifted as to the property, and it ceases to be property of the bankruptcy estate. Thus, in such cases, not only can the creditor take the collateral, but the Trustee in a Chapter 7 case loses the bankruptcy estate's interest in it as well. *See, Accord, In re Ruona*, 353 B.R. 688 (Bkrtcy.D.N.M. 2006); *In re Donald*, 343 B.R. 524 (Bkrtcy.E.D.N.C. 2006); *In re Anderson*, 348 B.R. 652 (Bkrtcy.D.Del. 2006); *In re Rowe*, 342 B.R. 341 (Bkrtcy.D.Kan. 2006).

Query: While it is no longer estate property, has the Trustee lost his right to avoid a lien against the property, and recover the value of the avoided transfer under §550?

15. Court extends "vaporization" of assets under §362(h) to include abandonment and loss of avoiding powers

Fears and concerns of the authors of this article as to the potential ramifications of amended §521 and §362(h), stated prior to BAPCPA's enactment and repeated frequently since, have unfortunately come true in a recent Ohio Bankruptcy Court case. Here, the Court has ruled that the Debtor's failure to perform the stated intention with regard to a secured claim against a vehicle, less than 30 days after the §341 hearing, not only lifts the stay and removes the vehicle from the bankruptcy estate; it also prevents the Trustee from bringing an action to avoid the creditor's unperfected security interest under §544. *In re Baine*, 393 B.R. 561 (S.D.Ohio 2008).

The issue was joined when the Trustee filed an adversary proceeding based on the secured creditor's violation of the stay when it repossessed the vehicle. The Trustee asserted, and the Court agreed, that the creditor's lien was unperfected under applicable Ohio law. The Trustee cited *In re Houseal*, Adv. No. 306-0429 (Bkrtcy.M.D.Tenn. February 15, 2007), where Judge Harrison found that §362(h) does not protect a secured creditor until the secured claim is proved to exist, but Judge Walter rejected this argument. The Court found there was a secured claim, even if it was unperfected; so the vehicle was no longer property of the estate, and the stay was no longer in effect when the Debtor failed to comply with §521(a)(2) within the prescribed time. However, the Court went much further, also finding that when the car left the estate, there was a parallel abandonment of the asset under §554, such that the Trustee lost his right to pursue an action to avoid the unperfected lien under §544. The Court stated it this way: "Because the operation of §362(h) is functionally equivalent to an abandonment, it has the effect of divesting the estate of all its interest in the property." The Court further explained that "all interests" include "the power of the Trustee to avoid an unperfected lien against the vehicle pursuant to 11 U.S.C. §544."

Comment: The Trustee's avoiding powers are statutory. They come into existence upon the filing of the bankruptcy case, and they belong to the Trustee. These statutory powers are separate and distinct from property owned by the debtor, such as the vehicle in

this case. Section 550 allows the Trustee to recover the "value" of an avoided transfer, a well as the "property" transferred. How did the Trustee in this case abandon his statutory power to avoid the lien and recover the value of the vehicle, when the vehicle left the bankruptcy estate. The Trustee's right of action is not the vehicle, and did not leave the estate with the vehicle.

Further Comment: Expanding §521(a)(2)(6) and §362(h), as this Court has done, effectively creates a 30-day statute of limitations for filing avoidance actions, which trumps the two-year limitation of §546.

Final Comment: Given the above, it probably goes without saying, but I'll say it anyway: The authors of this column strongly disagree with this result.

16. DSO exemption issue revisited

Two former spouses of the Chapter 7 Debtor, each holding domestic support obligations, objected to all of the Debtor's claimed exemptions under 11 U.S.C. §522(c)(1). They directed the Court to the amended language in BAPCPA which provides that exempt property "shall be liable for a debt of a kind specified in §523(a)(5)", which debt is a domestic support obligation. Because the subject property remained "liable" for payment of a DSO claim, the creditors contended they could object to the exemptions. *In re Bozeman*, 376 B.R. 814 (Bkrtcy.W.D.Ky. 2007).

Judge Lloyd cited the four cases where Chapter 7 Trustees have raised this issue by objecting to exemptions in order to administer assets for distribution to DSO claimants. The Court noted that the Trustees' objections were overruled in each of those cases. The Court then found the prior cases had "interpreted §522(c)(1) to mean that holders of domestic support obligations are not barred by federal bankruptcy law from pursuing exempt assets to satisfy their claims. However, §522(c)(1) does not limit a Debtor's right to claim the exemptions." The Kentucky Court agreed with this analysis and overruled the objections.

Editor's Note: All the cases prior to *Bozeman* involved Trustees seeking to sell "exempt assets". The reasoning behind disallowing the Trustee's sale of assets which were "liable" for the DSO debt was not based on §522(c)(1) at all. Rather, it was based on §§704(a)(1) and 363(b)(1), which provide that a Trustee may sell "property of the estate". Even though the property remained liable for the DSO obligation under §522(c)(1), it had been exempted from the estate, and was therefore no longer property of the estate subject to sale by the Trustee.

In *Bozeman* the Court overruled the exemption objection of the creditors, but found that DSO claimants are not barred from pursuing exempt assets to satisfy their claims. When read together, the four cases dealing with Trustees, and this case dealing with DSO creditors seem to hold that the creditor need not object to, nor even worry about the Debtor's exemptions, as exempt assets are "liable" for the DSO claim, and available to the creditor even after they are exempted. This means that creditors can pursue such assets to pay DSO claims in the bankruptcy case, but Trustees who are situated and available to administer the Debtor's assets cannot. Does that make sense? Could the DSO claimants assign their claims to the Trustee?

17. Trustee can administer exempt assets for the bankruptcy estate

The Debtors initially filed a case under Chapter 11, in which they claimed exempt personal injury and workers compensation claims. When the case was subsequently converted to Chapter 7, the Trustee reached a proposed settlement of the exempt claims, which was approved by the Bankruptcy Court. The Trustee then filed a complaint seeking a determination that the Debtors were not entitled to any of the proceeds from settlement of their claims. Rather, these funds were subject to administration because there were not sufficient non-exempt funds to satisfy the secured claim of the IRS. Therefore, under §522(c) the exempt assets were available to pay the IRS claim. Appeal was taken to the District Court, which affirmed. *In re Fearing*, 2008 WL 4690967 (Bkrtcy.C.D.Cal.). The District Court stated as follows: "Pursuant to 11 U.S.C. §522(c), exempt property, ordinarily not liable to satisfy any debt, can be liable to pay debt secured by certain liens, including a noticed tax lien. *See also In re Bolden*, 327 B.R. 657, 662 (Bkrtcy.C.D.Cal. 2005)." Therefore, even though no timely objection was made to the Debtors' exemptions, allowing the claims to be exempted from the estate, they remained available to the Trustee for case administration under §522(c).

Comment: As everyone knows, BAPCPA expanded §522(c) to include domestic support obligations as debts for which exempt property "shall be liable". What is the difference between administration of the exempt assets in this case, and the assets sought to be administered by Trustees in post-BAPCPA cases, for the benefit of DSO's? Is this a distinction without a difference???

18. Trustee allowed to sell assets subject to Debtor's homestead exemption rights

The Debtors scheduled $8,840,000.90 as the value of their residence, and claimed a $250,000.00 homestead exemption, to which no objection was made. Both the IRS and the State of Montana had filed secured claims, based on pre-petition tax liens. The Trustee moved to sell the real estate free and clear of liens, with all valid liens attaching to the sale proceeds. Without objection, a sale order was entered. Subsequently, the Trustee sought authority to sell personal property free and clear of liens. The Debtors objected. They asserted that their homestead claim, calculated at $225,117.35 after satisfaction of secured claims, would attach to the homestead sale proceeds, and objected to the personal property being sold prior to resolution of their right to the exempted sale amount, which they could use to bid on the personal property. They contended that no timely objection had been filed to their homestead exemption, and that the Trustee's motion to sell noticed no intent to limit or restrict it. Thus, under *Taylor v. Freeland and Kronz*, 503 U.S. 638 (1993), they were entitled to their scheduled exemption. *In re Duncan*, 406 B.R. 904 (Bkrtcy.D.Mont. 2009).

Judge Kirscher initially found that state homestead laws do not protect debtors from federal tax liens. *United States v. Rogers*, 461 U.S. 677 (1983). The Court then looked to §522(c)(2)(B) which specifically excepts tax claims "from the general rule that exempt property is not liable during or after the case for any debt that arose before the commencement of the case." The Court cited *In re Isom*, 901 F.2d 744 (9th Cir. 1990), which had found that tax liens on exempted property survive, even if based on a dischargeable tax debt. The Court then went further, based upon its prior decision

following Fifth Circuit precedent that §522(c)(1) "generally provides no shield in bankruptcy against claims to satisfy non-dischargeable pre-petition priority tax and family support claims." *In re Haas*, 16 Mont. B.R. 280 (Bkrtcy.D.Mont. 1997); *In re Davis*, 105 F.3d 1017 (5th Cir. 1997). Because the Debtors had not objected to the tax claims or filed an adversary action to contest their validity and extent; their homestead exemption had "no effect in the face of tax liens securing pre-petition claims." Accordingly, the Trustee's sale of the homestead was subject to the tax lien, which trumped the Debtor's exemption.

Comment: Here the Trustee is selling exempted property for the benefit of tax creditors as part of his case administration. What is the difference between that and selling exempted property for the benefit of DSO claimants in the administration of the case? Remember that DSO claims were amended to "remain liable", along with tax claims, under BAPCPA §522(c)(1).

19. New venue limitation (BAPCPA) does not prevent Trustee from pursuing preferences of less than $10,000 in home district

After BAPCPA amended §1409(b) to require actions to recover money or property of less than $10,000.00 in the Defendant's home district, it was speculated that this new restriction might not affect Trustee avoidance actions. In an unreported case out of the Northern District of Ohio, this issue was directly addressed. *In re Sterba*, Adv. Proc. 06-2037 (Bkrtcy.N.D.Ohio, July 10, 2007).

The parties stipulated that the Trustee had a valid preference action for $8,206.00, so the only issue was whether the Trustee could pursue the action in Ohio, or had to file it in North Carolina, where the Defendant resided. Judge Morgenstern-Clarren analyzed §1409(a) and (b) and focused on the use of the phrase, "*arising under Title 11 or arising in or related to"* a case under Title 11, in §1409(a), which allows the filing of actions in the home district. The Court then compared that with the phrase "*arising in or related to*" which is used in the $10,000.00 venue limitation language in §1409(b). The venue restriction provision of subsection (b) does not include actions "*arising under Title 11*". Thus, such actions do not appear to be included. The only section applicable to preference actions, which are specifically created by and "arise under" Title 11, is §1409(a), which allows proceedings to be filed in the case home district regardless of the amount in controversy. Held action could proceed in home court.

20. Proper venue for preference actions

BAPCPA amended §1409(b) by adjusting the jurisdictional amount and controversy from $1,000.00 to $5,000.00. Under the amendment, cases described in §1409(b) must be brought in the jurisdiction of the defendant, rather than the home Bankruptcy Court, where the recovery sought is less than $5,000.00. It was thought that this would force Trustees to bring avoidance actions in the district where the defendant resides, creating additional expense and difficulty. In a prior article we discussed the unreported case of *In re Sterba*, Adv. Proc. 06-2037 (Bkrtcy.N.D.Ohio, July 10, 2007), Judge Morgenstern-Clarren, which held that preference actions were not included in the proceedings covered by §1409(b). We now have a reported case which finds likewise. *In re Rosenberger*, 400 B.R. 569 (Bkrtcy.W.D.Mich. 2008).

Judge Gregg noted the distinction between §1409(a), concerning venue in proceedings "arising under Title 11"; and §1409(b), dealing with matters "arising in or related to" a bankruptcy proceeding. Because preference actions involve substantive rights created by federal bankruptcy law, they "arise under" the Bankruptcy Code. That is distinguished from cases which merely "arise in" a bankruptcy case, but do not involve a statutory provision of the Bankruptcy Code. The fact that "arising under" is included in §1409(a), but missing from §1409(b) must mean that one type of case is covered by one subsection, and not in the other. In so finding, the Court rejected the defendant's argument that Congress meant otherwise, but obviously made a mistake. Thus, the amount in controversy amendment was found not applicable in preference cases, and the Trustee could maintain his action in the home Bankruptcy Court. Finally, the Court further noted that this defendant "resided" in the district of the home court because it regularly did business there. Therefore, venue may have been appropriate even if §1409(b) applied to this case.

21. Administrative claim status for suppliers under BAPCPA includes secured creditors

A Chapter 11 Debtor which operated a chain of grocery stores objected to the administrative claim filed by one of its largest suppliers, which also held a security interest in the Debtor's inventory. The Bankruptcy Court allowed the claim, and appeal was made to the BAP. *In re Brown & Cole Stores*, 2007 375 B.R. 873 (9th Cir. BAP 2007).

The Debtor contended that the new §503(b)(9), which gives suppliers an administrative claim for unpaid goods delivered within 20 days prior to the petition filing, does not extend to secured creditors. Finding otherwise and affirming the Bankruptcy Court, the BAP followed a plain meaning interpretation of the statute. The Appellate Court found that §503(b)(9) applies to any claim that fits within the amended subsection, including secured claims. The Court acknowledged that giving an administrative expense priority to a secured creditor could be inequitable as to other priority claimants. However, there was "no ambiguity in §503(b)(9)", and the Court "must enforce it according to its terms and should not inquire beyond its plain language."

22. §503(b)(9) administrative expenses do not include services provided in conjunction with goods purchased and unpaid

The Debtor operated a chain of retail clothing stores. Claimant provided fulfillment services which included inspecting, ticketing and repackaging apparel purchased by the Debtor from other vendors. Claimant asserted an administrative claim based on unpaid invoices for such services provided during the 20 days immediately preceding the petition filing. The Debtor objected, contending the claim was misclassified as administrative under BAPCPA §503(b)(9), which expanded administrative expense claims to include the value of goods received by the Debtor during the 20-day period, if they were sold to the Debtor in the ordinary course of its business. *In re Goody's Family Clothing, Inc.*, 501 B.R. 131 (Bkrtcy.D.Del. 2009).

Judge Sontchi noted that the word "goods" is not defined in the Bankruptcy Code. The Court then assigned to goods the meaning stated in §21050(1) of the U.C.C.; which is something "moveable". Further, the Court noted that the term "goods" appears throughout

the Bankruptcy Code, disjunctively connected to the term "services". This was found to indicate that the terms have separate meanings. Finally, the Court looked to the language of the statute, which provides that "goods", rather than value, must be received by the Debtor to trigger application of §503(b)(9). Therefore, claimant's argument that its contribution of value to the goods based on its services in connection with the goods, was unavailing.

23. Is a debt from a marital dissolution action, which is payable directly to the ex-spouse's law firm, a priority claim?

A Chapter 13 Debtor was obligated on a fee award entered in favor of the law firm that had represented his former wife in their marital dissolution action. When the law firm filed a priority claim in the bankruptcy case, the Debtor objected. *In re Orzel*, 386 B.R. 210 (Bkrtcy.N.D.Ind. 2008).

Judge Klingeberger looked to the literal language and plain meaning of §507(a)(7) in this pre-BAPCPA case. The Court determined that the clear, express terms of the statute required that the debt be owed "to a spouse, former spouse, or a child of the debtor…," subject to several inapplicable limitations. The Court stated, "The identity of the claimant required by §507(a)(7) couldn't be clearer – the debt must be owed to a 'spouse' or 'former spouse', and not to a law firm which represented the 'spouse" or 'former spouse' in a dissolution of marriage action." The Court disagreed with the contra Eighth Circuit holding of *In re Kline*, 65 F.3d 749 (8th Cir. 1995), as not following the unambiguous statutory language.

Comment: Post-BAPCPA, DSO claims are now found at §507(a)(1), and are specifically identified as claims "owed to or recoverable by a spouse, former spouse, or child of the debtor, or such child's parent, legal guardian, or responsible relative…."; so this holding would seem to apply to the amended statute as well as its predecessor.

MISCELLANEOUS OTHER NON-BAPCPA CASES OF INTEREST

Exemptions

24. Exemption denied in IRA funds contributed in excess of the allowed tax deferred amount

After the death of her husband, the Debtor invested $35,000.00 of life insurance proceeds into an individual retirement annuity. She subsequently filed a Chapter 7 petition and claimed the full amount of the annuity as exempt. The Trustee objected, contending that while the account might otherwise qualify as an exemptible IRA under applicable state and/or federal exemption law, the method of funding the account exceeded the amounts qualified as exempt. Specifically, the maximum yearly contribution permitted under applicable Ohio law was $5,000.00, which was $30,000.00 less than the amount contributed. She was therefore allowed an exemption of $5,000.00, and the $30,000.00 balance was property of the estate subject to administration by the Trustee. *In re Mulsch*, 400 B.R. 584 (Bkrtcy.N.D.Ohio 2008).

25. What separates permissible pre-bankruptcy exemption planning from fraud? Eighth Circuit answer.

When the company partially owned by the Debtor defaulted, the creditor bank looked to the Debtor's personal guarantee to collect its $1.3 million obligation. Subsequently, and less than 90 days before his bankruptcy filing, the Debtor withdrew $8,000.00 from a brokerage account which contained approximately $45,000.00, and established Roth IRA accounts for his wife and him. An additional $9,000.00 was withdrawn from the brokerage account, along with $2,500.00 from a bank account, which was used to pay down the principal balance of the Debtor's home mortgage by $11,500.00. Once this transaction was complete, the bankruptcy petition was filed later that day. The Debtor elected the applicable Minnesota exemptions, claiming his Roth IRA and $91,250.00 of equity in his homestead as exempt. Upon the Trustee's objection, the Bankruptcy Court denied the exemptions, finding the Debtor's pre-petition transfers were made with intent to hinder, delay, or defraud creditors. On appeal the BAP affirmed, and further appeal was taken to the Eighth Circuit.

Subsequent to the Bankruptcy Court ruling on the exemption issue, the Trustee brought a §727(a)(2) action against the Debtor. The Bankruptcy Court denied the Debtor's discharge, finding that the prior ruling on the exemption issues was preclusive as to the §727(a)(2) issues. Appeal was again taken to the BAP, which immediately transferred and consolidated this appeal with the one already pending on the exemption objection. *In re Addison*, 540 F.3d 805 (8th Cir. 2008).

The Eighth Circuit looked first at the homestead exemption under Minnesota law and BAPCPA amended §522(o), both of which allow for reduction of the exemption where non-exempt funds are used to reduce debt and create exempt equity in a homestead, "with the intent to hinder, delay or defraud a creditor". The Court cited several cases which have addressed §522(o) and followed their analysis that this issue should be construed the same way Courts have previously construed §§548(a)(1) and 727(a)(2), to determine the requisite intent to trigger application of §522(o). The Court then addressed the issue of transfer of non-exempt funds into the Roth IRA, and found the analysis to be essentially the same.

The Court began with the proposition that the mere conversion of non-exempt into exempt property, on the eve of bankruptcy, for the purpose of placing the property beyond the reach of creditors, without more, does not deprive a Debtor of an exemption to which he would otherwise be entitled. Rather, a finding of the fraudulent intent required to trigger state and federal limitations on exemption rights must be based on some evidence of facts or circumstances extrinsic to the transfer itself. Further, these extrinsic facts must indicate a fraudulent purpose. Such evidence relevant to denial of exemption on fraudulent transfer grounds includes: 1) conduct intentionally designed to materially mislead or deceive creditors about the Debtor's position, 2) the Debtor's use of credit to buy exempt property, 3) conversion of a very large amount of property, or 4) the existence of conveyances for less than adequate consideration. Here, none of these specific badges of fraud existed, and the Bankruptcy Court was reversed. The Circuit Court found the Bankruptcy Court's failure to address any conduct "extrinsic" to the transfers themselves was clearly erroneous. Therefore, and likewise, the Debtor's discharge denial was also reversed.

See also, accord, In re Jones, 397 B.R. 765 (Bkrtcy.D.S.C. 2008) and *In re Wilmouth*, 397 B.R. 915 (8th Cir. BAP 2008), both of which used the §548(a)(1) and/or

§727(a)(2) analysis to determine that the transfers in question were not done with sufficient intent to defraud, and §522(o) did not apply.

26. No surcharge against exemptions in the Tenth Circuit

A few magazines ago, several cases were cited as examples of the expansion of Bankruptcy Court authority either through §105(a) or the "inherent power of the Court". It was noted that the Supreme Court decision of *In re Marrama*, 549 U.S. 365 (2007), at least impliedly expanded these powers, and was probably responsible for other Courts doing so. Among the cases cited was *In re Scrivner*, 370 B.R. 346 (10th Cir. BAP 2007), which allowed exempt retirement funds to be surcharged in order to compensate the bankruptcy estate for non-exempt funds which were not turned over to the Trustee after entry of a turnover order. However, the "strident dissenting opinion in *Scrivner*", which found no statutory basis for exemption surcharge, was also noted in the article.

Upon appeal, the Tenth Circuit Court has reversed the BAP, following the dissenting opinion and finding no authority for surcharge of a debtor's exempt property under 11 U.S.C. §105(a), anywhere else in the Bankruptcy Code, or anywhere else. *In re Scrivner*, 535 F.3d 1258 (10th Cir. 2008). While it recognized that many cases have authorized surcharge upon appropriate facts, the Circuit Court found no authority for such action. "In short, because the surcharge of exempt property is inconsistent with the Code's provision governing exemptions and debtor misconduct, it is beyond the scope of a bankruptcy court's equitable authority under §105(a)."

See also, In re Brooks, 393 B.R. 800 (BkrtcyM.D.Pa. 2008), where Judge France denied an exemption surcharge based on the unauthorized post-petition sale of a motor vehicle by the Debtors. The Court found this action did not reach the level of contemptuous conduct or fraud that would be a proper basis for surcharge or setoff. Though the sale was clearly unauthorized, there was no order which expressly prohibited it, and the Debtors had not received explicit instructions from the Trustee not to sell the car. Wow!!!!! Is this a backlash and/or pendulum swing???

Comment: It is noteworthy that the *Scrivner* Court failed to mention the *Marrama* discussion of Bankruptcy Court authority under its inherent powers, as well as under §105(a). In fact, the *Scrivner* Court never even cited *Marrama*.

27. Third Circuit holds that entire asset is exempted where scheduled exemption amount equals the scheduled value of the asset

Acknowledging a split in the circuits on this issue, the Third Circuit Court has affirmed the Bankruptcy and District Court holdings that the Trustee could not sell an asset for more than the claimed exemption amount, because he had not objected to the exemption or extended the time to object pursuant to Bankruptcy Rule 4003. Here, the asset was "business equipment" with a Schedule B value of $10,718.00 and claimed Schedule C exemptions of $10,718.00. Based on his appraisal of $17,200.00, the Trustee moved to sell the property, pay the $10,718.00 exemption, and hold the balance for the benefit of the bankruptcy estate. The Debtor asserted the business equipment had become fully exempt upon the Trustee's failure to timely object to the exemption. *In re Reilly*, No. 06-4290, United States Court of Appeals for the Third Circuit, Opinion filed July 21, 2008.

The Court looked to *Taylor v. Freeland and Kronz*, 503 U.S. 638 (1992), where the Debtor had listed both the value of the asset and the amount of the exemption as "unknown", and the *Taylor* Court's finding that this equated to a claim of the full amount, or entire asset as exempt. The Circuit Court then analogized *Taylor* to the facts of this case, where the Debtor had claimed an exemption in the same amount as the full scheduled value of the asset. The Court found this to be no different than listing "unknown" for value and "unknown" for the exemption amount. The Court reasoned that because the full value of the asset was claimed as exempt, the Trustee was put on notice of the Debtor's claimed exemption of the entire asset. Thus, the Trustee's failure to object prior to the 30-day deadline of Rule 4003 allowed the business equipment to leave the bankruptcy estate as an exempt asset, which the Trustee could not then sell.

Comment: This case favorably cites the Sixth Circuit BAP decision of *In re Anderson*, 377 B.R. 865 (6th Cir. BAP 2007). However, since *Anderson* was decided, Judge Gregg found contra in *In re Cormier*, 382 B.R. 377 (Bkrtcy.W.D.Mich. 2008), and a Michigan District Court did likewise in *In re Lewandowski*, 386 B.R. 943 (E.D.Mich. 2008). Additionally, the recent Ninth Circuit BAP case of *In re Chappell*, 373 B.R. 373 (9th Cir. BAP 2007), is also contra. Both the Eighth Circuit in *In re Wick*, 276 F.3d 412 (8th Cir. 2002), and the Ninth Circuit in *In re Hyman*, 967 F.2d 1316 (9th Cir. 1992), are, at the very least, arguably contra opinions, though the Third Circuit attempts to distinguish them. Finally, the Eleventh Circuit case of *In re Green*, 31 F.3d 1098 (11th Cir. 1994), which is cited as in accord, is at least arguably distinguishable, as it deals with a situation where the Debtor listed $1.00 for both the value and the exemption amount.

Further Comment: This issue has also recently appeared in a different context in the case of *In re* Raffone, 381 B.R. 30 (Bkrtcy,D.Conn. 2008). There the question was whether, under §522(c), "property exempted" is the exemption amount claimed by the Debtor in the asset, or the entire asset. The Court found as follows: "Because the word "exempted" is a past tense verb form, it is clear that the 'property' referred to is limited to that which had been successfully exempted at the point in time when the subject exemption became fixed. That property is precisely the exemption that was claimed by the debtor; nothing more, nothing less."

Final Comment: Thanks to Marty Sheehan who wrote the NABT Amicus Brief in this case, and will hopefully do that again at the Supreme Court level. A motion for certiorari will be filed.

28. Cert granted in "exemption in kind" case

The Supreme Court has granted certiorari in *Schwab v. Reilly* (Docket No. 08-538), 2009 WL 1107924, and will hear the appeal of *In re Reilly*, 534 F.3d 173 (3rd Cir. 2008). The issue on appeal is whether a Debtor's exemption of an asset, with the same asset value listed on Schedules B and C, indicates an intent to exempt the entire asset. Finding such intent under those facts, the Third Circuit denied the Trustee's proposed sale of the asset for more than the stated value. The Court found the Trustee's failure to object to the exemption within the 30-day deadline of Rule 4003 effected an abandonment of the asset from the estate, thus preventing its sale by the Trustee, even though the proposed sale price was more than the exemption value stated by the Debtor.

Comment: Congratulations to Bill Schwaub and Marty Sheehan for getting this issue to the Supreme Court. Bill is the case Trustee, and Marty wrote the Amicus brief for NABT.

29. "Retirement Plan" exemption denied

The Debtor served 30 months in jail for criminally fraudulent conduct that gave rise to a judgment against him for $3.2 million. In his subsequent Chapter 7 case, he claimed an exemption in his "retirement" accounts of approximately $1.2 million. The Bankruptcy Court sustained the judgment creditor's objection, holding the plans were not exempt because they were used primarily to shield assets, and not for retirement purposes. The District Court reversed, finding that although they had been used to shield assets, the plans were designed and used primarily for retirement purposes. *In re Rucker*, 570 F.3d 1155 (9th Cir. 2009).

The Circuit Court initially observed that a single-employee plan, established by a wholly owned corporation, could be fully exempt if it was primarily for retirement purposes, despite the fact that the account funds were placed beyond the reach of creditors. Here, however, the Debtor had "engaged in egregious and deceptive conduct in funding his Plans." He consistently funded them in excess of the Internal Revenue Code contribution limits, repeatedly and willfully lied to the IRS about the extent of his contribution, and secretly contributed to his Plans from a wholly-owned offshore corporation and a foreign bank account. The Debtor gave no explanation for this conduct which the Court found "more consistent with a primary goal of hiding assets than with the primary purpose of saving for retirement." Accordingly, based on the totality of the circumstances, the Circuit Court agreed with the Bankruptcy Court that the judgment creditor's objection to the exemption should be sustained, and reinstated its order.

30. Trustee's objections to amended exemptions sustained and BAP reversed

Debtor was employed as a paralegal with a medical malpractice law firm. Six months pre-petition she was injured in an automobile accident but did not list her pending lawsuit for personal injuries on her schedules, nor did she disclose it to her bankruptcy counsel. The Trustee filed a report of no distribution and the case was closed. Thereafter, the Debtor settled the lawsuit. Six months later, she filed amended schedules listing the asset and claiming it as exempt. The Trustee's objection to the amendment was sustained by the Bankruptcy Court, which concluded that the Debtor had acted in bad faith in delaying the disclosure of the personal injury lawsuit. On appeal, the BAP reversed, ruling that the Bankruptcy Court had clearly erred in finding bad faith, and abused its discretion in denying the exemption. Further appeal was taken to the Tenth Circuit Court of Appeals, where the Bankruptcy Court ruling was reinstated. *In re Ford*, 492 F.3d 1148 (10th Cir. 2007).

The Circuit Court agreed with the Bankruptcy Court that an amendment may be denied based on bad faith by the Debtor or prejudice to creditors. The Court then determined bad faith to be a question of fact that has to be established by circumstantial evidence or inferences drawn from a course of conduct. However, the defense of inadvertence can only be established by a specific showing that the Debtor either lacked knowledge of the undisclosed asset, or had no motive to conceal it. The Bankruptcy Court had concluded that the Debtor met neither of these safe havens, which the Circuit Court held was not clearly erroneous.

Avoidance Actions

Preferences

31. 11th Circuit rules on ordinary course defense application to first-time transactions between parties

Within the year before its Chapter 11 filing, the Debtor contracted with the defendant for installation of a heat and air control system at Debtor's plant. Payment was to be made in six installments. Within 90 days of the petition date, the Debtor paid two installments totaling $615,831.00. The Trustee sought avoidance of the payments as preferential transfers, and defendant raised the (c)(2) and (b)(5) defenses of ordinary course payments and no improvement of position by payment. The Bankruptcy Court held for the Trustee, and the District Court affirmed. Further appeal was taken to the 11th Circuit Court. *In re Globe Manufacturing Corp.*, 567 F.3d 1291 (11th Cir. 2009).

As to the ordinary course defense, the Circuit Court found there was no evidence that the parties had ever had dealings prior to the subject contract. The contract called for payment within 30 days from invoice date, and challenged payments were made approximately one month late. While the defendants two other payments, which were made outside the preference period, were also late, the Court found that was not enough to prove that late payments were ordinary as between the parties. In such a one-time transaction the Court found that the "ordinary business terms" prong of the defense must apply, and the terms between the parties must be consistent and comparable with terms generally used in the industry. As to §547(b)(5), defendant asserted that the payments received did not improve its position because it had rights to perfect a mechanic's lien if not paid, which would have made it a secured creditor. The Court rejected this argument, finding that under applicable Massachusetts law a mechanic's lien exists only after perfection by recording notice of the contract. Further, what the defendant could have done, had the payments not been made, was not relevant to the preference analysis. Finally, the Circuit Court affirmed the Bankruptcy Court's decision to deny pre-judgment interest. Because the defenses failed primarily for evidentiary reasons, the Circuit Court found it was not unreasonable for the Bankruptcy Court to use its equitable powers in disallowing the interest.

32. Performance of contractual obligation does not constitute "new value" under §547(c)(4)

A products manufacturer contracted with an equipment supplier to purchase a machine for approximately $4.2 million. The components of the machine were to be delivered, and payments were to be made in stages, pursuant to a schedule set forth in the contract. Within 90 days of its bankruptcy filing, the manufacturer made a payment of approximately $420,000.00. Subsequent to this payment, the equipment supplier shipped several machine components, and offered to ship all the rest, which were now produced and ready to go. The Chapter 7 Trustee sought avoidance and recovery of the payment, and the supplier/defendant asserted the "new value" defense of §547(c)(4), arguing that the equipment shipped subsequent to the payment constituted "new value" received by the Debtor. The Bankruptcy Court held for the Trustee, and the District Court affirmed. Appeal

was taken to the Seventh Circuit. *In re Globe Building Materials, Inc.*, 484 F.3d 946 (7th Cir. 2007).

Agreeing with the Courts below, the Circuit Court found that the defendant/supplier had a legal obligation to deliver the equipment prior to, and after the payment. The contract between the parties stated a single price for the entire machine. The fact that the parties structured the payment and delivery obligations to extend over a period of time did not "transform each payment, or each delivery of goods, into an independent transaction." Therefore, because defendant was obligated to make delivery, the delivery did not provide anything additional to the Debtor that would be "new value".

33. "Convenience Checks" and "Balance Transfers" constitute preferential transfers

A creditor who received payments from the Debtor, by means of convenience checks issued by another bank, asserted that such payments did not create a diminution to the estate, as they merely substituted one creditor for another. Thus, defendant argued that the earmarking doctrine should apply to except the payments from preference avoidance. *In re Wells*, 382 B.R. 35 (6th Cir. BAP 2008). Aff'd y Court of appeals 561 F.3d 633 (2009). The BAP cited *In re Montgomery*, 983 F.2d 1389 (6th Cir. 1993), in finding that earmarking was inapplicable. However, the Court went further to explain that "diminution to the estate" is not really an element in the avoidance of a preference, and only surfaces collaterally as to the issue of whether the transfer was of an "interest of the debtor in property". The Court noted conflicting results in other Circuits. *In re Marshall*, 372 B.R. 511 (Bkrtcy.D.Kan. 2007). Reversed 10th Cir. 550 F.3d 1251 (2008), see page 45, *infra*. *In re Perry*, 343 B.R. 685 (Bkrtcy.D.Utah, 2005). According to the BAP, those contrary decisions treated the transactions as "transfers of credit", and ignored the "economic substance" that the Debtors really obtained new credit and directed those funds to pay a particular creditor.

In a similar case, within 90 days of the bankruptcy filing, the Debtors directed their credit card account to issue a balance transfer draft to their credit union, to pay down their credit card account there. The Trustee argued that the pay down of the credit union account constituted a transfer of an interest of the Debtor in property that could be avoided as preferential, even though the Debtors never had possession or control of the funds. The issue was whether the balance transfer was a 'transfer of an interest" of the Debtor. The Bankruptcy Court held for the Trustee. *In re Fox*, 382 B.R. 800 (Bkrtcy.D.Kan. 2008).

Judge Nugent noted that the funds advanced to pay down another account could have been used by the Debtor for any purpose. They could have been paid, more equitably, to more than one creditor. Noting the Bankruptcy Code's policy of equality of distribution would be ignored to rule otherwise, the Court determined to follow the majority of cases that found balance transfers to be preferential. In its analysis, the Court had also rejected the earmarking doctrine because the Debtors' use of the money was entirely discretionary.

In yet another similar, recent case, the Debtor decided to consolidate her credit card debts pre-petition, and made credit card balance transfers to a bank for that purpose. Judge Isicoff held that even if the funds were never in the Debtor's actual possession, the disposition of the funds was in her control. The funds therefore constituted her property, and their transfer was subject to avoidance as preferential. *In re Egidi*, 386 B.R. 884

(Bkrtcy.S.D.Fla. 2008). Aff'd by 11th Cir. 2009 WL 168460 (June 18, 2009). *See also, accord In re Wells*, 382 B.R. 355 (6th Cir. BAP 2008).

34. Tenth Circuit finds credit card balance transfer to be avoidable preference payment

The Tenth Circuit Court has agreed with the recently emerging majority view that pre-petition pay down of one credit card balance with another credit card can create an avoidable preferential transfer. *In re Marshall*, 550 F.3d 1251 (10th Cir. December 30, 2008).

The defendant here asserted the same defenses raised in similar cases around the country; that the transaction did not constitute a transfer of an "interest of the debtor in property", and/or was excepted from avoidance under the earmarking doctrine. As to the first argument, the Court determined the test to be whether the Debtor had sufficient dominion and control over the access to credit provided by the credit card to constitute an "interest". Because the Debtor had the ability to apply the credit in any way he chose, the Court reasoned that the Debtor had complete dominion over the transfer. The Court further found that the transaction diminished the bankruptcy estate, because the Debtor had effectively borrowed from one credit card, and used the loan proceeds to pay another creditor. The borrowed funds were not only controlled by, but also belonged to the Debtor when they were subsequently transferred against the other credit card balance. Further, they were not directed or "earmarked" for payment to a specific creditor, as the earmarking defense requires.

35. 11th Circuit also finds credit card balance transfers avoidable

Expressly following the 10th and 6th Circuits cases of *In re Marshall*, 550 F.3d 1251 (10th Cir. 2008) and *In re Wells*, 382 B.R. 355 (6th Cir. BAP 2008), the 11th Circuit likewise held that credit card balance transfers are avoidable preferences, when occurring within 90 days of the bankruptcy filing. *In re Egidi*, 2009 WL 1684601 (11th Cir. June 18, 2009).

The Circuit Court found the transfer was in the control of the Debtor and that it diminished the assets in the estate available to other creditors by directing which creditor received the transfer. It was therefore an avoidable preferential transfer. The Defendant raised the earmarking defense to no avail. The fact that the Debtor, and not the lender, designated the recipient of the transferred funds, was enough for the Court to summarily render the earmarking doctrine inapplicable. Note that *Wells* was affirmed at 561 F.3d 633 (6th Cir. 2009) and also see *accord In re Dilworth*, 560 F.3d 562 (6th Cir. 2009).

36. Lease termination payment avoidable as preferential transfer

In a case that was reported earlier at the lower court level, the Eleventh Circuit Court has affirmed the bankruptcy and district court findings that a payment made pursuant to a lease termination agreement, entered into by the parties during the term of the lease, can be avoided as a preferential transfer. *In re Tanner Family, LLC*, 556 F.3d 1194 (11th Cir. 2009).

In this case the parties entered into a five-year lease with rent due and payable on the first day of each month. In the third year of the lease, the Debtor and the lessor

executed a termination agreement which provided that the Debtor would be released from any further obligations upon payment of $87,172.00. Within 90 days after making the payment, the Debtor filed a Chapter 11 petition. The case subsequently converted to Chapter 7, and the Trustee sought avoidance and recovery of the payment as a preferential transfer. The defendant argued that the debt was not antecedent, because it was not "legally collectible until it was due under the lease", which was on the first day of each month for the balance of the five years left on the lease term. The Eleventh Circuit rejected this argument, finding that the Bankruptcy Code adopts the broadest possible definition of "debt", such that a debtor incurs a debt and the creditor has a claim against the debtor, even if the claim is unliquidated, unmatured, unfixed, or contingent. Here, the debt was incurred when the lease was signed, and was therefore antecedent to the $87,172.00 payment.

37. Sixth Circuit rejects earmarking doctrine defense to late perfection of refinanced mortgage

The Sixth Circuit has recently joined the First Circuit in refusing to apply the judicially created "it's really all one transaction", earmarking defense applied by the Eighth Circuit in the case of *In re Heitkamp*, 137 F.3d 1087 (8th Cir. 1998); the split of authority is now two to one, in favor of a straightforward, logical reading of 11 U.S.C. §547. *In re Lee*, 530 F.3d 458 (6th Cir. 2008).

As discussed in a prior article, *In re Lazarus*, 478 F.3d 12 (1st Cir. 2007), was decided by the First Circuit Court when the *Lee* case was pending before the Sixth Circuit. Thanks to Joe Collins, Trustee and NABT member from Springfield, Massachusetts, news of his decision got to Tracy Clark, attorney for Mark Shapiro, Appellant in the *Lee* case, in time for her reply brief, and long before oral argument on December 7, 2007. The issue in both cases was whether the recording of a refinanced mortgage after the 10-day (now 30 days under BAPCPA) grace period of §547(e)(2)(a) was avoidable, where the prior mortgage had been paid in full but not released of record; or was the late perfection excepted from avoidance by application of the earmarking doctrine as in the Eighth Circuit *Heitkamp* case.

In the majority opinion, Judge Cole analyzed the purpose of the preferential transfer statute, the legislative history behind it, and the plain language of the current statute in the Bankruptcy Code. The Court further looked to the First Circuit opinion in the *Lazarus* case. Based on this thorough and scholarly analysis, the majority found that perfection of the mortgage was a distinct transfer, separate from the payment of the refinanced debt. Therefore, there were two transactions which were not, in reality, a single transaction as held by the Eighth Circuit in the *Heitkamp* case. Judge Rhodes' decision in favor of the Trustee was reinstated, and the District Court reversal of his holding was reversed.

Comment: Thanks to Mark Shapiro and Tracy Clark for their hard work and ultimate success in this very important case. Also, thanks to the Amicus Committee at NABT which approved the filing of an Amicus brief on behalf of the Trustee, which the Court allowed, along with oral argument by counsel for the Amicus. Sometimes good things come from the work of this Association, in conjunction with Trustees who recognize our possibilities, as well as our limitations.

Further Comment: The dissenting opinion of Judge Merritt is noteworthy. It is one page, and originally stated as follows: "Appellate judges should be aware that subtle

incentives exist for trustees and bankruptcy courts to enlarge the bankruptcy estate for a number of reasons – for example, trustees and bankruptcy courts draw additional fees when the estate is enlarged." The Court subsequently revised the opinion by deleting the two references to "bankruptcy courts" in the above sentence.

38. 11th Circuit excepts preference avoidance under state law equitable subrogation

NABT filed an Amicus Curiae Motion for Rehearing in a consolidated appeal of two cases involving a Trustee's actions to avoid mortgages which were untimely perfected in refinancing transactions. The motion deals primarily with the issue of whether the §(c)(1) "contemporaneous exchange for new value" defense to preference avoidance trumps the §(e)(2)(A) grace period for recording non-purchase money security interests. In addition to that issue, the Court in this case also considered whether the applicable Georgia law of equitable subrogation would except a late recording from avoidance. *In re Hedrick*, 524 F.3d 1175 (11th Cir. 2008).

The Circuit Court framed the question as "whether a bona fide purchaser could have acquired an interest superior to [the refinancing creditor] during the period between the time [the refinancing creditor] paid off the earlier creditors, thereby extinguishing their security deeds, and the time [the refinancing creditor's] own security deed was recorded". Based on a Georgia case, the Court found that under Georgia law the refinancing creditor "acquired a first priority interest"….upon paying off the debt, which was "applicable law which controls under §547(b)." Therefore, no purchaser who acquired an interest in the property between the time the earlier debts were paid and the new deed of trust recorded could be a bona fide purchaser under Georgia law, because equitable subrogation would defeat the purchaser's claim.

Comment: This appears to be the only Circuit Court case that allows state law equitable subrogation to essentially preempt the federal law of preferential transfer avoidance under 11 U.S.C. §547. The opinion never mentions the Supreme Court case of *Fidelity Financial Services, Inc. v. Fink*, 522 U.S. 211 (1998), which overruled a similar attempt at state preemption through state statutory law, rather than state case law as applied here. A motion for certiorari will be filed in this case.

39. Purchase by credit bid at non-collusive foreclosure sale avoided as preferential transfer

This is a further examination of a case referenced in the last *NABTalk* article, Winter 2009, Volume 26, Issue 4, regarding application of the Supreme Court case of *BFP v. Resolution Trust Corp.*, 511 U.S. 531 (1994), to state divorce court judgments. The reported case was *In re Bledsoe*, 569 F.3d 1106 (9th Cir. 2009), where the Ninth Circuit found that *BFP* applies to regularly conducted state law divorce cases, as well as to foreclosure proceedings; making property division judgments immune to fraudulent transfer attack absent a specific showing of fraud and/or collusion. The case of *In re Villarreal*, 413 B.R. 633 (Bkrtcy.S.D.Tex. 2009), was noted because it did not extend *BFP* to a preference action arising from a non-collusive, properly conducted state law foreclosure sale. This case is worthy of further explanation, as follows.

Within 90 days of their Chapter 13 filing, a third lien creditor on a $70,000.00 debt bid at the foreclosure sale of commercial property owned by the Debtors. The total debts against the property were less than $750,000.00, and the creditor was the successful bidder through a credit bid in the full amount of its $70,000.00 claim. Shortly after the sale, the purchaser had an appraisal done which indicated a value of $4,020,000.00 for the property. The Debtors sought to avoid the sale as a preferential transfer.

Judge Isgur noted that *BFP* was decided under §548, which requires determination of value at the time of the transfer, which was the foreclosure sale here. The Court recognized that the *BFP* holding had been extended to include §549 in *In re T.F. Stone v. Harper*, 72 F.3d 466 (5th Cir. 1995), but found this decision was based on "present fair equivalent value" in §549 being no different from "reasonably equivalent value" in §548. In the preference statute, §547(b)(5) requires the Court to compare the value at the time of sale with the amount the creditor would have received in a hypothetical Chapter 7 liquidation. In this analysis the Court determined that a Chapter 7 Trustee would have had time to orchestrate an orderly sale producing a far greater value than was received at the foreclosure sale; and, in this hypothetical Chapter 7 liquidation, the defendant would have received approximately $100,000.00. Doing the math, the Court then calculated that the creditor/bidder "received at least $3,250,000.00 to satisfy the remainder of his $70,000.00 claim"; significantly more than $100,000.00. The sale was therefore avoided as a preferential transfer. In so finding, the Court acknowledged a contra District Court decision from the same District, but held the District Court ruling lacked *stare decisis* authority.

Fraudulent Conveyances

40. Ninth Circuit rules on constructive fraudulent conveyance avoidance of transfers made in state court marital dissolution judgments

Following the Fifth Circuit case of *In re Erlewine*, 349 F.3d 205 (5th Cir. 2003), the Ninth Circuit Court has applied the Supreme Court case of B*FP v. Resolution Trust Corp.*, 511 U.S. 531 (1994), to property divisions in state court divorce case judgments: "A state court's dissolution judgment, following a regularly conducted contested proceeding, conclusively establishes 'reasonably equivalent value' for the purpose of §548, in the absence of actual fraud." *In re Bledsoe*, 569 F.3d 1106 (9th Cir. 2009).

In this divorce case, the court entered a default judgment against the wife for failure to comply with discovery orders. Property transfers made pursuant to the default dissolution judgment gave the former husband property valued at $93,737.00, while she received property valued at $788.00. Upon her Chapter 7 filing, the Trustee brought a constructive fraudulent conveyance action against the former husband, asserting that fair value was not exchanged in the property transfer. Affirming the Bankruptcy and District Courts, the Circuit Court analogized state court divorce proceedings to state law foreclosure proceedings. As the *BFP* Court found the amount paid in a properly conducted state law foreclosure sale was reasonably equivalent value, the Ninth Circuit found likewise as to judgments rendered in properly conducted marital dissolution cases, absent a showing of fraud.

Comment: It should be noted that this decision specifically applies to "a dissolution judgment entered at the conclusion of a regularly conducted state-court proceeding, rather than a marital settlement agreement." However, this case includes a default judgment

rendered for failure to comply with court orders as a "regularly conducted state-court proceeding." This also begs an important question: Is a final decree approving a settlement agreement a "dissolution judgment"?

Further Comment: This is an important case because it represents the second circuit court to apply the *BFP* analysis and reasoning to divorce actions. It is also contra to many cases around the country which allow fraudulent transfer recovery on a purely constructive fraud theory, i.e. if he got $93,737.00 and she got $788.00, that is not a fair value exchange, any way you look at it.

Final Comment: But see *In re Villarreal*, 2009 WL 2432338 (Bkrtcy.S.D.Tex.), where Judge Isgur specifically declined to extend *BFP* to a preferential transfer claim arising from a properly conducted state law foreclosure sale.

41. Plea agreement established Ponzi debtors' actual intent to defraud

After filing for Chapter 7 relief, the Debtor was charged with crimes in connection with an alleged Ponzi scheme. Pursuant to a plea agreement, he subsequently pled guilty to the charges and was sentenced to prison. In the plea agreement, he admitted that he operated a Ponzi scheme over a lengthy period. In a fraudulent transfer action, the Trustee sought to avoid transfers from the Debtor to investors, to the extent they exceeded the amount invested ("false profits"). The Bankruptcy Court granted summary judgment to the Trustee, finding that the Debtor's guilty plea and plea agreement conclusively established that the Debtor had operated a Ponzi scheme from which the actual intent to defraud his creditors would be imputed. The District Court affirmed. Further appeal was taken to the Ninth Circuit. *In re Slatkin*, 525 F.3d 805 (9th Cir. 2008).

The Circuit Court also affirmed, finding that once the existence of a Ponzi scheme is established, payments received by investors as purported profits are deemed fraudulent transfers as a matter of law. The Circuit Court further noted that the Debtor was not a "stockbroker" under the Code and, therefore, the Trustee was not barred by §546(e). The Court also rejected the investors' argument that the plea agreement should not have been admitted because it was hearsay. The Court found it to be admissible under Federal Rule of Evidence 807. The admissions in the plea agreement were more probative on issues of the Debtor's intent to defraud than any other evidence the Trustee could procure. The interest of justice would be best served by its admission as evidence. Further, the plea agreement had the equivalent circumstantial guaranties of trustworthiness as a statement covered by Rules 803 or 804.

Other Avoidance Actions

42. Bankruptcy estate diminution is not a required element of §549 post-petition transfer avoidance

Without Court authority, a Chapter 11 Debtor factored accounts receivable with a face value of $200,600, in exchange for $186,455 from the account purchaser. The purchaser was able to collect only $163,007 from these accounts. After conversion to Chapter 7, the Trustee sued to avoid the account sale transactions under §549, as unauthorized post-petition transfers. The Bankruptcy Court held for the Trustee, ordering repayment to the bankruptcy estate of the $163,007 collected from the accounts and all

uncollected accounts still held by the purchaser. The BAP affirmed on appeal, and further appeal was made to the Ninth Circuit Court. *In re Straight Line Investments, Inc.*, 525 F.3d 870 (9th Cir. 2008).

Appellant argued that the Trustee could not recover because there had been no diminution of the estate, as the amount paid to the Debtor was more than the value of the accounts that went out of the estate. The Court first considered whether such estate depletion is required under §549, noting this to be "an open question in this circuit." Though acknowledging that estate diminution "is commonly viewed as a prerequisite for avoidability of pre-petition preferential transfers…and fraudulent transfers…" the Court declined to "expand the diminution of estate doctrine" to §549 avoidance, holding as follows: "Plaintiff's failure to demonstrate a measurable depletion of the estate is not enough to allow a transfer to stand when it is otherwise avoidable under §549 because it satisfies all of the explicit requirements of an avoidable post-petition transfer." The Circuit Court further rejected the ordinary course of business defense, and application of the doctrines of earmarking and recoupment. Finally, the Court held that the measure of recovery applied by the Bankruptcy Court was correct. Section 550 provides for recovery of the property transferred and avoided under §549, or recovery of its value. This was correctly accomplished by ordering a monetary recovery for the value of the collected accounts, and return of the remaining uncollected accounts.

Section 542 Turnover

43. Section 542 turnover issues

Debtors overpaid their 2001 federal and state income taxes, entitling them to refunds. However, rather than claiming the refunds, they elected to leave them on deposit and apply them as overpayments to future tax liability. Sixteen days after making this election, the Debtors filed bankruptcy. When the Trustee demanded turnover of the deposited funds, the Debtors refused. The Bankruptcy Court ruled for the Trustee on his turnover complaint, finding the tax refund to be an asset of the estate subject to turnover. The District Court affirmed, and appeal was taken to the Ninth Circuit. *Nichols v. Birdsell*, 491 F.3rd 987 (9th Cir. 2007).

The Debtors argued that after making the irrevocable election to apply the refunds, they no longer had any right to receive them. Thus, the refunds were not property of the bankruptcy estate. The Circuit Court rejected this argument, finding the elected pre-payments to be estate property at the time of filing, under §542. The Court reasoned that if the Debtors had not elected to pre-pay their taxes, there would have been a refund available for estate administration just 16 days later. Therefore, the prepaid credit toward future taxes constituted estate property, subject to turnover.

One day prior to the issuance of the foregoing opinion, a Bankruptcy Court in Kansas denied a Trustee's motion to compel Debtors' turnover of tax refunds. *In re Blagg*, 372 B.R. 502 (Bkrtcy.D.Kan. 2007). There, Judge Somers found that the doctrine of marshaling asserted by the Trustee did not apply to compel turnover of the tax refund which was offset by the IRS post-petition, in satisfaction of Debtors' pre-petition tax liability. The Court noted that the Trustee should seek to recover directly from the IRS in the first instance. *See also*, and compare *In re Pyatt*, 486 F.3d 423 (8th Cir.), where the Eighth

Circuit held that turnover is only applicable against a Debtor who still has possession of the demanded funds at the time the turnover motion is filed.

44. Debtors not liable for turnover of bank account funds which were property of the estate, but subsequently transferred

In a case in which NABT joined several Trustees from the Eighth Circuit as Amici on behalf of the Appellant, Chapter 7 Trustee; the Eighth Circuit Court has ruled that §542 does not allow a Trustee to recover property of the estate from a Debtor, where such property is money in the Debtor's bank account at the time of filing, which gets transferred post-petition through negotiation of a check written by the Debtor. *In re Pyatt*, Opinion filed May 23, 2007, Eighth Circuit Court of Appeals.

On the date he filed his petition, the Debtor had $1,938.76 in his bank account. He had written several checks to creditors on the eve of filing, and scheduled $300.00 in the account on his Schedule B, having apparently subtracted the amount of the outstanding checks. The Trustee sought turnover of the $1,938.76 petition date balance under §542(a), which was subsequently compelled by Bankruptcy Court order. On appeal, the BAP reversed, with the majority finding the Bankruptcy Trustee was better positioned to recover the funds as unauthorized post-petition transfers, under §549. The concurring opinion disagreed, finding the Debtor was better able to prevent loss to the estate, but held that §542(a) was not authorized for turnover of funds that the Debtor no longer possessed or controlled.

The Trustee argued the funds were property of the estate because they remained in the account at the time of bankruptcy filing. She further argued that §542(a) provides for turnover of property or its "value"; and cited the Seventh Circuit Court case of *In re USA Diversified Products, Inc.*, 100 F.3d 53 (7th Cir. 1996), which held that a turnover defendant need not possess property of the estate for a Trustee to compel its turnover. The Seventh Circuit reasoned that if present possession were required, "the possessor…could thwart the demand simply by transferring the property to someone else."

The Eighth Circuit agreed with the BAP that a §542(a) turnover action is not available unless the property remains in the "possession, custody, or control" of the entity against whom turnover is sought. Answering the Seventh Circuit Court concern that this might lead to manipulation through planned transfers of property, the Eighth Circuit held that §549 was available for the Trustee to "proceed against the payees of the checks and bring the transferred funds back into the administration of the estate." The Court further suggested that Trustees could obligate banks to turn over the petition date balance under §542(b), by notifying them prior to post-petition honor of checks.

Editor's Note: In *NABTalk*, Volume 22, No. 4, Winter 2006, I reported the case of *In re Schoonover*, 2006 WL 3093649 (Bkrtcy.Kan. 2006). There a Bankruptcy Court in the Eighth Circuit specifically rejected the BAP holding in *In re Pyatt*, 348 B.R. 783 (8th Cir. BAP 2006), and noted that in seven prior reported decisions on this issue, four cases found the Debtor responsible for returning the funds to the estate, while three required the Trustee to recover the money from the payees under §549. In *Schoonover*, Judge Karlin took a practical approach, based on the realities of bankruptcy estate administration. He acknowledged that Trustees could file avoidance claims under §549, but the cost of filing and prosecuting these adversary complaints would frequently, if not almost always, outweigh the benefit of any recovery. The $250.00 filing fee alone would chill many

actions. Judge Karlin further considered the Trustee's ability to expeditiously notify banks prior to post-petition honor of checks. Unlike the Eighth Circuit, the Bankruptcy Judge acknowledged the "real life" difficulty, if not impossibility, of accomplishing this. The *Schoonover* Court further noted the obvious fact, which was somehow overlooked by the Eighth Circuit, that Debtors are in control of their checkbooks and accounts, while the Trustee is not. When read in the context of actual, rather than academic bankruptcy estate administration, the Eighth Circuit *Pyatt* decision does exactly what the Seventh Circuit feared in *USA Diversified Products, Inc.* It allows Debtors to thwart estate administration by permitting them to transfer estate property to whom they choose, while remaining immune from any consequence for this action.

45. Trustee awarded *quantum meruit* judgment for funds transferred pre-petition

Two days pre-petition, the Debtor delivered a check for $2,700.00 to pay property taxes due on real estate he owned. The check was not negotiated until after the petition filing. Thus, at the time of filing, the funds were property of the bankruptcy estate. The Trustee moved for turnover of the amount paid from the Debtor, under §542. *In re Borowiec*, 396 B.R. 598 (Bkrtcy.W.D.NY 2008).

Judge Bucki accepted the Debtor's argument that he could not be compelled to deliver funds no longer in his possession. However, the Trustee was not without a remedy. The Court determined that the Trustee could obtain a *quantum meruit* judgment for the value of the tax payment. Because the Debtor had received the benefit of an increase in the fully exempted equity value of his homestead, he had been unjustly enriched. Thus, the Debtor was liable to the Trustee for this unjust enrichment, which could be obtained by motion rather than adversary proceeding under Bankruptcy Rule 7001(1).

Property of the Estate

46. Discharge of Debtor does not preclude malpractice claim asserted by Trustee for the bankruptcy estate

Pre-petition, a multi-million dollar judgment was entered against the Debtor in a civil rights action. When the Debtor's bankruptcy Trustee asserted a legal malpractice action regarding the Debtor's representation, his pre-petition attorneys argued that under applicable Louisiana law, there was no requisite element of damages to establish a cause of action. They asserted that the Debtor's discharge of the judgment debt in his bankruptcy case purged the pre-petition damage. Upon appeal, this issue was ultimately presented to the Fifth Circuit Court of Appeals. *Stanley v. Trinchard*, 500 F.3d 411 (5th Cir. 2007).

The Circuit Court distinguished the Debtor's personal liability on the judgment from the existence of the obligation, which the Trustee could pursue as successor in interest for the benefit of the bankruptcy estate. The Court held that the Debtor's discharge of personal liability did not affect the Trustee's right and duty to pursue the malpractice claim for the benefit of the bankruptcy estate.

47. How are refunds from joint tax returns divided between a debtor and a non-filing spouse?

The Eighth Circuit BAP has recently addressed the persistent issue of how to divide a tax refund between a Debtor, who is the sole or primary wage earner; and his non-filing spouse, who earned little if any of the income reflected in their joint tax return. *In re Carlson*, 2008 WL 4148318 (8th Cir. BAP 2008).

The Court noted three different methods used to allocate the refunds between the debtor's estate and the spouse: (1) Divide the refund in proportion to the withholdings contributed by each spouse, which is thought to be the majority view. *In re Kleinfeldt*, 287 B.R. 291 (10th Cir. BAP 2002); *In re WDH Howell*, 294 B.R. 613 (Bkrtcy.D.N.J. 2003); *In re Levine*, 50 B.R. 587 (Bkrtcy.S.D.Fla. 1985); (2) Divide the refund in proportion to the income earned by each spouse. *In re Kestner*, 9 B.R. 334 (Bkrtcy.E.D.Va. 1981); or (3) Divide the refund equally between the bankruptcy estate and the non-filing spouse, regardless of earnings or withholdings. *In re Trickett*, 391 B.R. 657 (Bkrtcy.D.Mass. 2008); *In re Marciano*, 372 B.R. 211 (Bkrtcy.S.D.N.Y. 2007); *In re Barrow*, 306 B.R. 28 (Bkrtcy.W.D.N.Y. 2004); *In re Hajmowski*, 296 B.R. 645 (Bkrtcy.W.D.N.Y. 2003); *Loevy v. Aldrich*, 250 B.R. 907 (Bkrtcy.W.D.Tenn. 2000).

The BAP noted that state law should be reviewed to determine the division of property between the parties, but rejected the Debtor's argument that marital dissolution law, with a presumption of equal distribution, is dispositive. The Court stated that the goals of bankruptcy law are different from marital dissolution law, and agreed with the first, majority view. Because the non-filing wife did not contribute any of the tax withholdings, she was not entitled to any of the refund.

See also, In re Morine, 391 B.R. 480 (Bkrtcy.N.D.Fla. 2008), where Judge Paskay followed (2) above, and the Debtor's non-filing wife had no interest in the refund from a joint federal tax return because she contributed no taxable income, and the refund check was not deposited into a tenants by the entireties bank account prior to the bankruptcy filing. Therefore, the Debtor could not exempt the refund as entireties property.

48. Real estate commissions earned pre-petition are property of the bankruptcy estate

The Debtor, a self-employed real estate agent, negotiated contracts for buyers of real estate prior to filing a Chapter 7 petition. At the time of filing, the deals had not closed, and there were several remaining contingencies to be satisfied. The Debtor continued work post-petition to facilitate sale consummation, including the assistance of one buyer in obtaining desired zoning. The contracts closed and the Debtor received commissions. The Trustee moved for turnover, which the Bankruptcy Court approved. Appeal was taken to the Bankruptcy Appellate Panel. *In re Smith*, 402 B.R. 887 (8th Cir. BAP 2009).

Relying on *In re Parsons*, 280 F.3d 1185 (8th Cir. 2002), and §541(a)(1), the BAP affirmed the Bankruptcy Court. The BAP found that under applicable Iowa law, the Debtor earned the commissions pre-petition. Pursuant to *Parsons*, such commissions are property of the estate even if the Debtor continued to perform services post-petition. The Court rejected the Debtor's argument that he could not have earned commission payment until all contingencies were satisfied, finding no such provision in the contract or any supporting legal authority for this proposition.

Claims

49. Untimely creditor claims filed by Trustee not entitled to distribution

After settlement of the Debtor's Fen-Phen litigation, payment of allowed exemptions, attorney fees and expenses; the Trustee was left with $21,927.13. However, no creditor claims were filed prior to the bar date of February 2, 2006. The Chapter 7 Trustee then filed proofs of claim for 11 creditors on August 14, 2006, and the Debtor moved for payment of all the money held, as surplus funds. The Debtor argued that the claims filed by the Trustee were untimely and not entitled to any distribution. The Trustee countered that he had authority to file claims on behalf of creditors, and even if the claims were untimely, §726(a) provides that such claims must be fully satisfied before funds are returned to the Debtor. *In re Rothman*, 373 B.R. 785 (Bkrtcy.S.D.Ga. 2006).

Judge Davis first looked to Bankruptcy Rule 3004 which allows a Trustee to file claims "in the name of the creditor, within 30 days after expiration of the time for filing claims…." The Court then referenced the analogous Code §501(c) which allows the Trustee to file a claim if a creditor "does not timely file a proof of such creditor's claim". From the statute and rule the Court concluded that the claims filed by the Trustee were not timely filed. As to the Trustee's argument that §726(a)(3) provided for payment of late-filed claims prior to distribution to the Debtor, the Court again looked to the statutory language, which referred only to claims "tardily filed under §501(a)." As stated, the provision allowing claims to be filed by a Trustee is §501(c), not §501(a). Accordingly, the Court ruled that the Trustee's claims were not entitled to any distribution, and ordered turnover to the Debtor.

50. Unenforceable claim disallowed

A Chapter 7 Debtor objected to a creditor's claim on the ground that the applicable state law statute of limitations had lapsed pre-petition, making the claim unenforceable. An evidentiary hearing was held, and the Bankruptcy Court found that the Debtor had carried his burden as to this affirmative defense. Judge Somma noted that the claims were contractual in nature, and that under applicable Massachusetts law a contracts action must be commenced within six years after it accrues. Here the last charges comprising the claim were incurred over seven years prior to the bankruptcy filing, rendering it unenforceable at that time. The claim was, therefore, disallowed. *In re Makein*, 334 B.R. 527 (Bkrtcy.D.Mass. 2005).

Editor's Note: Holders of credit card accounts frequently file proofs of claim with mere summaries that do not indicate the age of the charges. Many Courts have denied Trustee objections to such claims for lack of sufficient documentation, based on the Debtor's scheduling of the claim. This case highlights one reason why such documentation is important. While Debtors may recognize that they incurred a debt, they might not understand that it could no longer be legally collected. Trustees should be entitled to independently determine the validity and enforceability of such claims.

51. Seventh Circuit upholds Nevada casino's claims in Wisconsin bankruptcy case

A case previously reported in this article at the Bankruptcy and District Court levels has worked its way to the Seventh Circuit Court. Here, a Wisconsin citizen gambled in Nevada, lost approximately $1.5 million, then went home to file bankruptcy. The Wisconsin Bankruptcy Court denied the casino claims as "unenforceable" under the Wisconsin anti-gaming statute which invalidates gambling debts as a matter of public policy. On appeal the District Court reversed, based on the Debtor's signing an agreement in Nevada that Nevada law (with its very different public policy about gambling) would apply to his gaming transactions in Nevada. The Circuit Court agreed with the District Court's assessment of the issue and looked to Wisconsin choice of law rules. The Court found that the law of the forum state (Wisconsin) presumptively applies unless "it becomes clear that non-forum contacts are of the greater significance." Because the Debtor was in Nevada when he made the agreements; the funds were loaned to him for gambling in Nevada; and, moreover, because the Nevada casinos did business in Nevada the "significant contacts in this case strongly favored Nevada, not Wisconsin." Thus the Nevada casino claims were valid in the Wisconsin bankruptcy case. *In re Jafari*, 569 F.3d 644 (7th Cir. 2009).

But don't mess with Texas. In a case with almost identical facts, substituting Louisiana casinos and a Texas gambler filing bankruptcy in Texas, the result is the reverse of this Seventh Circuit decision. The Texas Bankruptcy Court found that Texas had a more significant relationship to the transactions. It was the state where the Debtor resided and where his repayment obligation would be performed, from his Texas bank account. Further, even though the credit agreement was signed in Louisiana, credit was extended there, and funds were gambled away there; Texas had a greater interest in determining the enforceability of the debt because application of Louisiana law would be contrary to a fundamental policy of the State of Texas against gambling on credit. *In re Guevara*, 2009 WL 2046770 (Bkrtcy.S.D.Tex.).

52. Second Circuit holds §502(b) does not apply to administrative expense claim

Addressing an issue of first impression, the Second Circuit has ruled that §502(b), which bars allowance of claims filed by alleged recipients of preferential transfers, does not bar allowance of §503(b) administrative expenses. *In re Ames Dept. Stores, Inc.*, 582 F.3d 422 (2d Cir. 2009). In so holding, the Circuit Court disagreed with the Ninth Circuit Appellate Panel that §502(b) was a valid defense to allowance of administrative claims. *In re Microage, Inc.*, 291 B.R.503 (9th Cir. BAP 2002). The Third Circuit rejected the BAP's finding that §502(b) "by its terms applies to 'any claim' of an entity that received an avoidable transfer, and the definition of a 'claim' in §101(5) is sufficiently broad to include requests for payment of administration." Instead, the Circuit Court found that the "structure and context" of §502(b) suggests that Congress intended to differentiate between claims and administrative expenses. Additionally, the Court noted the higher priority of administrative expense requests to pre-petition claims under the Bankruptcy Code, which encourages third parties to supply goods and services on credit to the benefit of all estate creditors. Allowing a Debtor to avoid paying administrative expenses by alleging a vendor

had received a preferential transfer would hinder that policy. Thus, based upon its language, as well as a recognized policy advanced by the statute, §502(b) was held inapplicable to administrative expense claims under §503(b).

Standing

53. Eighth Circuit allows derivative standing to creditors upon Trustee's consent

In a case of first impression, the Eighth Circuit has held that creditors may bring Trustee actions for the benefit of the estate upon consent of the Trustee, subject to Bankruptcy Court approval. *In re P.W. Enterprises, Inc. v. North Dakota Racing Com'n.*, 540 F.3d 892 (8th Cir. 2008). In this case a creditor filed a motion to pursue avoidance actions, and the Trustee formally responded that he did not oppose the motion, but wanted reassurance that the actions would be pursued for the bankruptcy estate. The motion was denied, based on the creditor's failure to show that the Trustee had abused his discretion or acted unjustifiably in not asserting the avoidance claim, which the Court deemed a requirement for derivative standing. The BAP affirmed, and appeal was taken to the Circuit Court.

The Eighth Circuit held that a creditor may proceed derivatively when a Trustee or DIP either consents, or does not formally oppose the creditor's action, thereby adopting the Second Circuit standard of *In re Commodore Int'l Ltd.*, 262 F.3d 96 (Ca. 2 2001). However, the Appellate Panel emphasized that "under no circumstances may a creditor prosecute its derivative complaint without the Bankruptcy Court's permission." Thus, even if the Trustee consents, the creditor must still obtain leave from the Court for derivative standing, which may be denied under appropriate circumstances, even if the Trustee has consented.

54. Trustee lacks standing to bring conspiracy to commit fraudulent transfer action against non-debtor

In an unreported opinion, the Fifth Circuit has ruled that a Chapter 7 Trustee lacked standing to pursue a civil conspiracy claim against a third party who allegedly conspired with the Debtor to fraudulently transfer assets. Here the issue was not whether such a cause of action existed, but whether it could be asserted by the Trustee. Affirming the District Court dismissal of the Trustee's Texas law conspiracy claim, the Circuit Court held that the subject claims belonged exclusively to creditors of the bankruptcy estate. The Court followed the Supreme Court case of *Caplin v. Marine Midland Grace Trust Co.*, 406 U.S. 416 (1972), and its prior holding in *In re Seven Seas Petroleum, Inc.*, 522 F.3d 575 (5th Cir. 2008), for the proposition that Trustees have no right to bring claims "that belong solely to the estate creditors." The argument that the claims here sought "to remedy an injury to all…creditors and not merely a subset thereof," was unavailing. The action against the alleged third party conspirator belonged to the creditors; and because the Debtor had no interest in these actions, neither did the Trustee. *In re Bradley*, 326 Fed.Appx. 858 (5th Cir. 2009).

See also, *Grede v. Bank of New York, Mellon*, 409 B.R. 467 (N.D.Ill. 2009), where an Illinois Bankruptcy Court ruled that the Trustee of a liquidating trust lacked standing to pursue claims assigned to the trust by individual creditors in a confirmed plan. There,

Judge Hibbler found that assertion of these claims would benefit only the assigning, individual creditors, rather than all trust beneficiaries. Because the Trustee represented all beneficiaries, he did not have standing to bring actions on behalf of a group of individual creditors.

Abandonment

55. Sixth Circuit rules on revocability of technical abandonment

In a case of first impression in the Circuit, the Sixth Circuit Court has found that a Rule 60(b) analysis should be applied to determine if a technical abandonment of the Debtor's assets may be revoked. *LLP Mortg., Ltd. v. Brinley*, 547 F.3d 643 (6th Cir. 2008).

The Court first found "technical abandonment" to occur pursuant to §544(c) as to any property scheduled by the Debtor "not otherwise administered at the time of the closing of a case is abandoned to the Debtor." The Court adopted the approach of the Tenth Circuit in the case of *In re Woods*, 173 F.3d 770 (Ca. 10, 1999), which applied the guidelines of F.R.C.P. 60(b) to Bankruptcy Rule 9024. The Court noted that this requires the parties to act with due diligence, but also allows some flexibility in situations where relief is appropriate. The Court found such application to strike "the appropriate balance between promoting finality and allowing courts to grant relief in limited circumstances." In these consolidated cases, the Trustee's action in not administering the property did not result from mere carelessness, and the equities weighed in favor of preserving unencumbered equity for the bankruptcy estate. Accordingly, the abandonment was revoked.

56. Assets not included on Schedule B are not abandoned upon case closing

Key man life insurance policies owned by the Chapter 7 corporate debtor were not listed on Schedule B. They were, however, scheduled as executory contracts on Schedule G. An NDR was filed and the case was closed, but the Trustee subsequently moved to reopen to administer the insurance policies. The Debtor objected, asserting that the Schedule G listing, and the Trustee's apparent knowledge of the policies prior to case closing were sufficient to cause the assets to be abandoned under §544(c). The Bankruptcy Court disagreed. Judge Ninfo cited the "explicit requirement of §521(a)(1)(B)(I) that the debtor file a schedule of assets." The Court then found that neither the Schedule G listing nor the fact that the Trustee may have been aware of the policies constituted "the administration of those assets for purposes of §544(c)." Held Trustee allowed to administer the insurance policies in the reopened case. *In re J&S Conveyors, Inc.*, 409 B.R. 635 (Bkrtcy.W.D.NY 2009).

Judicial Estoppel

57. Judicial estoppel applies where Trustee fails to intervene

The *pro se* Debtors failed to schedule a personal injury claim in their Chapter 13 case. When the Debtors subsequently brought the action in District Court, the defendants

moved to dismiss based on judicial estoppel. Upon dismissal, plaintiffs appealed. *Pavlov v. Ingles Markets, Inc.*, 236 Fed.Appx. 549 (11th Cir. 2007).

In an opinion "not selected for publication", the Eleventh Circuit affirmed case dismissal "despite any interest of the bankruptcy trustee in the causes of action…." The Court distinguished *Parker v. Wendy's Int'l, Inc.*, 365 F.3d 1268 (11th Cir. 2004), which held that a district court had abused its discretion in applying judicial estoppel because the plaintiff's cause of action was the property of her Chapter 7 bankruptcy estate. There, the Trustee had intervened as a party plaintiff in the underlying lawsuit. Here, however, there had been no appearance by the Trustee through intervention of otherwise.

Editor's Note: Once an undisclosed personal injury or other claim is discovered, the Trustee should take immediate steps to intervene to prevent a result like this one.

58. Judicial estoppel upheld by Fifth Circuit

The Debtors neither disclosed their pending personal injury action in the schedules filed in their Chapter 7 case, nor otherwise informed the Trustee, who filed a no asset report. The Debtors subsequently received their discharges. When the personal injury action defendants filed a motion in state court seeking dismissal based on judicial estoppel, for failure of the Debtors to list the action as an asset in their bankruptcy case; the Debtors moved to reopen the bankruptcy proceeding to allow the Trustee to administer the lawsuit for the bankruptcy estate. Over the defendants' opposition, the Bankruptcy Court granted the motion to reopen. The case was then removed by the state court defendants to federal court, where they again moved for dismissal based on judicial estoppel. Shortly thereafter, the Trustee moved to substitute himself for the Debtors in the lawsuit as the real party in interest. The Federal District Court granted the dismissal motion, and summarily denied the Trustee's motion as moot. Appeal was taken to the Fifth Circuit. *In re Kane v. National Union Fire Ins. Co.*, 535 F.3d 380 (5th Cir. 2008).

The Circuit Court distinguished its earlier case of *In re Superior Crew Boats, Inc.*, 374 F.3d 330, upon which the District Court had relied. The Court noted that the prior case had involved an asset which the Trustee was informed about, and which was formally abandoned under §554. There, the Debtors had the asset back and stood to profit from their prior nondisclosure. Here, the asset had not been abandoned and the Debtor could only benefit from surplus funds available after case administration. The Fifth Circuit cited and followed the Seventh Circuit case of *Biesek v. Soo Line R.R. Co.*, 440 F.3d 410, 413 (7th Cir. 2006), which stated, "Judicial estoppel is an equitable doctrine, and using it to land another blow on the victims of bankruptcy fraud is not an equitable application."

Miscellaneous

59. Eleventh Circuit clarifies grounds for revocation of discharge

After the Debtor received his Chapter 7 discharge, a creditor sought revocation based on, among other grounds, the Debtor's failure to obey a court order directing production of documents and setting a four-week deadline for production. The Debtor produced 694 documents prior to the deadline, and another 5,300 after the deadline. On appeal the Eleventh Circuit affirmed the lower Court's denial of discharge revocation. *In re Matos*, 267 Fed.Appx. 884 (11th Cir. 2008).

The Court found late production of documents alone was insufficient to show the requisite willful or intentional refusal to obey an order, or that the order was ignored. The Circuit Court also noted that the Bankruptcy Court's analysis had fully comported with the relevant factors set out in *In re Jones*, 490 F.2d 452 (5th Cir. 1974). The factors to be considered thereunder are (1) the detriment to the proceedings and the dignity of the court versus the potential harm to the Debtor if discharge is denied; (2) whether the Debtor's acts were willful, or was there a justifiable excuse, (3) whether there was injury to creditors, and (4) whether there was some way the Debtor could make amends for the conduct.

Compare this to another revocation case where the Debtor failed to comply with a series of court orders requiring production of documents and testimony at a BR 2004 examination, and was ordered to pay a $3,000.00 sanction. The Debtor failed to pay the sanction, produce the documents, testify, or otherwise respond to material questions concerning disposition of property of the bankruptcy estate. The Trustee and some creditors filed a complaint to revoke the Debtor's discharge under §§727(d)(3) and (a)(6)(C). *In re Eckert*, 375 B.R. 474 (Bkrtcy.N.D.Ill. 2007).

Judge Squires joined the majority court view that the plaintiffs in a revocation of discharge action had to establish that the Debtor willfully and intentionally refused to obey a court order and not just failed to obey the order as a result of inadvertence, mistake, or inability to comply. This required the plaintiffs to demonstrate some degree of willfulness on the part of the Debtor. However, the plaintiffs could meet their initial burden by showing that the Debtor received the order in question and failed to comply with its terms, thereby shifting the burden of proof to the Debtor to explain non-compliance. Here, plaintiffs showed that the Debtor had a "disparaging pattern of refusing to comply with lawful orders of the court." This constituted grounds for revocation of discharge, along with separate grounds established by the failure to produce documents and respond to material questions concerning the disposition of assets.

60. Collateral cannot be surcharged after it leaves the bankruptcy estate

The Fifth Circuit Court of Appeals has held that once assets are sold free and clear, they are no longer "property securing an allowed secured claim", and cannot be surcharged under §506(c). *Borrego Springs Bank, N.A. v. Skuna River Lumber, LLC, (In re Skuna River Lumber, LLC)*, 564 F.3d 353 (5th Cir. 2009).

In this case, the Bankruptcy Court authorized a sale of substantially all of the Debtor's assets over the objection of the secured creditor. Prior to that, the Court had approved the employment of the auctioneer to conduct the sale, over the same creditor's objection. At the auction, the secured creditor was the successful bidder by a credit bid; and, over the same creditor's objection, the Bankruptcy Court subsequently authorized payment of the auctioneer under §506(c). The District Court affirmed on appeal. In reversing the lower courts, the Fifth Circuit determined that the Bankruptcy Court had no jurisdiction over the assets at the time of the surcharge, because they had already been conveyed to the lender, free and clear of liens and encumbrances, nearly one month earlier. The Circuit Court cited and agreed with *In re Edwards*, 962 F.2d 641 (7th Cir. 1992), which held that when property is transferred out of a bankruptcy estate free and clear of all liens, the Bankruptcy Court ceases to have jurisdiction over that property.

61. What is the extent of Debtor's duties to cooperate with Trustee?

After the order for relief was entered in an involuntary Chapter 7 case, the Trustee sought information about changes in the Debtor's corporate structure over the preceding three years. Specifically, the Trustee sought documentary explanation of the relationships among a number of companies both prior to and after the corporate restructure. The Debtor representative allowed access to voluminous documents which the Trustee, along with two CPA's, one computer technician and three attorneys spent an entire day examining, without finding significant relevant information. The Trustee then moved to compel turnover of specific documents relative to the Debtor's financial condition. *In re Royce Homes, LP*, 2009 WL 3052439 (Bkrtcy.S.D.Tex.).

Judge Bohm cited §521(a)(3), which requires Debtors to "cooperate with the Trustee as necessary to enable the Trustee to perform the Trustee's duties." The Court also looked to Bankruptcy Rule 4002(a)(4), which requires that the Debtor cooperate with the Trustee in the preparation of the inventory, examination of proofs of claim, and administration of the estate. Further, under §704 the Trustee was obligated to investigate the financial affairs of the Debtor, and under §105(a) the Court had the power to fashion remedies necessary to preserve these Bankruptcy Code rights and duties. The Court thus had power to order the Debtor's representative to turn over the requested documents. Importantly, the Court ruled that the Bankruptcy Code and Bankruptcy Rules establish an affirmative duty for the Debtor to do more than simply allow the Trustee access to rooms full of paper. Rather, the Debtor has an affirmative obligation to help the Trustee discover relevant information.

62. §108(a) applies to statutes of repose

The Trustee commenced a state law malpractice suit against the Debtor's pre-petition attorneys under §108(a), which allows such actions to be brought in the period allowed by state law or within two years after the order for relief, whichever is later. Defendants argued, and the District Court agreed that the applicable Louisiana law was a statute of repose, rather than a statute of limitations. Therefore, all rights were extinguished upon expiration of the one-year statutory deadline, pre-empting commencement of any action thereafter. This ruling was based on the District Court's finding that §108(a) could not alter such substantive state law property rights. Appeal was taken to the Fifth Circuit. *Stanley ex rel Estate of Hale v. Trinchard*, 579 F.3d 515 (5th Cir. 2009).

The Circuit Court first found that bankruptcy falls within the constitutional powers of Congress, and that bankruptcy law could therefore take precedence over state laws under the Supremacy Clause. The Court further determined that the clear purpose of §108(a) was to afford Trustees extra time to assess and pursue potential assets of Debtors' estates. These findings compelled the Court's conclusion that Congress expressly extended the time for pursuing any action that would otherwise be time-barred under state law. It made no difference that the state law deadline was one of "limitation or prescription, repose or pre-emption." The District Court reversed, and Trustee was permitted to prosecute the malpractice action.

§503(b)(9) priority does not negate new value defense under §547(c)(4)

A Tennessee Bankruptcy Court recently considered an important BAPCPA issue of first impression. Here the Chapter 11 Debtor was a wholesale distributor to restaurants. After deciding to liquidate rather than reorganize, the Debtor sought a declaratory judgment that creditors with unpaid invoices allowing §503(b)(9) administrative expenses could not also claim the unpaid delivered goods as §547(c)(4) subsequent new value in preference actions brought by the Debtor. This was a significant issue, as more than 200 creditors had asserted more than 200 §503(b)(9) claims. *In re Commissary Operations, Inc.*, 2010 WL 99036 (Bkrtcy.M.D.Tenn.).

The Debtor argued that including §503(b)(9) claims in the §547(c)(4) defense effectively granted "double value" by giving administrative priority to unsecured creditors while also reducing their preference liability in the amount of the administrative claim. The creditors countered that the plain language of the §503(b)(9) BAPCPA amendment included no indication that it in any way affected or impaired the new value defense of §547(c)(4).

Ruling for the creditors, Judge Harrison found no connection between a §503(b)(9) claim and the right to reclamation under §546(c), which does negate the (c)(4) defense. The Court also found that unlike a reclamation claim, (b)(9) claims arise only post-petition, and apply only in bankruptcy. The Court further cited the Congressional policy favoring allowance of payments to a struggling business, and found that forcing a creditor to elect between an administrative expense claim and a preference defense was contrary to that policy. Finally, as to the statutory language the Court stated: "There is nothing in the plain language of…§503(b)(9) or…§547(c)(4) that indicates any Congressional intent to offset the intended benefit that…§503(b)(9) confers upon sellers for a reduction of available new value in defending a preference action."

More Barton Doctrine cases

A proliferation of decisions based on the Barton Doctrine is probably not a good sign for Trustees, but it may be a sign of the times. Several recent rulings, including the following by Florida and Ohio Bankruptcy Courts should provide some solace. In both cases, the Trustee was not found to be liable in very different situations, and for very different reasons.

OHIO: The corporate liquidating trustee in a confirmed Chapter 11 Plan, along with the individual acting on its behalf and its attorneys ("Trust Parties") were sued in state court. The plaintiff alleged a pre-petition conspiracy which led to a "whistle blower action", which led to a settlement agreement which was invalid and/or unenforceable. In addition, there were allegations related specifically to events which occurred post-bankruptcy. Upon request of the Trustee, the action was removed to Federal District Court, which transferred it to Bankruptcy Court. When the dust settled, the Trust Parties sought money damages and injunctive relief based on violations of the Barton Doctrine in connection with the state court lawsuits. *In re National Century Financial Enterprises, Inc.*, 426 B.R. 282 (Bkrtcy.S.D.Ohio 2010).

Judge Hoffman divided the allegations into two categories. One dealt with actions pertaining to the Trust Parties' administration of the Chapter 11 Plan; and the other with events that occurred prior to this case administration. The Court found a presumption that the Trust Parties were acting within the scope of their authority as to actions occurring after appointment; and under the Barton Doctrine any party seeking to sue them regarding those acts had to first obtain leave of Bankruptcy Court. As to the alleged pre-petition activity, the Court found that the state court plaintiff was required, at the time suit was filed, to possess information demonstrating that the Trustee Parties were acting outside the scope of their authority. The fact that discovery was sought to obtain this information post-filing made no difference. Unless actual evidence of actions beyond the scope of case administration was known when the case was filed, the Barton Doctrine would control to disallow continued prosecution of the action. The Court then ruled as follows: (1) the Trust Parties had the opportunity to prove damages incurred in defending the state court actions; and (2) the state court plaintiff was permanently enjoined from further prosecuting the state court lawsuits.

NOW TO FLORIDA where another Bankruptcy Court has recently considered a different aspect of the Barton Doctrine. Here a creditor filed a motion to remove the liquidating Trustee of a confirmed Plan. In response, the Court appointed an examiner who submitted a report indicating various failures of the Trustee to competently administer the Plan. However, this report also found the Trustee lacked "the background experience and foundational qualifications required to serve in a fiduciary role of liquidating trustee…." The report further noted that Trustee counsel "did not provide the requisite level of overseeing advice and guidance…." However, the examiner found "no evidence of misappropriation of funds." Based on that report, the Court found that the Trustee had mismanaged the liquidating trust, but it was in the best interest of the estate not to remove him. Rather, it was ordered that he would not make any further disbursements in the case. The creditor then filed a motion to disgorge fees from the Trustee's counsel, which had already voluntarily disgorged $324,000.00. An additional amount of $165,691.00 was ordered disgorged for fees paid without the Court's authorization. An adversary complaint was also filed for disgorgement of all fees paid to the Trustee, which was defended by the surety who issued a bond "for the faithful performance" by the Trustee "of his official duties as the Liquidating Trustee…." *In re TSN USA, Inc.*, 2010 WL 1169752 (Bkrtcy.S.D.Fla.).

Judge Cristol stated the "general rule" of the Eleventh Circuit that Trustees are "entitled to qualified judicial immunity for acts taken within their authority as an officer of the Court." Further, in order to be held personally liable, "the actions of the Trustee must rise to the level of willful and deliberate conduct or gross negligence." In order to be "grossly negligent" the Trustee must have "willfully and deliberately attempted to cause harm…." The Court listed the many transgressions of the Trustee, including comingling of funds, failure to put reserve funds into interest-bearing accounts and paying professionals without Court authorization; and conceded that these actions may have diminished the estate. However, there was no deliberate or malicious basis for these actions. They were inadvertent and/or based upon advice of counsel to a Trustee who "admittedly…did not fully understand the requirements of the Plan." Most importantly, these mistaken actions did not amount to "willful and deliberate conduct or gross negligence." In other words, "Stupidity does not equal malice." Thus, there was

no basis for personal liability, and no corresponding liability of the surety on the Trustee's bond.

State Court claim for equitable distribution of marital assets was part of bankruptcy estate

Two years before filing her Chapter 7 petition, the Debtor initiated a divorce proceeding in Pennsylvania which requested equitable distribution of the marital estate. The Debtor's estranged spouse had a retirement account with an approximate balance of $130,000.00 which she claimed exempt on her Schedule C. When the Trustee objected to the exemption, the Debtor argued that despite having scheduled the asset, the equitable interest she sought in the divorce case was not part of the bankruptcy estate. *In re Radinick*, 419 B.R. 291 (Bkrtcy.W.D.Pa. 2009).

The Debtor relied upon *Kane v. Kane*, 2009 WL 3208653 (D.N.J. 2009), and *In re Frederes*, 141 B.R. 289 (Bkrtcy.W.D.N.Y. 1982), for the proposition that her divorce claims had not matured into her property when the bankruptcy case was filed. Judge McCullough rejected those decisions, based on the respective state laws of New Jersey and New York, both of which provided that the right to equitable distribution of marital interests arises only upon the entry of a divorce judgment. Applicable Pennsylvania law was contra, providing that interests in marital property vest immediately upon the filing of a divorce action. The Court found the right to the retirement account to be proceeds from or the product of this vested asset under §541(a)(6), regardless of when it was or would be distributed to the Debtor. However, because there had not yet been a distribution ordered by the divorce court, it was premature to rule on the exemption objection.

Trustee's alleged slander and libel protected by absolute quasi-judicial immunity

A Chapter 11 Trustee was appointed soon after the case was filed, upon motion of several of the Debtor's investors. The motion alleged that the principal was operating a Ponzi scheme. At the §341 hearing the Trustee stated that the Debtor's principal had "lied" and played a "cruel hoax" on investors. After the principal sent a letter contradicting these statements, the Trustee responded with a letter he posted on the official bankruptcy website of the Debtor's estate. In that letter the Trustee made several allegedly defamatory remarks, including that the principal had knowingly operated a Ponzi scheme and that continuation of the business would mean more investors would "lose their life savings in a hopeless vortex of fraud." A defamation action was subsequently filed in state court, which the Trustee removed to Bankruptcy Court, and which was subsequently dismissed upon the Trustee's motion, but not based on derived judicial immunity as asserted by the Trustee. Appeal was taken to the BAP. *In re Cedar Funding, Inc.*, 419 B.R. 807 (9th Cir. BAP 2009).

The BAP found that the Trustee's communications occurred while he was performing official statutory duties. Further, they were made to the very creditor body represented and served by the Trustee which conferred on him functional judicial immunity. *Antoine v. Byers and Anderson, Inc.*, 508 U.S. 529 (1993). The BAP therefore ruled: "The statutory provisions regarding the trustee's duties give the trustee

broad discretion and supervisory powers over the administration of a Chapter 11 estate. As such, we construe them as inextricably intertwined with the Court's functions in the Chapter 11 bankruptcy process, which are aimed at preserving the business as a going concern and maximizing the value of assets for creditors." The BAP then concluded: "A trustee's duties to uncover and report on insider fraud or other fraudulent conduct…should not be compromised by the threat of litigation against a trustee. Granting immunity to bankruptcy trustees for functions which are judicial in nature is based on a policy of protecting the bankruptcy process." Dismissal of the defamation action against Trustee affirmed.

Member of Debtor LLC was insider for preference avoidance purposes

The Chapter 11 Trustee of a Debtor LLC sought avoidance and recovery of $200,000.00 paid to one of five managers of the LLC. The payment was part of a $400,000.00 settlement between the Debtor and the interest holder, which was received more than 90 days, but less than a year before the bankruptcy filing. Avoidance and recovery were therefore subject to a finding that the transferee/interest holder was an insider under §547(b)(4)(B). *In re Longview Aluminum, LLC*, 419 B.R. 351 (B.R.N.D.Ill. 2009).

Judge Wedoff noted two conflicting approaches to determination of this issue. One requires at least some showing of control of the Debtor by the alleged insider, while the other focuses on the similarity of the transferee's position to the per se insider categories of §101(31). The Court found the latter was the better approach. Thus, if a member or manager of an LLC holds a position substantially identical to someone listed in the statutory list of insiders; he is an insider by virtue of that position alone. Here the Court found the preference defendant's position to be effectively equivalent to that of a corporate director. He was, therefore, an insider. Additionally, the Court noted that the LLC member/transferee had agreed to relinquish his management rights only conditionally, until subsequent payment of the full settlement amount. He was therefore very different from an arm's length creditor, and an insider, whether statutory or non-statutory.

The fifth element required for allowable informal proof of claim. Is it equitable to allow the claim???

Based on his pending §544(a) action to avoid a mortgage on real estate, the Trustee moved to sell the property under the "bona fide dispute" provision of §363(f). The mortgage holder objected, and moved for stay relief and abandonment of the property. The Bankruptcy Court authorized the sale, and subsequently avoided the mortgage. The BAP affirmed on appeal, and no further appeal was taken. Throughout this process and beyond, the creditor never filed a proof of claim. Therefore, when the Trustee submitted his final report, he did not recommend distribution on the mortgage creditor's now unsecured claim. The creditor objected, and moved for allowance as an informal proof of claim. The Court denied this relief, finding the various pleadings filed by the creditor lacked the requisite elements to constitute an informal claim. Additionally, the Court found that the equities weighed in favor of disallowing the claim.

On appeal, in a split decision, the Sixth Circuit BAP found the pleadings contained the elements required to qualify as an informal proof of claim. However, the majority agreed with the Bankruptcy Court that allowance would be inequitable, and disallowed the claim on that basis. Appeal was then taken to the Sixth Circuit Court. *In re Nowak*, 586 F.3d 450 (6th Cir. 2009).

The Circuit Court stated the four elements required for allowance of an informal proof of claim: (1) It must be in writing, (2) containing a demand by the creditor on the debtor's estate, (3) expressing an intent to hold the debtor liable for the debt, and (4) must be filed with the Bankruptcy Court. If these conditions are met, there is a fifth factor to be examined. This last factor is a determination of whether it is equitable to allow the claim. The Appellate Court found this determination to be within the sound discretion of the Bankruptcy Court, requiring a balancing of the interests of the parties involved. The Court then reviewed the three factors on which the Bankruptcy Court based its decision. The first was the length of the creditor's delay in pursuing an unsecured claim. After the Trustee initiated the adversary proceeding the creditor was on ample notice of a likelihood that its secured creditor status might be lost, necessitating the filing of a claim. Further, regardless of the avoidance action, sale of the Debtor's residence would not have paid the secured claim in full, leaving an unsecured deficiency necessitating a proof of claim filing. Indeed, the creditor had recognized and noted this fact in objecting to the proposed §363(f) sale. As such, the creditor simply failed to protect its own interest. The second factor was the creditor's inability to explain its delay as other than an "oversight". The Circuit Court called that a "self-inflicted wound" that bode against recognizing an informal proof of claim for a sophisticated party represented by counsel. The third consideration was the amount other claims would be reduced by allowance of the informal claim. Here the distribution to other creditors would decrease from 100% to 29%. Finding that reasonable people could differ in this required balancing of equities, the Sixth Circuit held the Bankruptcy Court had not abused its discretion and affirmed its holding.

Post-petition appreciation of stock value held by sole shareholder of Debtor is property of the estate

The Chapter 7 Trustee of the sole shareholder of an ambulance company moved to sell the Debtor's stock back to him for $400,000.00. The offer included a provision whereby the Debtor's rights to any sale proceeds under §541(a)(6) would be waived, but only if the Debtor were the successful buyer. When a competing offer of $500,000.00 was made, the Debtor argued that any equity in the business above that amount would go to him under §541(a)(6) as non-estate personal services income. This argument was based on Debtor's assertion that any post-petition increase in the stock value was a result of his efforts as sole shareholder. *In re Moyer*, 421 B.R. 587 (Bkrtcy.S.D.Ga. 2007).

Judge Barrett explained the distinction between the Debtor and the ambulance company. The Court noted that the company was formed around 2001, had more than 120 employees, owned a fleet of approximately 40 ambulances and contracts with various healthcare facilities. The company had continued to operate profitably during its

shareholder's bankruptcy, with its equity value allegedly increasing by over $300,000.00.

The Court then looked to §541(a)(6) and found it did not apply to the increase in value of the corporate shares. As an employee of the corporation, the Debtor received approximately $75,000.00 per year, which represented personal services income. The shares of stock were property of the Debtor's estate, and their increase in value was "profits and proceeds of or from property of the estate and not earnings from Debtor's post-petition services." Interestingly, the Court cited a Ninth Circuit case dealing with a sole proprietorship rather than a corporation, which held that the post-petition earnings of a sole practitioner law practice were not §541(a)(6) earnings of the attorney Debtor. *In re FitzSimmons*, 725 F.2d 1208 (9th Cir. 1984). Even in a single lawyer proprietorship, income could be attributed to assets such as invested capital, accounts receivable and goodwill, which were separate from the sale of the proprietor's personal services. Thus, the proposed buyer of the ambulance company stock was buying all of the value of the Debtor's stock in the company at the time of the purchase.

State law "bankruptcy specific" exemption held unconstitutional

A Michigan Bankruptcy Court has recently addressed an issue fraught with contentious disagreement and varied application. Can a state implement legislation which applies only to debtors in bankruptcy? Is such legislation an unconstitutional violation of the Supremacy Clause because it impermissibly infringes on the exclusive right of Congress to establish "uniform laws on the subject of bankruptcies throughout the United States" U.S. Constitution art. I, section 8, cl. 4 (V) ("Bankruptcy Clause")? In this case the statute provided that "A debtor in bankruptcy under the Bankruptcy Code,…" could exempt up to $34,500.00 in value from a homestead. Outside of bankruptcy, the general homestead exemption was limited to $3,500.00 under the Michigan Constitution. The Chapter 7 Trustee triggered the question by objecting to the Debtor's $34,500.00 exemption claim, asserting the state exemption statute was unconstitutional. *In re Contius*, 421 B.R. 814 (Bkrtcy.W.D.Mich. 2009).

Judge Gregg initially noted cases going both ways, including the recent Fourth Circuit case of *Sheehan v. Pevich*, 574 F.3d 248 (4th Cir. 2009). The Court also acknowledged "the admonition that it should not decide a constitutional issue unless it is absolutely compelled to do so." However, there was no way around the issue here. The Court cited *In re Hood*, 541 U.S. 440 (2004), for its holding that the Bankruptcy Clause "was intended to grant exclusive power to the federal government." The Court further cited *In re Wallace*, 347 B.R. 626 (W.D.Mich. 2006), for the proposition that Congress cannot delegate this exclusive legislative authority to states. Under the Bankruptcy Clause, Congress must establish "uniform laws on the subject of bankruptcy throughout the United States." The Court found this to mean, said another way, that Congress is forbidden from adopting laws of states which are not "uniform". While it may be uniform for all states to have the ability to opt out of the federal exemption laws, that is different from Congress adopting state laws which treat bankruptcy debtors different from other debtors. The Court then gave an example of how the Michigan statute created "non-uniformity". A creditor in Michigan might reasonably choose state court action, rather than involuntary bankruptcy against a Debtor with homestead equity

above $3,500.00. Any amount over that would be exempt by the Debtor in bankruptcy, but not otherwise. As such, the Michigan statute would frustrate a particular aspect of federal bankruptcy law, involuntary filings, rendering it unconstitutional under the Supremacy Clause.

Different exemptions for joint debtors?

Prior to filing their Chapter 13 petition in North Carolina, joint Debtors had lived in different states for different periods of time. The husband had lived in North Carolina for the entire 730 days prior to the filing. The wife had resided in Florida during part of the 730 days, and under §522(b)(3)(A), Florida was her domicile for 180 days immediately preceding the 730-day period. Thus, under §522(b)(3)(A), the Florida exemptions would have applied to her, but for the fact that they only apply to Florida residents. She then defaulted to the federal exemptions under §522(b)(3). That left the Debtor with North Carolina exemptions and the joint Debtor with federal exemptions. The situation was further complicated/simplified by §522(b)(1), which provides that one debtor in a joint case may not elect the federal exemptions and the other elect state exemptions. The Debtors allegedly followed that, by both claiming the federal exemptions and the Trustee objected. *In re Connor*, 419 B.R. 304 (Bkrtcy.E.D.N.C. 2009).

Sorting all this out, Judge Leonard noted that the BAPCPA amended subsections §522(b)(2) and (b)(3) came along after §522(b)(1). The Court then looked to the specific language of (b)(1) which prohibits joint debtors from "electing" the federal and state exemptions. Here the husband could not elect the North Carolina opt out exemptions. He was required by the residency requirements to use them. Likewise, the joint Debtor was not eligible for either North Carolina or Florida exemptions, thereby defaulting to §522(b)(3), which required her to use the federal exemptions. Section 522(b)(1) was therefore irrelevant and inapplicable. The Debtors had no choice in this matter and, as compelled by the BAPCPA amendments, had to use different exemptions. North Carolina for him and federal for her.

Federal choice of law rules apply to fraudulent conveyance action

The Debtor, a Texas corporation, filed its bankruptcy petition in Texas. Its Trustee sued an Ohio limited partnership, with its principal place of business also in Texas, for recovery of Ohio real estate which had allegedly been fraudulently transferred. The action was brought under §544(b) and Texas fraudulent transfer law. The Ohio fraudulent conveyance "look back" limitation had expired prior to the bankruptcy filing; but this period was longer under Texas law, and had not run pre-petition. The Court was left to decide which law to apply. *Tow v. Rasizadeh (In re Cyrus II T "SHB")*, 413 B.R. 609 (Bkrtcy.S.D.Tex. 2008).

The Court initially determined that federal choice of law rules apply if any compelling federal bankruptcy interest is present. Though §544(b) incorporates state law as a rule of decision, the action remains part of the administration of the bankruptcy, which implicates the federal interest in maintaining a uniform bankruptcy law. That required a determination of the state with more significant contact or relationship. Here, the action did not involve the validity of the contract by which the real property was

transferred, or the transferee's property interest. Rather, focus was on whether the transfer was fraudulent as to creditors. Indeed, the Court noted it was not even necessary for the Trustee to recover the transferred property itself. He could recover its value under §550(a). From that, the Court concluded that the action sounded in tort, and the Court must determine the choice of law based on the place where the conduct and the injury occurred, the locations of the parties, and their relationship. The analysis of those factors weighed in favor of applying Texas law, and the Trustee's action was allowed to proceed.

Estate property includes assets in deferred compensation plans.

Some of the Debtor's key employees entered into deferred compensation plans to provide them supplemental retirement benefits. The deferred compensation was placed in an unfunded trust maintained by an independent trust company. These plans were "top hat" plans under which high-level employees effectively postponed receipt of part of their compensation until a later tax year. While such plans are subject to certain ERISA regulations, they are exempted from nearly all substantive requirements such as minimum funding or investing standards. Moreover, the trusts were "rabbi trusts", which could set aside deferred compensation amounts without jeopardizing the unfunded status of the "top hat" plans. The question before the Court was whether the assets in these plans constituted bankruptcy estate property. *Synovus Trust Co., N.A. v. Bill Heard Enterprises, Inc., et al. (In re Bill Heard Enterprises, Inc.)*, 219 B.R. 858 (Bkrtcy.N.D.Ala. 2009).

Under §541(b)(7) estate property does not include any amount withheld by an employer from employees' wages for payment as contributions to an employee benefit plan. However, all plans are not alike, and all plans are not exempt under this statute. The Court noted that funds held in a "rabbi trust" are out of the reach of the settlor/employer, but remain subject to claims of creditors in the event of the employer's insolvency. The Court further noted that the employees did not pay any taxes on the deferred amounts, and pointed out the distinct differences between this plan and other ERISA qualified pension plans such as 401(k). The Court then held that §541(b)(7) did not exclude from estate property the funds held in trust pursuant to these "top hat" plans.

Trustee remains bona fide purchaser despite simultaneous electronic filing of petition and schedules

When the Debtor refinanced her condominium mortgage debt, the refinancing creditor failed to record its deed of trust. Only the prior deed of trust, which had been marked paid in full, remained in the property record. In her subsequent Chapter 7 case, Schedule D listed the unperfected, refinancing mortgage holder as a secured creditor, and the creditor brought an adversary proceeding seeking determination that its lien was valid and unavoidable. The Bankruptcy Court ruled for the mortgage creditor based on *In re Professional Investment Properties of America*, 955 F.2d 623 (9th Cir. 1992), which had held a scheduled secured claim provided constructive notice to the

Trustee. On appeal the BAP reversed. Further appeal was taken to the Ninth Circuit. *Chase Manhattan Bank, USA, N.A. v.Taxel (In re Deuel)*, 594 F.3d 1073 (9th Cir. 2010).

Affirming the BAP, the Circuit Court focused on the phrasing in §544(a)(3), which provides the Trustee with the status of a bona fide purchaser of real property from the debtor "at the time of commencement of the case"; and without regard to any knowledge of the Trustee "as of the commencement of the case." The Court observed that only the petition filing commences the case, regardless of what else happens at the same time. Moreover, because the strong arm power exists without regard to any knowledge of the Trustee, it did not matter if a hypothetical Trustee had immediately read the simultaneously filed Schedule D, thereby giving him constructive notice. Finally, the Circuit Court distinguished "Professional Investment" as limited to involuntary petitions where the Order for Relief always and necessarily occurs after the petition is filed.

Debtors ordered to turn over checking account balance at time of bankruptcy filing, notwithstanding that funds had been paid through post-petition negotiation of pre-petition checks written by the Debtors

Pro se Debtors indicated $513.00 in a joint checking account on their Schedule B, but claimed no exemptions on Schedule C. Schedule C was subsequently amended to include the $513.00. The Chapter 7 Trustee objected to all of the Debtors' claimed exemptions with the exception of their Jaguar and IRA's. This objection specifically included the sum of $5,862.38 which remained in the joint checking account on the date of filing. In their response, the Debtors argued that the $513.00 was exempt, and that the balance in the account stated by the Trustee represented the total of checks written pre-petition, but honored post-petition. The Debtors cited the case of *In re Pyatt*, 486 F.3d 423 (8th Cir. 2007), in support of their position. The Trustee argued that the funds were property of the estate because they were in the account on the petition date. Thus, under §542 the Debtors were required to turnover "such property or the value of such property…to the Trustee." *In re Brubaker*, 2010 WL 1260131 (Bkrtcy.M.D.Fla.).

Judge Paskay first found that the funds did not leave the checking account until the previously written checks were honored post-petition. The Court reasoned that "until the checks were honored by the Debtors' bank, the Debtors still had the opportunity to close the account or to stop payment on the checks." The Court cited §2-104 of the U.C.C and the case of *Barnhill v. Johnson*, 503 U.S. 393, 112 S.Ct. 1386 (1992), as support for this finding. However, this did not completely answer the question. While the funds were property of the estate when the case was filed, they no longer belonged to the Debtors after the checks were negotiated post-petition. Should the funds be recovered from the Debtors under §542, or from the post-petition recipients under §549 as the Eighth Circuit found in *Pyatt*? While the Court noted no bad faith or fraudulent intent by these Debtors, the fact remained that (1) their interest in the bank account became estate property upon their petition filing, and, (2) though they may have lacked "technical custody" they maintained control of them until the checks were honored. They were therefore ordered to turn over the non-exempt portion of their bank account as of the date of their bankruptcy filing.

Comment: Though it is not specifically mentioned in this holding, there is one inescapable fact in all these cases. The Debtors chose to write the checks. They also chose which creditors were paid by these checks. They had total control of the situation, and made a conscious decision. Why should they not be responsible for the consequences?

Action under Fair Debt Collection Practices Act (FDCPA) arising from creditor actions pre-petition is bankruptcy estate property

A Chapter 7 Debtor filed a complaint in Bankruptcy Court alleging that a creditor had engaged in pre-petition collection activity which violated the FDCPA. The Debtor asserted that this violation had made him "severely agitated, traumatized, emotionally damaged and inconvenienced." He sought both actual damages of $1,000.00, punitive damages, legal fees and expenses pursuant to 15 U.S.C. §1629. The Bankruptcy Court *sua sponte* raised the issue of the Debtor's standing to bring this action. *In re Solp*, 425 B.R. 263 (Bkrtcy.W.D.Va. 2010).

Judge Klumm cited *Bluemark Inc. v. Geeks On Call Holdings, Inc.*, 2010 WL 28720 (E.D.Va.), as authority for acting on this issue as a threshold matter. Because an action must be brought in the name of the real party in interest, the Court lacks subject matter jurisdiction to hear a case where the plaintiff does not have standing. Therefore, such actions cannot proceed and must be dismissed. *Mirant Potomac River, LLC v. U.S. Envtl. Agency*, 577 F.3d 223 (4th Cir. 2009). The Court then looked to the Bankruptcy Code and found that under §554(d) "property of the estate that is not abandoned and not administered by a trustee remains property of the estate." Because the pre-petition action came into the estate under §541(a)(1), and had neither been abandoned nor administered, it remained solely under the control of the Trustee for the bankruptcy estate. Therefore, only the Trustee could prosecute this FDCPA claim, which mandated dismissal of the Debtor's lawsuit.