

Case Law Update: "Yours, Mine and Ours"

8th Circuit Update

Hon. Barry S. Schermer
U.S. Bankruptcy Court (E.D. Mo.); St. Louis

10th Circuit Update

Hon. Robert E. Nugent
U.S. Bankruptcy Court (D. Kan.); Wichita

Supreme Court Update

Hon. Arthur B. Federman
U.S. Bankruptcy Court (W.D. Mo.); Kansas City



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Kansas City, Missouri

The Honorable Robert E. Nugent¹

Tenth Circuit Case Law Update

(Tenth Circuit Court of Appeals and Tenth Circuit Bankruptcy Appellate Panel)

Property of the Estate, §541, Turnover, §§ 521 & 542

In re Dittmar, 618 F.3d 1199 (10th Cir. Sept. 14, 2010) (2-1 decision) (Kelly, J., majority) (Holloway, J., dissenting)

These consolidated appeals concerned stock appreciation rights in a contingent, relatively-unspecified equity participation program under a collective bargaining agreement that were given to former employees of the Boeing Company who became employees of Spirit Aerosystems when it bought Boeing's Wichita plant. The debtors all filed Chapter 7 bankruptcies within a few months of the unions' ratification of the collective bargaining agreement. More than a year after all the bankruptcies were filed, Spirit issued a plan that fully defined the employees' rights in the equity participation program and specified which employees were eligible. A month after that, Spirit engaged in an initial public offering of its stock, an event that triggered the equity participation program. The issue was whether money and stock the employee-debtors received as a result were property of their bankruptcy estates under § 541. The Circuit ruled they were. First, the court determined the employee-debtors' rights under the program were similar to an employee's stock option rights, which are property under Kansas law, even though they are contingent in several ways. Next, the court noted that federal law governs collective bargaining agreements, and allows for a company and its employees' unions to make binding oral agreements about matters that will be later formalized in writing. The summary judgment materials established that Spirit and its employees' unions reached such an agreement about the equity participation program. For example, a slide presentation explaining the program had been produced and shown to union members before they voted to ratify the CBA. The subsequent ratification of the CBA

¹ Many thanks to Jana D. Abbott, my career law clerk, and Nicole Schneider, a summer intern and second year law student at Tulane University, who both made substantial contributions to these written materials.

had therefore created the debtors' rights in the program. The court held the debtors' rights under the program were sufficiently rooted in the pre-bankruptcy past to become property of their bankruptcy estates. The fact the interests were contingent on Spirit's future economic decisions did not prevent their interests from being property of their estates. Before the debtors filed for bankruptcy, Spirit had a contractual obligation to fund the equity participation program if it made a stock IPO, and had no discretion to eliminate that obligation.

The dissenting judge opined the employee-debtors' interests in the equity participation program were too uncertain to be included in their bankruptcy estates. He agreed with the majority that the debtors' interests constituted property under Kansas law. However, relying on the facts that (1) Spirit had full discretion to avoid the obligation to fund the equity participation program by not issuing stock or taking certain other actions, (2) Spirit's stock offering had to produce more than fifteen percent profit for certain investors before the employees' equity participation program would be triggered, and (3) Spirit's obligation would continue for up to fifteen years, the dissenter concluded the debtors' interests were so contingent they did not become property of their estates.

In re Dittmar, 2011 WL 1238914 (Bankr. D. Kan. Mar. 30, 2011) (Nugent, C.J.)

After the remand described above, the debtor amended schedules B and C and claimed his Stock Appreciation Rights (SARs) as partially exempt earnings pursuant to K.S.A. § 60-2310. The trustee objected. The bankruptcy court held that the SARs were exempt as compensation paid by Spirit to the debtor as part of the consideration for his prior work and were sufficiently tied to the debtor's personal services. The SARs benefits were paid as wages with paychecks and pay-stubs and were juxtaposed with the wage give-back. The SARs were similar to "bonuses" which are expressly mentioned in the definition of "earnings" under the exemption statute.

Crowson v. Zubrod (In re Crowson), 431 B.R. 484 (10th Cir. BAP May 26, 2010) (Nugent, J.)

The BAP reversed and remanded the bankruptcy court's order determining that all of a 2008 federal tax refund received by a Chapter 7 debtor and her non-debtor spouse was property of the estate under § 541(a)(1). Relying on *In re Kleinfeldt*, 287 B.R. 291 (10th Cir. BAP 2002), the bankruptcy court had ruled that the entire tax refund was property of the bankruptcy estate because only the debtor had taxes withheld from her wages. The BAP concluded that *Kleinfeldt* did not provide any guidance for dividing the joint refund in this case because it was limited to the very narrow situation where only one spouse had income and that spouse's wage withholdings generated the entire refund. In this case, the joint refund arose not only from the debtor's wage withholdings, but also from three tax credits that are treated as refundable overpayments: the earned income credit, the additional child

tax credit, and the recovery rebate credit. Relying on the approach and formulas the IRS would use to allocate tax liabilities and credits between a decedent's estate and the surviving spouse, or between spouses for purposes of offsetting only one spouse's refund against a prior liability, the BAP concluded that in this case it must determine what each spouse's refund or liability would be on a hypothetical separate tax return, divide the debtor's hypothetical refund or liability by the sum of both spouses' refunds, and apply the resulting fraction to the joint refund to give the debtor's (and therefore the bankruptcy estate's) share of the joint refund. Applying those calculations resulted in the estate being entitled to slightly less than one-half of the joint refund.

Trustee's Avoiding Powers

Sovereign Bank v. Hepner (In re Roser), 613 F.3d 1240 (10th Cir. July 20, 2010) (Hartz, J.)

Rejecting the BAP's decision in *In re O'Neill*, 370 B.R. 332 (10th Cir. BAP 2007), the Circuit concluded that the Colorado certificate of title law governed the manner and timing of the perfection of a lien in a motor vehicle, but that § 9-317(e) of the Colorado Uniform Commercial Code was a "generally applicable law" that gave a perfected purchase-money security interest in a motor vehicle priority over certain liens that arose during the time (up to 20 days) between the date when the purchaser took delivery of the vehicle and the date when the lien was perfected. Section 546(b) made the bankruptcy trustee's avoidance rights subject to that UCC provision. Furthermore, the lender did not violate the automatic stay by perfecting its lien after the debtor filed for bankruptcy because § 362(b)(3) provides an exception to the stay for an act to perfect a security interest to the extent the trustee's avoiding powers are subject to that perfection under § 546(b).

Morris v. Kasperek (In re Kasperek), BAP No. KS-10-075, slip op. (10th Cir. BAP July 6, 2011) (Romero, J.) ("*Kasperek II*"), following remand from *Morris v. Kasperek (In re Kasperek)*, 426 B.R. 332 (10th Cir. BAP Apr. 5, 2010) ("*Kasperek I*").

In *Kasperek I*, the BAP remanded the case to the bankruptcy court for findings on the § 363(h) elements and a determination of whether all the joint tenants' interests in certain farmground could be sold by the trustee. The property was purchased by the father but held by the father and his two sons (one of whom later filed bankruptcy) as joint tenants with the right of survivorship. The chapter 7 trustee sought to sell the property to realize on the debtor-son's one-third interest. *Kasperek I* held that K.S.A. § 58-2402 and § 544(a)(3) gives a trustee the right to defeat unrecorded interests (the father claimed a beneficial interest in the son's one-third share under an alleged implied trust) in real property that a bona fide purchaser could defeat. The trustee qualified as a bona fide purchaser and was entitled to sell

the property but because the bankruptcy court had not made the requisite findings under § 363(h), the case was remanded. On remand, the bankruptcy court made the requisite findings on the 4 elements of § 363(h) based upon the agreement of the parties. The father then appealed the remand order to the BAP, again challenging the trustee's rights under § 544(a)(3). The BAP declined to reach the merits of the second appeal and affirmed, concluding that the law of the case doctrine barred consideration of the merits and that appellant had not demonstrated the existence of any of the 3 narrow exceptions to depart from the doctrine.

Exemptions

Dykstra Exterior, Inc. v. Nestlen (In re Nestlen), 441 B.R. 135 (10th Cir. BAP Dec. 21, 2010) (Rasure, J.)

A provision added by BAPCPA, § 522(p)(1), generally precludes a debtor who claims exemptions under state law from exempting “any amount of interest [in a homestead] that was acquired by the debtor during the 1215-day period” before filing bankruptcy that exceeds \$136,875 in value (this amount is adjusted periodically). Courts have split on the question whether “interest that was acquired” is limited to obtaining title to the homestead or includes increasing the debtor's unencumbered equity in it. The bankruptcy court here adopted the former view, and overruled a creditor's objection to the debtors' homestead exemption because the debtors obtained title to the homestead more than 1215 days before filing bankruptcy. The BAP affirmed on a different ground. Section 522(m) says, “[T]his section shall apply separately with respect to each debtor in a joint case,” and the BAP ruled that meant the cap was doubled for this joint case. Even under the creditor's calculation, the debtors did not increase their equity in the homestead during the 1215-day period by more than two times the \$136,875 cap.

Dunckley v. Cohen (In re Dunckley), ___ B.R. ___, BAP No. 10-057-CO (10th Cir. BAP July 11, 2011) (Nugent, J.)

The BAP reverses the bankruptcy court's order sustaining the trustee's objection to debtors' claim of exemption on the non-refundable portion of their child tax credit. Colorado bankruptcy courts had uniformly held that the Colorado child tax credit exemption is inapplicable to the non-refundable portion because debtors were never legally entitled to claim a refund from the non-refundable credit and thus no part of the refund can be attributed to the credit. The BAP concluded that the Colorado legislature did not distinguish between the refundable and non-refundable portions of the credit and that the bankruptcy court defined “attributed” too narrowly. The BAP panel concluded that application of the child tax

credit invariably causes the debtors' tax refund to increase and the difference in the refund is attributable to the credit.

Dischargeability, §523

Williams v. Meyer (In re Williams), 438 B.R. 679 (10th Cir. BAP. Nov. 9, 2010) (Rasure, J.)

Twelve years after receiving a Chapter 7 discharge, the debtor filed an adversary complaint against two creditors, alleging they had violated the discharge injunction by reporting his alleged securities fraud and participating in his prosecution for that crime, a prosecution that resulted in the debtor's conviction and the creditors' collection of restitution imposed as part of the debtor's sentence. The BAP affirmed the bankruptcy court's dismissal of the debtor's complaint, holding that although the civil prepetition debt that formed the basis for the fraud conviction had been discharged, the criminal restitution obligation arising from the debtor's prepetition conduct had automatically been excepted from discharge by § 523(a)(7). Further, because the debtor had been convicted by a jury after he had a full and fair opportunity to defend, the conviction and sentence conclusively established that the criminal prosecution had not been abusive or frivolous, and therefore the creditors had not violated the discharge injunction by reporting the crime after the debtor's discharge had been granted, even if their motivation had been to collect their discharged debt.

Miscellaneous Chapter 12 Rulings

In re Dawes, ___ F.3d ___, 2011 WL 2450930; No. 09-3129 (10th Cir. June 21, 2011) (Gorsuch, J.)

The Dawes decision involves the same issue addressed by the BAP in *Ficken*, 430 B.R. 663 (10th Cir. BAP May 7, 2010) (Nugent, J.) and implicitly overrules *Ficken*. The Bankruptcy Code provision at issue is § 1222(a)(2) which was added by BAPCPA and allows certain taxes to be treated in a Chapter 12 plan as non-priority unsecured claims that will be paid a ratable share of the debtors' disposable income and otherwise discharged if the debtors receive a discharge under § 1228, instead of as priority claims that must be paid in full. The question is whether that section strips the priority of capital gains taxes generated on post-petition sales of farm assets used in a debtor's farming operation. In *Ficken*, the BAP said yes, as did the Eight Circuit in *In re Knudsen*, 581 F.3d 696 (8th Cir. 2009). But in *Dawes*, the Tenth Circuit said no, as did the Ninth Circuit in *In re Hall*, 617 F.3d 1161 (9th Cir. 2010). The Supreme Court very recently granted certiorari in the Ninth Circuit's *Hall* case (2011 WL 2297804, June 13, 2011).

The answer to the question presented in these cases depends primarily upon whether the taxes are viewed as incurred by the debtor or by the estate. If incurred by the estate, the taxes fall within the definition of administrative expenses in § 503(b)(1)(B)(I) by way of § 507(a)(2), and therefore receive beneficial treatment under § 1222(a)(2)(A). But if the taxes are viewed as incurred by the debtor, they do not. The BAP concluded the taxes were incurred by the estate because they arose post-petition and § 1207(a) creates a separate bankruptcy estate even in Chapter 12 cases. The Tenth Circuit, however, concluded the taxes were incurred by the debtor because the debtor is liable for paying them in absence of a separate taxable entity under the Internal Revenue Code.

Chapter 13

In re Liehr, 439 B.R. 179 (10th Cir. BAP Nov. 4, 2010) (Michael, J.)

Reversing the bankruptcy court's order confirming the above-median-income debtors' Chapter 13 plan, the BAP ruled that in calculating their disposable income on Form B22C, the debtors could not deduct amounts scheduled as contractually due on debts secured by their residence because they proposed in their plan to surrender the residence to the secured creditors. The BAP said the Supreme Court's decision in *Hamilton v. Lanning*, ___ U.S. ___, 130 S.Ct. 2464, 177 L.Ed.2d 23 (2010), required this result.

Timothy v. Anderson (In re Timothy), 442 B.R. 28 (10th Cir. BAP Dec. 29, 2010) (Cornish, J.)

These Chapter 13 debtors had above-median income for the six months before filing bankruptcy, but their Form B22C showed their monthly disposable income was negative \$188 because one of them had Social Security income, which is statutorily excluded from "current monthly income" for purposes of calculating disposable income. Their schedules of present income and expenses showed a monthly surplus of \$130. They proposed a plan without a minimum plan length under which they would pay \$130 per month only for as long as necessary to return a specified amount to their unsecured creditors. Affirming the bankruptcy court's decision, the BAP ruled that the phrase "applicable commitment period" in § 1325(b)(1)(B) and § 1325(b)(4) means above-median-income debtors, like the ones in this case, must propose to make payments for 60 months (unless they pay their unsecured creditors in full in a shorter time), even though the Form B22C calculation shows they have no projected disposable income.

Civil & Bankruptcy Procedure

Standard Indus., Inc. v. Aquila, Inc. (In re C.W. Mining Co.), 625 F.3d 1240 (10th Cir. Nov. 8, 2010) (Kelly, J.)

Affirming the lower courts, the Circuit ruled that a bankruptcy court order finding two creditors in contempt for violating the automatic stay imposed by the filing of an involuntary bankruptcy petition did not violate due process, even though no actual hearing on the matter was held. Due process requires only reasonable notice and a meaningful opportunity to be heard, which the creditors were provided but failed to take advantage of, and not an actual hearing. The creditors waived their argument that a local rule allowing the bankruptcy court to issue an order for civil contempt based solely on a motion without a hearing was unconstitutional because they had not raised it in either of the lower courts. The bankruptcy court's order had voided the creditors' actions that violated the stay and awarded attorney fees to the party that pursued the contempt motion. The Circuit determined no adversary proceeding was required because Fed. R. Bankr. P. 9020 and 9014(a) provide that contempt relief may be sought by motion.

Stay Relief

In re Gindi, 642 F.3d 865 (10th Cir. Feb. 24, 2011) (Hartz, J.)

Debtor and former business associate Chizzali were involved in state court litigation to resolve their respective liabilities incurred in their business ventures and from which several appeals filed by both debtor and Chizzali emanated. Chizzali appealed the dismissal of a contempt citation against Debtor and the setting aside of an entry of default against a bank garnishee when Chizzali sought to collect on a judgment. Debtor appealed a judgment resulting from an arbitration award entered in favor of Chizzali. During the pendency of the appeals, Gindi filed a chapter 11 petition. Debtor pursued his state court appeal of the arbitration judgment while Chizzali sought to stay that appeal. Chizzali sought stay relief to pursue his state court appeals. As for the appeal related to the garnishment and setting aside the entry of default, Chizzali sought stay relief under § 362(d)(1) (cause). Two noteworthy conclusions were reached by the Circuit. One, with respect to Debtor's appeal of the judgment against him, the Circuit determined that the stay did not prevent Debtor from pursuing his state court appeal, reluctantly following *In re Lyngholm*, 24 F.3d 89 (10th Cir. 1994), but expressing "caution that our precedent rests on a shaky foundation" and seemingly inviting bankruptcy courts to disregard *Lyngholm* in future cases. In fairness, the 3-judge panel's conclusion appears to be largely influenced by the fact that the state appellate court had resolved Debtor's appeal. Two, in connection with Chizzali's appeal of the garnishment default, the Circuit held that Chizzali did not show cause to lift the stay because he failed to show a likelihood of success on that appeal. The Circuit Court borrowed this factor from a stay of litigation in the receivership context. This holding appears to inject a new standard for granting movants stay relief that would require bankruptcy courts to examine and

determine the merits of the underlying state court action.

Miscellaneous Bankr. D. Kan. Cases of Interest

Mortgage Standing

Martinez v. Mortgage Electronic Registration Systems, Inc. (In re Martinez), 444 B.R. 192 (Bankr. D. Kan. Feb. 11, 2011) (Karlin, J.), *clarified on denial of reconsideration*, ___ B.R. ___, 2011 WL 1519877 (Bankr. D. Kan. Apr. 20, 2011)

Debtor brought adversary proceeding seeking a determination of the secured status of MERS and Countrywide. Debtor claimed that because the original mortgage was given to MERS and the original note was given to Countrywide, the note and mortgage were split, making the mortgage unenforceable under Kansas law and the note unsecured.

The first issue was what effect, if any, the dismissal of a prior state court foreclosure proceeding initiated by MERS had on the current litigation. The Kansas Court of Appeals had dismissed the foreclosure on the basis that MERS had not presented sufficient evidence that it was an agent of Countrywide, which resulted in MERS lacking standing. The bankruptcy court held that (1) the prior adjudication had not been decided on the merits because it was dismissed for a lack of jurisdiction, based on standing, and (2) MERS and Countrywide had not had a full and fair opportunity to litigate the issue of whether MERS was an agent of Countrywide. Therefore, *res judicata* did not apply, and MERS and Countrywide could proceed to present evidence to support their case.

The second issue was whether naming MERS on the mortgage and Countrywide on the note resulted in a fatal splitting of the two instruments, rendering the mortgage unenforceable. The court held that under Kansas law, which relies heavily on the Restatement (Third) of Property (Mortgages), the note and mortgage are not fatally split as long as the holder of the mortgage is serving as an agent for the holder of the note. MERS and Countrywide submitted sufficient evidence to establish an agency relationship. Therefore, the note remained secured by the mortgage and MERS had standing to seek stay relief.

This case did not involve a situation where the note and mortgage had been assigned to other entities, and the court did not address what effect, if any, that might have on the decision.

The court denied the motion for reconsideration because even with the facts plaintiff asserts, the outcome would have been the same. Plaintiff argued that the Court should set aside its decision and re-open discovery because the Court had made two erroneous findings: 1) that Countrywide was the holder of the note; and 2) that the Court of Appeals' decision was not

res judicata on the issue of whether MERS was an agent of Countrywide. Plaintiff claimed that Countrywide and MERS misled the Court by failing to explain that Countrywide had sold its beneficial interest in the note to a third party, Fannie Mae, prior to bankruptcy, and that Fannie Mae “probably” has “securitized the debt and sold it to others as a mortgage-backed security.” First, although that information was not overtly disclosed, the Court nonetheless found that its prior decision finding Countrywide is entitled to relief from the automatic stay was nevertheless correct based on the undisputed material facts properly presented to the Court. Second, in the re judicata argument, plaintiff essentially rehashes the same arguments she previously made, which the Court rejected. Therefore, the motion to reconsider was denied.

Trustee’s Rights after Avoiding Liens

Parks, Trustee v. Emprise Bank, et al (In re Brooks), ___ B.R. ___, Adv. No. 10-5005; Case No. 09-12383 (Bankr. D. Kan. July 15, 2011) (Nugent, C.J.)

Pursuant to § 544(a) the chapter 7 trustee sought to avoid the bank’s unperfected lien on a mobile home that debtors’ claimed exempt as their homestead but instead of preserving the avoided lien under § 551, the trustee sought to recover the value of the avoided lien by receiving a proportionate share of the debtors’ ongoing stream of note payments to the bank under § 550(a). This Court had permitted in the past such relief with respect to an avoided lien on mobile homes (up to the value of the collateral) where the debtor remained in possession of the mobile home and continued to make payments to the lender. *See Nazar v. North American Savings Bank FSB (In re Born)*, Adv. No. 05-5067; Case No. 04-14382 (Bankr. D. Kan. Mar. 2, 2006), *aff’d* 357 B.R. 630 (10th Cir. BAP 2006). The Court reevaluated this practice in light of the Tenth Circuit decision *Rodriguez v. Drive Financial Services, L.P. (In re Trout)*, 609 F.3d 1106, 1110-11 (10th Cir. 2010). In *Trout*, the Tenth Circuit held that relief under § 550(a) was discretionary and only available in circumstances where the avoidance and preservation of the avoided lien for the benefit of the Estate did not make the Estate whole, such as where the underlying collateral has been sold or is otherwise unrecoverable. In these limited situations, preservation of the avoided lien under § 551 does not restore the Estate to the position it was in before the transfer, and the bankruptcy court may award a monetary remedy for the value of the avoided lien under § 550(a). The Court concluded that the factual circumstances of the *Brooks* case did not warrant the exercise of the Court’s discretion to allow the trustee a § 550(a) recovery. The automatic preservation of the avoided lien under § 551 restored the estate to the position it occupied before the transfer. None of the circumstances recognized in *Trout* warranting a monetary recovery for the value of the avoided lien were present in the case. Accordingly, the trustee’s request for a money judgment for the value of the avoided lien or a proportionate share of the debtors’ ongoing note payments under § 550(a) was denied. The Court found that trustee was entitled

to avoid the unperfected lien under § 544(a) but that preservation of the avoided lien for the benefit of the estate under § 551 adequately restored the Estate to the position it was in before the transfer.

Nazar v. Carmichael (In re Carmichael), 439 B.R. 884 (Bankr. D. Kan. Sept. 21, 2010) (Somers, J.)

After avoiding a lien the debtor had given on her one-half interest in a manufactured home, the Chapter 7 trustee filed a complaint seeking authority under 11 U.S.C.A. § 363(h) to sell both the debtor's and the co-owner's interests in the home, as well as the debtor's and co-owner's interests in real property where the home was installed. But the debtor had claimed the home and the real property as her exempt homestead, and the court concluded that all the property had left the bankruptcy estate after the time to object to her exemption claim passed with no objections being filed. Under § 363(h), the trustee could sell only property of the estate. The avoided lien had become property of the estate under § 541(a)(4), but all the trustee could sell under § 363 to recover the value of the avoided lien was the estate's one-half interest in an unperfected lien in the manufactured home. The court said the trustee's options for realizing on the lien included: (1) selling the estate's lien interest to a third party, (2) agreeing with the debtor to release the lien on receipt of a lump sum or periodic payments, or (3) waiting for the holder of the other lien interests on the home and real property to foreclose and give him the value of the estate's lien interest. It concluded that § 363(h) does not authorize the trustee to sell the entire real estate together with the manufactured home situated thereon and then allocate the proceeds of the sale to the lender, the value of the co-tenant's interest, and the bankruptcy estate.

Exemptions: Annuities and Certificates of Deposit

Ortiz v. Rajala, 436 B.R. 133 (D. Kan. 2010) (Marten, J.)

The District Court affirmed the bankruptcy court's determination that an annuity debtor purchased with settlement proceeds received as a minor from a wrongful death lawsuit over a car accident in which debtor's mother was killed was not exempt under K.S.A. 60-2312(b) (adopting by reference federal exemption § 522(d)(10)(E)), the provision exempting certain retirement-related benefits. The District Court concluded that § 522(d)(10)(E) is intended to replace lost future earnings of a debtor, or a person on whom a debtor is dependent, related to employment. It is not intended to exempt death benefit annuities resulting from a wrongful death settlement unrelated to employment or earnings. The federal exemption of compensation for loss of future earnings caused by a personal injury, § 522(d)(11), is not available to Kansas debtors.

In re Jones, 446 B.R. 466 (Bankr. D. Kan. 2011) (Berger, J.)

Final annuity lump-sum payment that debtor, who had been severely injured during the course of employment with a railroad company, received as part of a FELA (Federal Employers' Liability Act) claim settlement was exempt under § 522(d)(10). Settlement agreement required debtor to retire due to the work-related, disabling injury and replaced debtor's Railroad Retirement Act disability and retirement benefits with an annuity satisfying the requirements of § 522(d)(10)(C) and (E).

In re Tessendorf, ___ B.R. ___, 2011 WL 2469688, Case No. 10-12211-7 (Bankr. D. Kan. June 21, 2011) (Nugent, C.J.)

Chapter 7 trustee objected to debtor's claim of exemption in certificate of deposit acquired with life insurance benefits. Debtor claimed the certificate of deposit was exempt under K.S.A. 40-414(a)(4). The Court predicted that Kansas appellate courts would allow the exemption in the certificate of deposit based upon the Kansas Supreme Court's decision in *Decker & Mattison Co. v. Wilson*, 273 Kan. 402, 44 P.3d 341 (2002) where it was held that a certificate of deposit purchased with an exempt worker's compensation award did not lose its exempt character. The Court distinguished the situation where it has disallowed an exemption in an annuity purchased with exempt life insurance benefits, concluding that an annuity was an investment. The trustee's objection to the exemption was overruled.

Chapter 13 Post-Confirmation Modifications

In re Auernheimer, 437 B.R. 405 (Bankr. D. Kan. Sept. 8, 2010) (Nugent, C.J.)

In this Chapter 13 case, the court held that the "effective date" of a post-confirmation modified plan under § 1329 is the date of the modification, not the date the original plan was confirmed. Debtors sought a post-confirmation modification to pay a postpetition mortgage arrearage through the plan, and to reduce the payment to general unsecured creditors because some of the unencumbered, non-exempt property of the estate had declined in value and was worthless. Recognizing a split in the courts that have addressed the issue and recognizing that both interpretations present problems, the court concluded that the better view was that the date of modification was the "effective date."² As a result, debtors had to satisfy the

² *But see In re Forbes*, 215 B.R. 183 (8th Cir. BAP 1997) (Because modified plans "become the plan" under § 1329(b)(2) once approved, the "plan" is a unitary constant that exists throughout the case and brings with it a constant effective date—that relating to the initially-confirmed plan).

liquidation or best interests of creditors test in § 1325(a)(4) at the time of the modification, and could “re-value” the unencumbered, non-exempt property. Debtors’ motion to modify their confirmed plan was granted.

In re Clay, Case No. 09-10618-13 (Bankr. D. Kan. June 21, 2011) (Nugent, C.J.), *motion for rehearing filed July 5, 2011*.

Case submitted to court on stipulated facts. The chapter 13 trustee sought post-confirmation modification of debtors’ plan with respect to creditor’s 910-car loan claim. Subsequent to confirmation, debtors’ car was totaled in a wreck and the insurance proceeds were provided to the creditor. The trustee proposed to surrender the car insurance proceeds and pay the creditor’s deficiency claim as an unsecured claim. The creditor modified its proof of claim to reduce the amount of its claim by the car insurance proceeds but still claimed it as a secured claim. The court concluded that the modification sought was permitted by § 1329(a)(1) and (a)(3) and that proposed modification complied with provisions of § 1329(b) because modification of creditor’s secured claim is permitted by § 1322(b)(2) and surrender of collateral pursuant to § 1325(a)(5)(C) is permitted as an alternative treatment of the creditor’s secured claim. The balance of the claim was treated as unsecured claim. In addition § 502(j) allows reconsideration of an allowed claim for cause and destruction of collateral through no fault of the debtors is cause. Judge Nugent agreed with Judge Somers’ decision in *In re Lane*, 374 B.R. 830 (Bankr. D. Kan. 2007), a nearly identical case, and rejected the Sixth Circuit case *In re Nolan*, 232 F.3d. 528 (6th Cir. 2000), the leading case that does not permit such modification. Trustee’s motion to modify was granted and objection to creditor’s amended proof of claim was sustained.

**CASE LAW UPDATE: “YOURS, MINE AND OURS”
EIGHTH CIRCUIT UPDATE**

**JUDGE ARTHUR B. FEDERMAN
WESTERN DISTRICT OF MISSOURI**

**CHIEF JUDGE BARRY S. SCHERMER
EASTERN DISTRICT OF MISSOURI**

11 U.S.C. §707(b)

1. **Advanced Control Solutions, Inc. v. Justice**, 639 F.3d 838 (8th Cir. 2011). An individual Chapter 13 debtor converted his case to Chapter 7. The debtor failed to rebut the presumption of abuse under 11 U.S.C. § 707(b), and the bankruptcy court ordered him to convert his case back to Chapter 13, or the case would be dismissed. The bankruptcy court overruled an objection by the creditor to the debtor's motion to convert his case to Chapter 13. The district court and the Eighth Circuit affirmed. The Eighth Circuit explained that § 707(b)(1) gives the bankruptcy court the discretion to dismiss a Chapter 7 case or, with the consent of the debtor, convert the case to a case under another chapter, including Chapter 13, if the granting of relief under Chapter 7 would be an abuse of the Bankruptcy Code. It noted that it had previously indicated that § 707(b)(1) applies to cases that were converted to Chapter 7 from Chapter 13. In response to the creditor's contention that § 706(a) governs this situation, the court said that §§ 706(a) and 707(b)(1) "speak to two different situations, and § 706 (a) does not coopt the clear grant of authority that the plain language of § 707(b)(1) provides to bankruptcy courts."

2. **Fokkena v. Chapman (In re Chapman)**, 447 B.R. 250 (B.A.P. 8th Cir. 2011). In consolidated appeals of two consumer Chapter 7 cases converted from Chapter 13, the BAP ruled that 11 U.S.C. § 707(b)(1) applies to cases converted by individuals from Chapter 13 to Chapter 7. The bankruptcy courts had denied the U.S. Trustee's motions to dismiss the Chapter 7 cases under 11 U.S.C. § 707(b)(2) and (b)(3) on the basis that § 707(b)(1) did not apply to cases converted from Chapter 13 to Chapter 7. The BAP recognized that it had jurisdiction to hear the appeal based on the Eighth Circuit's recognition in *Stuart v. Koch (In re Koch)*, 109 F.3d 1285 (8th Cir. 1997), that an order denying dismissal under § 707(b) is final and appealable.

The BAP then explained that §§ 707(b)(2) and (3) cannot be used unless § 707(b)(1) applies. After recognizing that courts are split on the issue of whether § 707(b)(1) applies in cases converted from Chapter 13 to Chapter, the BAP explained it was bound by the decision in *Resendez v. Lindquist*, 691 F.2d 397, 399 (8th Cir. 1982), in which the Eighth Circuit stated that “[i]t is also established that when there is a conversion, the debtors are *deemed to have filed a Chapter 7 case at the time the Chapter 13 case was filed.*” *Resendez v. Lindquist*, 691 F.2d 397, 399 (8th Cir. 1982) (emphasis added). It reversed the decisions of the bankruptcy courts and remanded the cases for determinations of dismissal under §§ 707(b)(2) and (3).

CHAPTER 13

3. Fink v. Thompson (In re Thompson), 439 B.R. 140 (B.A.P. 8th Cir. 2010). The Form 22C filed by the debtors with their Chapter 13 petition excluded Social Security income, showed that their annualized current monthly income was above median and showed that the debtors had a negative monthly disposable income. The debtors’ Schedule I included their Social Security income. Based solely on their Schedules I and J as filed, the debtors would have surplus income each month. However, the debtors’ monthly expenses would exceed their income if their Social Security income was not included on their Schedule I. The debtors proposed a Chapter 13 plan that paid \$1,500 each month, even though their income would exceed their expenses by a significantly greater amount if their Social Security income was included in the calculation. The proposed plan provided for payment of approximately 10% to unsecured nonpriority creditors.

The BAP affirmed the bankruptcy court’s order that overruled the trustee’s 11 U.S.C. § 1325(a)(3) good-faith objection to confirmation. The plain language of 11 U.S.C. § 101(10)(A)

excludes Social Security income from a debtor's current monthly income and, thus, the debtor's required plan payments. Section 1325(b)'s ability to pay test would be meaningless if exclusion of Social Security income was considered as part of the good faith analysis. Even if exclusion of Social Security income could contribute to a finding of bad faith, it would not be enough - standing alone - to prevent a finding of good faith. Also, in light of the Eighth Circuit's recent decision in *Carpenter v. Ries (In re Carpenter)*, 614 F.3d 930 (8th Cir. 2010), ruling that Social Security proceeds are excluded from the bankruptcy estate, it would be inconsistent to say that the debtor acted in bad faith by failing to devote such benefits to their plan.

4. **Harman v. Fink (In re Harman)**, 435 B.R. 596 (B.A.P. 8th Cir. 2010). Chapter 13 debtors, husband and wife, maintained separate households and filed separate B22C forms showing their separate income and expenses. When each debtor's current monthly income was considered separately, their current monthly income was below median, allowing them to file a 36 month plan, but when it was considered together, their current monthly income was above median and they must file a 60 month plan. The bankruptcy court denied confirmation of the debtors' plan. The debtors eventually proposed a confirmable plan and the debtors objected to confirmation of their own plan. The BAP affirmed, deciding that joint debtors must combine their income to determine the applicable commitment period for a Chapter 13 plan. It is the statute, 11 U.S.C. § 1325, rather than the B22C form, that determines the applicable commitment period. Section 1325(b)(4) requires that when a debtor calculates the applicable commitment period, he include the current monthly income of a spouse (regardless of whether spouses maintain separate households) and 11 U.S.C. § 101(10A)(A) also provides that in a joint case current monthly income includes a spouse's income. Accordingly, married debtors who file a

joint case are required to file a single form B22C.

CHAPTER 11

5. Ritchie Special Credit Inv., Ltd. v. U.S. Trustee, 620 F.3d 847 (8th Cir. 2010).

Pre-petition, the debtors were involved in various litigation in connection with an alleged Ponzi scheme. The government obtained a temporary restraining order freezing the assets of the debtors and other companies and a receiver was appointed. Pursuant to his authority, the receiver filed Chapter 11 bankruptcy petitions for the companies. The cases were jointly administered. A creditor and the U.S. Trustee filed a motion seeking appointment of Chapter 11 trustees for the debtors' estates. The bankruptcy court entered an order allowing the U.S. Trustee to appoint one or more trustees. The creditor objected to the U.S. Trustee's appointment of the receiver as trustee for all the cases.

The Eighth Circuit first examined whether the order appointing the receiver was a final order for the purposes of appeal. Joining the majority of circuits to consider the issue, the Eighth Circuit held that an order appointing a bankruptcy trustee is a final order. The Eighth Circuit then said that the receiver qualified as a "disinterested person" under 11 U.S.C. § 1104(d) and the bankruptcy court did not abuse its discretion when it determined that the creditor failed to show that it would be prejudiced by the appointment of the receiver as trustee. Concurring in the judgment, Judge Colloton noted that an administrative panel of the court had previously denied a motion to dismiss the appeal based on lack of jurisdiction. He explained that decision was law of the case.

6. Zegeer v. Pres. Casinos, Inc. (In re Pres. Casinos, Inc.), No. 10-2325, 2010 WL 4366434 (8th Cir. 2010) (per curiam) (unpublished). The Eighth Circuit agreed with the district

court's decision that an appeal from an unstayed bankruptcy court order confirming a Chapter 11 debtor's plan of reorganization was equitably moot because the confirmation order had not been stayed and the plan had been substantially consummated.

**JURISDICTION, STANDING, REMOVAL, REMAND
AND FULL FAITH AND CREDIT**

7. **GAF Holdings, LLC v. Rinaldi (Farmland Indus., Inc.)**, 639 F.3d 402 (8th Cir. 2011). Before GAF Holdings, LLC ("GAF") was able to purchase certain assets from Farmland Industries, Inc. ("Farmland") pre-petition, Farmland filed a Chapter 11 bankruptcy petition. GAF did not: object to Farmland's proposed procedures for sale of the assets, contest Farmland's determination that GAF's bid was not qualified, or object to or appeal from the bankruptcy court's sale order. GAF then moved to set aside the sale order (under Rule 60(b)), alleging that the sale to a third party was collusive. GAF did not appeal the bankruptcy court's denial of the Rule 60(b) motion or contest or appeal from another order regarding the sale, but it brought an adversary proceeding claiming that various parties intentionally interfered with GAF's business expectancy and participated in a civil conspiracy. The bankruptcy court dismissed the complaint with prejudice as an improper collateral attack on its prior sale orders, for failure to state a claim upon which relief could be granted or, in the alternative, for lack of standing. The BAP remanded the case to the bankruptcy court to dismiss for lack of jurisdiction over GAF's state court tort claims against non-debtor third parties.

The Eighth Circuit reversed, explaining that subject matter jurisdiction existed, and remanded the case to the BAP for a ruling on whether the bankruptcy court's dismissal was proper. On remand, the BAP affirmed the bankruptcy court's dismissal. On appeal, the Eighth Circuit affirmed the bankruptcy court's order dismissing GAF's complaint because GAF lacked

standing, explaining that GAF “has not established an injury traceable to the appellees’ actions.” It rejected GAF’s argument for standing based on a fraud on the court. After recognizing fraud on the court as an “extraordinary means by which to obtain equitable relief, [that] requires the plaintiff to provide no adequate remedy at law,” the court explained that GAF had not met that standard and, using the traditional standing analysis, said GAF lacked standing.

8. Mid-City Bank v. Skyline Woods Homeowners Ass’n (In re Skyline Woods Country Club), 636 F.3d 467 (8th Cir. 2011). A purchaser bought a portion of a golf course from a debtor free and clear of interests under 11 U.S.C. § 363(f). Thereafter, the debtor’s case was closed. When the purchaser began to use the property other than as a golf course, homeowners in a planned community around the golf course sued the purchaser in Nebraska state court in an effort to enforce restrictive covenants regarding the use of the property. According to the Nebraska Supreme Court, the sale did not extinguish the restrictive covenants. When the purchaser’s lender sought to sell the property (after the purchaser defaulted on its loan), the homeowners brought a second state court action to subordinate the bank’s lien to their equitable lien for maintaining the golf course.

The Eighth Circuit held that the bankruptcy court did not abuse its discretion in denying a motion by the purchaser and the bank to reopen the case so the state court’s judgment could be declared void and future state court judgments could be void. Even if the case was reopened, the state court’s decision would be entitled to full faith and credit. The Eighth Circuit noted that the Purchaser had withdrawn an earlier motion to reopen the case and had litigated the matter in state court. Citing *England v. La. State Bd. of Med. Exm’rs*, 375 U.S. 411 (1964), it pointed out that the Supreme Court has explained that a party that submits its federal claims for decision in

state court cannot then return to federal district court.

9. **National Benev. Ass'n of the Christian Church (Disciples of Christ) v. Weil, Gotshal & Manges, LLP**, 437 B.R. 342 (B.A.P. 8th Cir. 2010). The debtor in a Texas bankruptcy case filed an adversary proceeding against its attorneys for malpractice, negligence and breach of fiduciary duty. The bankruptcy court granted summary judgment to the attorneys and the case made it to the Fifth Circuit where the Fifth Circuit dismissed the case for lack of subject matter jurisdiction. The debtor lacked standing to pursue its pre-petition malpractice action because it had not provided for retention of ownership of it in its confirmed Chapter 11 plan. The debtor, joined by the State of Missouri, commenced an action in state court alleging the same cause of action against the attorneys that it had alleged in the Texas bankruptcy court regarding the attorneys' pre-petition representation of it. The attorneys removed the case to the bankruptcy court and the court dismissed the case, explaining that the State's claims against the attorneys were derivative of the debtor's claims and that the Fifth Circuit had already decided that the debtor failed to preserve its claims. The Fifth Circuit's decision barred the debtor and the State from pursuing their cause of action in any court. The BAP reversed and instructed the bankruptcy court to remand the case to the state court. It agreed with the bankruptcy court's determination that it lacked subject matter jurisdiction over the debtor's claim against its attorneys. However, it said that, pursuant to 28 U.S.C. § 1447(c), the bankruptcy court was required to remand the case to state court.

DISCHARGE AND DISCHARGEABILITY

10. **Marcusen v. Glen (In re Glen)**, 639 F.3d 530 (8th Cir. 2011). Pre-petition, creditors entered into an agreement with debtors whereby the debtors developed real property

and the creditors provided the financing. The creditors did not record the mortgage from the debtors for two lots of property that they financed. Without disclosing the creditor's prior unrecorded mortgage, the debtors granted a bank a mortgage on one lot in connection with a loan from the bank. The bank recorded its mortgage, obtaining priority over the creditors. The debtors also granted a third party a mortgage on the other lot and again, the third party's lien gained first priority when the third party recorded its mortgage. The Eighth Circuit said that the debts owed to the creditors should not be excepted from the debtors' discharges under 11 U.S.C. § 523(a)(2)(A). The creditors did not give the Debtors and money, property, services, or an extension, renewal or refinancing of credit at the time the debtors gave the mortgages to the bank and the third party, and any misrepresentations made at the time of giving the mortgages to the bank and the third party were made to the bank and the third party, not to the creditors. Any reduction in the creditors' equity in the properties was a result of their failure to record the mortgages, not from fraudulent conduct by the debtors.

11. Treadwell v. Glenstone Lodge (In re Treadwell), 637 F.3d 855 (8th Cir. 2011).

Through a company (the "Company"), the debtors (a husband and wife) arranged an event at the creditor's hotel and left town without paying the hotel bill that they had promised to pay. The creditor obtained a judicial lien on the debtors' home resulting from a judgment against them. The debtors brought an adversary proceeding, seeking to avoid the judicial lien as a fraudulent transfer, and the creditor filed a counterclaim, seeking to except the debt from the debtors' discharges under 11 U.S.C. § 523(a)(2)(A). The bankruptcy court found no fraud under § 523(a)(2)(A), but it did not decide whether the debtors were partners in the Company or whether such a partnership would impute the wife's fraud to her husband. On appeal to the BAP, the

creditor argued that (1) the creditor justifiably relied on the wife's misrepresentations; and (2) the wife's fraud should be imputed to the husband because they were partners in the Company. The BAP reversed the bankruptcy court's decision with respect to the wife, and it affirmed with respect to the husband. The Eighth Circuit reversed and remanded the case to the bankruptcy court for factual findings on the imputed fraud issue. It explained that the BAP raised and ruled on the issue of whether the wife's fraud could be imputed to her husband, but it should have instructed the bankruptcy court to make factual findings necessary to determine the imputed fraud issue, rather than making its own factual findings.

12. Islamov v. Ungar (In re Ungar), 633 F.3d 675 (8th Cir 2011). A creditor brought an adversary proceeding to except from the debtor's discharge the money he had given to the debtor to invest in the stock market for him. To induce the creditor to continue to invest money with her, the debtor had made false statements to the creditor regarding profits she made from his investments. The bankruptcy court did not clearly err when it found the creditor justifiably relied on the debtor's representations and excepted the debt from the debtor's discharge under 11 U.S.C. § 523(a)(2)(A). The Eighth Circuit joined other circuits in holding that the bankruptcy court has jurisdiction to enter a money judgment in a nondischargeability action. The court rejected the debtor's argument that the bankruptcy court should not have issued a money judgment in this case because that issue was allegedly not properly before the court. The complaint sought "such other and further relief as the Court deems just and equitable" and the debtor had submitted himself to the equitable powers of the bankruptcy court. In addition, the amount owed was an issue before the bankruptcy court, there was no evidence that the debtor was prejudiced by this alleged lack of notice and there was no harm to the debtor. Because the

creditor's testimony about the specific amount in issue was largely uncontested, the bankruptcy court did not err in its interpretation of the evidence of the amount of the debt.

13. Hidy v. Bullard (In re Bullard), 449 B.R. 379 (B.A.P. 8th Cir. 2011). An argument ensued while the debtor and a creditor were at a bar. The debtor threw a glass that shattered and a piece of it went into the creditor's eye, destroying his vision in that eye. The debtor plead guilty in Arkansas state court to the charge of criminal battery in the second degree. The debtor also stipulated to liability in a state court civil action for the intentional tort of battery and the matter went before a jury on the issue of damages, after which the jury awarded compensatory damages. The issue of The BAP affirmed the bankruptcy court's determination that collateral estoppel did not bar it from deciding whether the debtor's actions met the requirements of 11 U.S.C. § 523(a)(6) and that the debtor's actions were "willful," but they were not "malicious." The judgment in the criminal action did not bar the bankruptcy action because the issues in the dischargeability action were not essential to the judgment in the criminal action. The BAP could not consider whether collateral estoppel should apply in the civil action based on the creditor's argument on appeal that liability was "in essence" adjudicated on summary judgment based on an admission or lack of contest by the debtor. Also, the bankruptcy court did not clearly err when it said that the debtor lacked maliciousness.

14. Arvest Mortgage Co. v. Nail (In re Nail), 446 B.R. 292 (B.A.P. 8th Cir. 2011). A threshold issue on appeal was whether the proceeds that the debtor received from the settlement of a lawsuit against the builders of a house the debtor purchased qualified as "Miscellaneous Proceeds" under a mortgage. The other issues included whether the debtor assigned to its creditor such proceeds and whether the debtor's failure to remit the proceeds to

the creditor was excepted from the debtor's discharge under 11 U.S.C. § 523(a)(4) as a debt for defalcation by the debtor while acting in a fiduciary capacity. A cross-appeal by the debtor raised the issue of whether the debtor was entitled to reduce the debt excepted from her discharge. The BAP ruled that the settlement proceeds were not "Miscellaneous Proceeds" under the mortgage, but if they were Miscellaneous Proceeds arising from a tort action they could not be assigned to the creditor under Arkansas law. If they were Miscellaneous proceeds under either a contract or a tort theory, the Arkansas statutes upon which the bankruptcy court relied to find a fiduciary relationship and to except the debt from the debtor's discharge, ARK. CODE ANN. §§ 4-58-102 and 105, did not, in fact, create a trust that would impose a fiduciary duty under § 523(a)(4). The BAP did not consider the issue raised in the cross-appeal

15. Northland Nat'l Bank v. Lindsey (In re Lindsey), 443 B.R. 808 (B.A.P. 8th Cir. 2011). The BAP affirmed the bankruptcy court's grant of judgment in favor of the debtor on 11 U.S.C. § 523(a)(2)(B) action. The bankruptcy court did not err when it found that the personal financial statements of the debtor and his wife were not materially false because they "did not paint a substantially untruthful picture of their financial condition." The bankruptcy court did not impose a higher standard of reliance than the reasonable reliance standards of § 523(a)(2)(B) based on a comment by the bankruptcy court taken out of context that it did not believe the creditor "seriously and primarily" relied on the financial statements. The court did not need to determine whether the creditor's reliance was reasonable because the bank's finding that the creditor did not rely on the financial statements was not clearly erroneous. Even though there was evidence in the record that might allow the bankruptcy court to find otherwise, the bankruptcy court also did not clearly err when it assessed the evidence and found that the debtor

lacked the requisite intent to deceive.

16. Reuter v. Cutcliff (In re Reuter), 443 B.R. 427 (B.A.P. 8th Cir 2011). The debtor had convinced investors to invest in a venture that resulted in the investors' loss of all of their investments. During the pendency of a civil suit brought by the investors against the debtor and his company in federal court, the debtor filed his bankruptcy petition. The investors commenced an adversary proceeding, alleging that the debtor had operated a Ponzi scheme and seeking to deny the debtor's discharge and to except debts owed to them from his discharge.

The BAP affirmed the bankruptcy court's orders: denying confirmation of the debtor's Chapter 11 plan, converting his case to a case under Chapter 7 and entering judgment in favor of the investors pursuant to 11 U.S.C. §§ 523(a)(2)(A) and (a)(19). The debtor asserted many issues in his statement of issues on appeal. The BAP considered the debtor's arguments regarding denial of confirmation of his plan and conversion of his case to be abandoned because, aside from raising them in his statement of issues on appeal, none of the debtor's arguments on appeal went to those issues. The debtor's arguments for reversal of the bankruptcy court's decisions under §§ 523(a)(2)(A) and (a)(19) were not supported by the law or the facts. The BAP explained that: the debtor had conceded to the validity of the investors' claims, the dischargeability claim for fraud was based on the general common law of torts - not on Missouri state law of fraud, the investors could rely on circumstantial evidence for their fraud claim, the creditor only needed to prove justifiable (not reasonable) reliance under § 523(a)(2)(A), the bankruptcy court did not err in finding that the debtor "offered to sell" unregistered securities in violation of state law, and the fraud of the debtor's business associate could be imputed to the debtor.

17. Southeast Neb. Coop. Corp. v. Schnuelle (In re Schnuelle), 441 B.R. 616 (B.A.P. 8th Cir. 2011). The BAP affirmed the bankruptcy court's decision that a judgment creditor's claim against the debtor was non-dischargeable pursuant to 11 U.S.C. § 523(a)(2)(A) and (a)(2)(B). The debtor, a farmer, borrowed money from a creditor to put into his crops. Before making loans to the debtor, the creditor required the debtor to submit a balance sheet and a worksheet with information about crop insurance coverage. The lender's policies were designed so the creditor could be sure it had a first lien on the current year's crops and that the debtor had crop insurance to protect the lender's investment. The balance sheets and sheets regarding crop insurance were inaccurate. The debtor unilaterally decided to feed some of the crops to his cattle without telling the lender that he was doing so. The debtor also failed to tell the creditor about various lawsuits and judgments against him. The BAP explained that the bankruptcy court's findings were not clearly erroneous. The elements of § 523(a)(2)(A) were established with respect to the debtor's use of his crops to feed the cattle. The elements of § 523(a)(2)(B) were met with respect to the debtor's misstatements on the balance sheets and sheets regarding crop insurance coverage.

18. United States v. Horras (In re Horras), 443 B.R. 159 (B.A.P. 8th Cir. 2011). The BAP affirmed the bankruptcy court's: (1) grant of summary judgment to the United States Department of Health and Human Services ("HHS") and against the debtor, a former officer of a home health care agency, on claims to except from the debtor's discharge under 11 U.S.C. §§ 523(a)(2)(A) and (a)(7), assessments and penalties he owed to HHS for knowingly presenting or causing to be presented false or fraudulent claims for payment to Medicare and Medicaid; and (2) its application of collateral estoppel to prior administrative rulings. Even though the Federal

Rules of Evidence did not apply in the administrative tribunal, the tribunal applied a preponderance of the evidence standard and the Eighth Circuit had affirmed the administrative court's decision. In response to one of the debtor's arguments, the BAP noted that *Grogan v. Garner*, 498 U.S. 279 (1991), "does not address the issue of whether a federal court is precluded from giving res judicata or collateral estoppel effect to a judgment from a court not governed by the Federal Rule of Evidence."

19. Phegley v. Phegley (In re Phegley), 443 B.R. 154 (B.A.P. 8th Cir. 2011). A former wife brought an adversary proceeding in the debtor's Chapter 13 bankruptcy case, contending that obligations of the debtor under a pre-petition state court divorce decree, that required him to pay to her "contractual maintenance" and a portion of her attorney's fees, were non-dischargeable domestic support obligations under 11 U.S.C. § 523(a)(5). The BAP affirmed the bankruptcy court's holding that the debts were excepted from the debtor's discharge as domestic support obligations. The divorce decree explained that the maintenance payments would enable to former wife to complete her education so she could earn an income sufficient to support herself and that the payments would cease upon death or remarriage. In response to the debtor's argument that the Eighth Circuit was incorrect in *Williams v. Williams (In re Williams)*, 703 F.2d 1055 (8th Cir. 1983), when it said that the court should look to the function the award was intended to serve, the BAP said it could not ignore the Eighth Circuit's precedent in *Williams* and that, even if it could, it disagreed with the debtor.

20. American Nat'l Bank v. Babb (In re Babb), 440 B.R. 523 (B.A.P. 8th Cir. 2010). A bank brought an 11 U.S.C. § 523(a)(2)(B) action against a Chapter 7 debtor. After the debtor failed to appear at the trial, the court ruled in the creditor's favor. The debtor then sought relief

from the judgment, alleging that the bank's witness lied at the trial. At a hearing on the motion for relief from the judgment, the court allowed the testimony of the debtor and another party produced by the debtor. The BAP affirmed the bankruptcy court's denial of the motion for relief, explaining that the debtor had not shown that the alleged fraud impacted his ability to fairly litigate the case. Even if the allegedly inaccurate testimony would satisfy the false testimony requirement of Rule 60(b), the debtor had not proven the witness lied in light of the fact that the bankruptcy court's judgment of the witnesses's credibility was not clearly erroneous.

21. State of Minn. v. Moretto (In re Moretto), 440 B.R. 534 (B.A.P. 8th Cir. 2010). The BAP affirmed the bankruptcy court's grant to the State of Minnesota of summary judgment on a complaint to except a debt from a stipulated restitution judgment owed by the debtor to the State of Minnesota from the debtor's discharge. It denied motions by the debtor to supplement the record on appeal because the debtor did not explain why the new documents were not presented to the trial court and because the documents did not seem relevant to the issue on appeal. The BAP said the bankruptcy court's grant of summary judgment could be affirmed because of either: (1) failure by the debtor to provide a copy of the transcript from the bankruptcy court's hearing; or (2) on the merits, rejecting the debtor's arguments that service of the State of Minnesota's complaint on her was improper or because the restitution judgment was invalid. The summons was properly served and the remaining arguments were a collateral attack on a state court order.

22. Doeling v. Coating Specialties, LLC (In re Toftness), 439 B.R. 499 (B.A.P. 8th Cir. 2010). The bankruptcy court's revocation of the debtor's discharge was proper pursuant to

11 U.S.C. § 727(d)(2), providing for revocation of a debtor's discharge if the debtor "acquired property that is property of the estate. . . , and knowingly and fraudulently failed to report the acquisition of. . . such property, or to deliver or surrender such property to the trustee[.]"

Payments on promissory notes flowed through bank accounts in the name of the debtor and limited liability companies that were controlled by the debtor. The debtor was allowed to use the funds for payment of his own needs and the needs of the companies he controlled, but the debtor did not turn over to the trustee the funds or his interest in or any assets of the companies he controlled. The bankruptcy court's finding of fraudulent intent was supported by the evidence.

23. Sederlund v. Educ. Credit Mgmt. Corp. (In re Sederlund), 440 B.R. 168

(B.A.P. 8th Cir. 2010). A 42 year-old debtor with no known disabilities sought a discharge of her student loan debt based on undue hardship. The debtor obtained her bachelor's degree about 16 years before filing her bankruptcy petition. She never obtained work in her field of study, but she had various jobs. She also experienced periods of unemployment. For several years before she filed her dischargeability action, the debtor's income fell below the poverty level. Even though the debtor was unmarried and had no dependents, she lived with her boyfriend for the past six years and the boyfriends paid more than half of the household expenses. The BAP affirmed the bankruptcy court's decision that the debt was non-dischargeable. The bankruptcy court did not err in finding that the boyfriend's contributions should be considered as part of the household income and that the debtor was voluntarily underemployed. Citing the Eighth Circuit's decision in *Educ. Credit Mgmt, Corp. v. Jespersen (In re Jespersen)*, 571 F.3d 775, 781 (8th Cir. 2009), the BAP explained that the availability of an Income Contingent Repayment Plan (which was undisputably available to the debtor) is a factor to be considered in evaluating

the totality of the debtor's circumstances.

AVOIDANCE ACTIONS

24. Lovald v. Hunter (In re Paul), 446 B.R. 272 (B.A.P. 8th Cir. 2011). Pre-bankruptcy, the debtor's father transferred a mobile home to him. The father also transferred land to the debtor upon an oral agreement that the debtor would reconvey the land to his father upon request. For no consideration, the debtor transferred the mobile home to his sister and, at his father's request, the land to his step-mother. The Chapter 7 trustee for the debtor's bankruptcy estate brought an adversary proceeding against the debtor's sister and step-mother seeking recovery of the land and the mobile home. The trustee's complaint was based on the Wyoming Uniform Fraudulent Transfer Act. The BAP affirmed the bankruptcy court's finding that the trustee failed to prove that "at the time of the transfers, [the debtor] was engaged in or was about to engage in a business or transaction for which his remaining assets were unreasonably small in relation to the business or transaction." The date of the transfers, rather than the petition date, were the relevant dates for determining whether the debtor's assets were unreasonably small.

25. Lange v. Inova Capital Funding, LLC (In re Qualia Clinical Serv., Inc.), 441 B.R. 325 (B.A.P. 8th Cir. 2011). The BAP affirmed the bankruptcy court's grant of summary judgment in the Chapter 7 trustee's favor, avoiding as a preference a lender's financing statement filed during the preference period. The debtor entered into a pre-petition invoice purchase agreement (the "Agreement") whereby a lender purchased accounts receivable from the debtor and the lender would have an ongoing security interest in the debtor's property. The lender filed a UCC-1 financing statement in Nebraska before the preference period commenced.

After the last date when the lender provided new value to the debtor and within the preference period, the lender filed another UCC-1 financing statement - this time in Nevada. The trustee commenced an action against the lender, alleging that the Agreement was a financing arrangement, rather than a true sale, and seeking to avoid as a preference the lien the lender obtained by filing its Nevada financing statement. The lender moved for summary judgment under 11 U.S.C. § 547(c)(5), and the trustee moved for summary judgment on all his claims.

The BAP explained that the transfer was of an interest of the debtor in property because the transaction was a financing arrangement, not a true sale, since a recourse provision in the Agreement shifted the risk of uncollectability to the debtor. In accordance with the choice of law specified in the Agreement, the financing statement had to be filed in Nevada to be effective, and the Nevada financing statement was filed within the preference period. The § 547(c)(5) defense did not apply because the lender was unsecured at the beginning of the preference period and on the date when it last gave new value. There were no fact issues regarding additional preference defenses raised in the lender's answer to the complaint because the lender was aware that the bankruptcy court was disposing of the entire proceeding.

26. Kaler v. Able Debt Settlement, Inc. (In re Kendall), 440 B.R. 526 (B.A.P. 8th Cir. 2010). The BAP affirmed the bankruptcy court's judgment in favor of a debt service company and against the Chapter 7 trustee in an 11 U.S.C. § 548(a)(1)(B) action. Even though the goal of the debtors' agreement with the debt service company, to avoid bankruptcy, was not reached, the bankruptcy court did not clearly err when it determined that the debtors received value from the debt service company that was reasonably equivalent to the fees that they paid to it. The transaction between the parties was made at arm's length, the debtors thought they could

make the required monthly payments to the debt service company and there was a chance the debt service company could have successfully negotiated with the debtors' creditors. It was irrelevant whether the debtors' agreement with the debt service company was void or illegal under applicable state law because such a finding would not require the court to find a lack of reasonably equivalent value.

RULE 60(b), EXCUSABLE NEGLIGENCE AND RULE 8002

27. **Needler v. IRS (In re Burival)**, 449 B.R. 371 (B.A.P. 8th Cir. 2011). The BAP affirmed the bankruptcy court's decision on a Rule 60(b) motion filed by the debtor's attorney who held an administrative expense claim for his attorney's fees. The Rule 60(b) motion challenged the bankruptcy court's orders allowing the trustee to pay taxes incurred in connection with the sale of the debtors' property as a surcharge against the sale proceeds. The BAP would not consider whether the court erred in its ruling on the merits of the underlying motion because only the denial of the Rule 60(b) motion was appealed. The bankruptcy court did not abuse its discretion because, under Rule 60(b)(1), the attorney's mistake of law was not excusable neglect. His failure to adequately consider the administrative solvency of the case was not exceptional circumstances. The prejudice to other parties and impact on the bankruptcy estate if relief was granted under Rule 60(b) was significant under the facts of the case. Newly discovered evidence alleged by the attorney as grounds for relief under Rule 60(b)(2) - that the sale did not bring enough funds to pay all administrative creditors - was insufficient for relief from the surcharge order. The bankruptcy court also did not abuse its discretion under Rule 60(b)(6)'s catchall provision because the attorney filed his motion after the sale occurred.

28. Holsinger v. Hanrahan (In re Miell), 439 B.R. 704 (B.A.P. 8th Cir. 2010). The BAP affirmed the bankruptcy court's dismissal of an action brought by junior lienholders (the "Creditors") on the debtor's property. The complaint challenged the Chapter 7 trustee's notice of a sale of the debtor's real estate free and clear of liens, claims and encumbrances, and sought a declaration that the Creditors' liens were unaffected by the sale or that their liens attached to the sale proceeds. The trustee gave written notice of her sale motion to the Creditors and the Creditors did not object to the sale. The trustee did not serve a copy of the actual sale motion on the Creditors. The bankruptcy court approved the sale, the order was not appealed and the sale took place. Federal Rule of Civil Procedure 60(b) governed the Creditors' ability to obtain relief from the sale order. The only basis for relief under Rule 60(b) implicated by the complaint, if the judgment was void, was not satisfied. The Creditors were not denied due process because the trustee's sale motion failed to specifically identify their lien or name them as secured creditors. The trustee violated a procedural rule by failing to serve her sale motion on the Creditors, but such failure did not deprive them of due process.

29. Fokkena v. Goodwin (In re Goodwin), 437 B.R. 844 (B.A.P. 8th Cir. 2010). There were three appeals related two adversary proceedings that were tried in the bankruptcy court. After a combined trial in the two adversary proceedings, the bankruptcy court denied the debtor's discharge and it also determined that the debt to a certain creditor would be non-dischargeable. The first two appeals, filed by the debtor, were of the rulings in the discharge and dischargeability actions. In the third appeal, the creditor sought reversal of the bankruptcy court's allowance to the debtor of an extension of time to appeal its decisions regarding denial of the debtor's discharge. The BAP reversed the bankruptcy court's order allowing the debtor an

extension of time to appeal the decisions in the discharge and dischargeability action and, accordingly, the appeal was dismissed. The debtor did not request an extension of time to file a notice of appeal until after the original appeal had expired and the debtor did not show excusable neglect as required under Rule 8002(c).

AUTOMATIC STAY AND RELIEF FROM STAY

30. Crossroads Ford, Inc. v. Dealer Computer Servs., Inc. (In re Crossroads Ford, Inc.), 449 B.R. 366 (B.A.P. 8th Cir. 2011). The debtor and the creditor entered into a contract for the installation of a computer system for electronic communications. The contract included a clause requiring the parties to arbitrate disputes. Days before the hearing in an arbitration was to commence, the debtor filed a bankruptcy petition. The BAP affirmed the bankruptcy court's grant of the creditor's request for relief from the automatic stay to proceed with the arbitration. The two issues on appeal were whether: (1) "the bankruptcy court erred by not ruling on the issue of whether the agreement to arbitrate was obtained by fraud," and (2) "the bankruptcy court should have tailored its order to require [the creditor's] claim to be arbitrated by [an] allegedly, then-pending class action arbitration."

The propriety of the bankruptcy court's decision to allow arbitration of the issue of whether the agreement was obtained by fraud depended on whether the debtor's challenge was directed to the specific agreement to arbitrate or to the contract as a whole. Under the Federal Arbitration Act, if the debtor challenged the contract as a whole, the matter could proceed to arbitration. Notwithstanding the debtor's allegation that it challenged the contract specifically with respect to the arbitration provision, the debtor's argument amounted to a contention that the agreement as a whole was procured by fraud. The BAP quoted the Supreme Court in *Rent-A*

Center West, Inc. v. Jackson, 130 S.Ct. 2772, 2778 (2010) - “[W]here the alleged fraud that induced the whole contract equally induced the agreement to arbitrate which was part of that contract . . . we nonetheless require the *basis* of challenge to be directed specifically to the agreement to arbitrate before the court will intervene.” The bankruptcy court properly decided to not require the Creditor to arbitrate the claim in the alleged class action arbitration, given that the class was not certified as of the date of the hearing on the creditor’s stay relief motion. In addition, the issue was moot because the arbitration panel declined to certify the class.

31. National Bank of Ark. v. Panther Mtn. Land Dev., LLC (In re Panther Mtn. Land Dev., LLC), 446 B.R. 282 (B.A.P. 8th Cir. 2011). A Chapter 11 debtor’s secured creditor held mortgages on lots in a subdivision and on undeveloped land owned by the debtor. The creditor sought relief from the automatic stay to file a state court lawsuit challenging the validity of Improvement Districts that the debtor formed pre-bankruptcy under Arkansas law “to create easements and to obtain financing for sewers, roads, and utility services to the undeveloped land, and to impose assessments on the landowners to pay for such improvements.” As separate entities, the Improvement Districts were not debtors in bankruptcy. The BAP affirmed the bankruptcy court’s denial of the creditor’s request for stay relief. The bankruptcy court properly determined that “unusual circumstances” existed that would justify applying § 362(a)(3) to a non-debtor and cause did not exist to lift the automatic stay. The debtor’s property was subject to the protections of the Bankruptcy Code and the bank’s Fourteenth Amendment rights in its collateral would be protected, leaving no basis to allow the bank to proceed with a state court action that could harm the interests of the parties to the reorganization process.

32. Bates v. BAC Home Loans (In re Bates), 446 B.R. 301 (B.A.P. 8th Cir. 2011).

Bankruptcy Code § 362(c)(4)(A)(i) (providing that the stay does not go into effect in a case if the debtor had two or more cases dismissed within the previous year and neither case was a case refiled under a chapter other than Chapter 7 on “abuse” grounds) went into effect in the debtor’s bankruptcy case. The debtor claimed, however, that § 362(c)(4)(A)(i) should be read with § 362(c)(3), with the result that the stay was terminated with respect to the debtor and property of the debtor, but not with respect to property of her estate. Recognizing a split of authority regarding which part of the automatic stay terminates after 30 days under § 362(c)(3), the BAP did not have to analyze that issue because, as the BAP explained, § 362(c)(4)(A)(i) is the relevant provision, not § 362(c)(3). Section 362(c)(4)(A)(i) was unambiguous and the automatic stay never went into effect in the debtor’s bankruptcy case. There is no exception to that rule for property of the estate.

33. Marino v. Seeley (In re Marino), 437 B.R. 676 (B.A.P. 8th Cir. 2010). While the

debtor rented a room in a homeowner’s home, the debtor filed a Chapter 7 bankruptcy petition. Due to tension between the homeowner and the debtor, the debtor left the home. The day before the noticing center mailed notice of the debtor’s bankruptcy filing, the homeowner obtained an *ex parte* order of protection against the debtor under Minnesota law. The bankruptcy court dismissed an action filed by the debtor in which the debtor alleged that the homeowner violated the automatic stay when he obtained the order of protection. The BAP affirmed. Bankruptcy Code § 362(b)(2)(A)(v) explains that the stay does not apply to a civil action “regarding domestic violence.” The meaning of the term “domestic violence” in § 362(b)(2)(A)(v) encompassed the term “domestic abuse” as it was included in the relevant state statute and the

homeowner's action seeking the order for protection was not stayed.

PROPERTY OF THE ESTATE, CLAIMS AND RECOUPMENT

34. Robinson v. Wildlife Farms II, LLC (In re Robinson), No. 10-2785, 2011 WL 148789 (8th Cir. Jan. 19, 2011) (per curiam) (unpublished). The Eighth Circuit adopted the reasoning of the district court and affirmed the district court's affirmance of the bankruptcy court's order restraining the debtors from pursuing certain claims and defenses in state court because they were property of their bankruptcy estates.

35. Edwards v. R.G. Edmundson, Trustee of the Jewell Edmundson Testamentary Trust (In re Edwards), 446 B.R. 276 (B.A.P. 8th Cir. 2011). A creditor filed a secured proof of claim in the debtors' bankruptcy case based on a judgment lien acquired through a pre-petition state court action against the debtors. Based on MO. REV. STAT. § 408.040.1 and the dispositions of cases before the court of appeals regarding the state court matter, the BAP agreed with the bankruptcy court's allowance of post-judgment interest that accrued pre-petition as a part of the creditor's claim. Included in the claim was interest accrued during the pendency of the appeals. In addition, the BAP disallowed the debtors' request to enlarge the record on appeal by considering documents that were not submitted to the bankruptcy court. It also would not consider issues raised by the debtors for the first time on appeal.

36. Terry v. Standard Ins. Co. (In re Terry), 443 B.R. 816 (B.A.P. 8th Cir. 2011). Pre-petition, the debtor repaid to the insurer an overpayment for disability benefits. The debtor then filed a Chapter 7 bankruptcy petition and obtained a discharge. The insurer sent the overpayment to the Chapter 7 trustee after the trustee demanded return of it as a preference. The insurer then began deducting the amount of the overpayment from the debtor's post-petition

disability benefits. The bankruptcy court said that 11 U.S.C. § 502(h) barred the insurer's right to recoupment. It did not consider the merits of the alleged recoupment defense. The BAP considered "whether [the insurer] may exercise the equitable right of recoupment post-bankruptcy to recover from the debtor the money that [the insurer] turned over to the trustee." In a 2 to 1 decision, it reversed and remanded, explaining that § 502(h) "does not create claims or confer priority and . . . , it does not purport to limit [the insurer's] right to recovery." The insurer's recoupment defenses survived even though the debtor's debt to the insurer for the overpayment was discharged. The BAP remanded the case to the bankruptcy court for a determination of "whether the equities favor allowing recoupment." The dissent agreed that § 502(h) does not, standing alone, preclude a recoupment defense, but it said it would affirm the bankruptcy court's decision under a review for abuse of discretion.

EXEMPTIONS

37. Walters v. Bank of the West (In re Walters), --- B.R. ---, 2011 WL 2150020 (B.A.P. 8th Cir. June 2, 2011). When the debtor filed her bankruptcy petition, she claimed a homestead exemption in an Iowa house. The BAP affirmed a bankruptcy court order sustaining an objection to the claimed exemption that was filed by a bank holding judgments against debtor. Under Iowa law, the debtor's homestead normally would not be exempt because it was acquired after the debt to the bank was incurred, but if the homestead was acquired with the proceeds of a different homestead that was acquired before the debtor incurred the debt to the bank, it would be exempt. The BAP saw no error in the bankruptcy court's finding that the debtor's Iowa house was not acquired with proceeds from the sale of a homestead because Florida property that the debtor claimed had previously been her homestead did not qualify as her homestead under

Florida law. Even if the Florida property had been the debtor's homestead, the debtor failed to show that the Iowa property was actually purchased with the proceeds from the Florida property.

38. Moon v. Hurd (In re Hurd), 441 B.R. 116 (B.A.P. 8th Cir. 2010). A Chapter 7 debtor listed his trailer on his schedule of personal property and claimed its entire value as exempt under MO.REV.STAT. §513.430.1(6). The bankruptcy court overruled the trustee's objection to the debtor's exemption. The BAP reversed the decision of the bankruptcy court, determining that the trailer did not qualify as a "mobile home," as required under MO. REV. STAT. § 513.430.1(6). It explained that, even though the term "mobile home" is not defined in § 513.430.1(6), MO. REV. STAT. § 700.010(6) defines the term "manufactured home," and it interpreted the description of "manufactured home" in § 700.010(6) as defining the term "mobile home" in § 513.430.1(6). Because the trailer did not meet the threshold requirement that it be a "mobile home," the BAP did not analyze whether it was used by the debtor as his principal residence. The BAP also noted that a claim by the debtor of an exemption under MO. REV. STAT. § 513.475.1 would have failed because the trailer did not qualify as a "dwelling house."

39. Danduran v. Kaler (In re Danduran), 438 B.R. 658 (B.A.P. 8th Cir. 2010). The debtor sold his home and established a bank account specifically for the purpose of depositing the sale proceeds. He deposited into the bank account both the proceeds from the sale of his home and the proceeds from the sale of personal property sold in conjunction with the home sale. Because there was no evidence that the debtor had acted fraudulently by converting the non-exempt personal property into the exempt assets by depositing them in the bank account that was established for depositing the proceeds of the sale of his home, the debtor was allowed to claim the entire amount in the account as exempt.

SALES

40. VanCura v. Hanrahan (In re Miell), 441 B.R. 610 (B.A.P. 8th Cir. 2010). Pre-bankruptcy in 2002, the debtor and creditor entered into a contract for the debtor's purchase of property from the creditor by paying a portion of the price at the sale, with the balance due over time. The contract allowed the creditor to make certain advancements and to add such amounts to the balance secured under the contract. The creditor then gave the debtor an additional pre-bankruptcy loan in 2008 that was evidenced by a new promissory note, but the note was not recorded. The Chapter 7 trustee filed a motion to sell the property that the debtor purchased from the creditor free of the creditor's lien. Despite the trustee's significant marketing of the property, the sale price was less than its assessed value. If the creditor's lien secured the 2008 advancement, the estate would gain no funds from the sale after the payment of the creditor's lien and another lien. If the 2008 advancement was not secured by the property, the estate would retain net equity from the sale. The BAP affirmed the bankruptcy court's grant of the motion to sell. The debtor did not prove that the 2008 loan was a secured advancement under the contract. In light of the circumstances, the sale price was fair and reasonable even though it was less than the assessed value of the property.

41. Lovald v. Tennyson (In re Wolk), 437 B.R. 850 (B.A.P. 8th Cir. 2010). The Chapter 7 debtor held title to a residence as tenants in common with his non-debtor wife. Pursuant to 11 U.S.C. § 363(h), the trustee sought to sell the property in its entirety, free of the wife's interest. The bankruptcy court denied the trustee's request to sell the property. All the equity in it was attributable to the co-owner's financial input and under South Dakota law, all of the equity would accrue to the co-owner. Since the estate stood in the shoes of the debtor, the

estate had nothing to gain from the sale. The trustee argued for the first time on appeal that the sale would benefit the estate because his rights as a hypothetical lienholder or bona fide purchaser under § 544(a) prevent a presumption of equal ownership of the property under South Dakota law from being rebutted. Even though the BAP normally would not address an issue raised for the first time on appeal, the trustee's rights under § 544(a) needed to be addressed in connection with the sale under § 363(h). The bankruptcy court did not have the opportunity to complete the § 363(h) analysis by considering the trustee's status as a hypothetical bona fide purchaser. The BAP remanded the case to the bankruptcy court to determine the impact of the trustee's rights and powers under § 544(a) and to finish the § 363(h) analysis.

EMPLOYMENT OF PROFESSIONALS

42. Blumenthal v. Myers (In re M&M Marketing, L.L.C.), 397 Fed. Appx. 258 (8th Cir. 2010) (per curiam) (unpublished). Proposed counsel was disqualified from representing the debtors based on a conflict of interest. Section 327(e) of the Bankruptcy Code, governing special purpose representation, is inapplicable where the professional did not previously represent the debtors. Proposed counsel held an interest adverse to the estates because he was counsel to several creditors of the estates.

MISCELLANEOUS

43. Alexander v. Hedback, 395 Fed. Appx. 314 (8th Cir. 2010) (per curiam) (unpublished). In consolidated appeals, Larry Alexander challenged the district court's dismissal of his declaratory judgment action regarding his ownership of certain real property and G. Yvonne Stephens challenged the BAP's order approving the bankruptcy court's approval of a settlement regarding the same property. The Eighth Circuit affirmed, accepting the reasoning of

the district court and the BAP.

44. Brown v. Bank of North Dakota (In re Brown), 446 B.R. 270 (B.A.P. 8th Cir. 2011). The bankruptcy court sustained a creditor's objection to confirmation of the debtor's Chapter 13 plan. The order denying confirmation of the plan does not explain the basis for the court's ruling and the transcript of the hearing was not provided to the BAP. The creditor's motion for relief from the automatic stay and the Chapter 13 trustee's motion to dismiss the debtor's case were each granted without a hearing when the debtor failed to respond to them. The BAP affirmed the bankruptcy court's rulings without considering the substance of the arguments. The debtor failed to provide an adequate record of the bankruptcy court's decision to deny confirmation of the plan. In addition, because the debtor had not objected to the motions for relief from stay and to dismiss the case, he could not challenge those orders on appeal.

46. George-Running v. Grimlie (In re Grimlie), 439 B.R. 710 (B.A.P. 8th Cir. 2010). The BAP affirmed orders and judgments of the bankruptcy court: (1) vacating and denying the debtor's discharge under § 727(a)(2) and (a)(4)(A); (2) sustaining an objection to the homestead and farming exemptions claimed by the debtor; and (3) avoiding fraudulent transfer to the debtor's wife and children and ordering the sale of his home. When a creditor obtained a state court judgment against the debtors, the debtor and his wife transferred various property between themselves and their children, and then filed a petition for relief under the Bankruptcy Code. The BAP would not question various factual findings made by the bankruptcy court because the debtor did not provide the trial transcript. In light of the debtor's and his wife's interest in their homestead property as of the petition date in accordance with Minnesota law and the case record, the bankruptcy court correctly found that the sale of the debtor's interest and his wife's interest in

their home under § 363(h) was proper. In addition, the debtor could not prove the bankruptcy court erred when it determined that the debtor's land was not used primarily for agricultural purposes and, thus, only a portion of the equity in the debtor's home was exempt under state law.

Supreme Court addresses limits on bankruptcy judges' powers
7/24/2011

By Patrick Scott, Esq., GrayRobinson PA*

In a 5-4 opinion delivered June 23, the U.S. Supreme Court ended litigation that had outlived all three of the parties involved: Vickie Marshall (aka Anna Nicole Smith); her husband, J. Howard Marshall II; and Howard's son Pierce Marshall.¹ In doing so it has addressed in an important way the extent to which bankruptcy judges have jurisdiction over state law claims.

The decision in *Stern v. Marshall* is the court's most thorough assessment of the 1984 law by which Congress sought to preserve the authority of bankruptcy judges to enter judgments and final orders on state law claims that have some connection to the bankruptcy process.

The practical result of the decision is that creditors facing state law claims by a bankruptcy estate may choose between the bankruptcy judge and a district court as the fact finder in the case. Prior to the *Stern* decision, this option was already available to the parties in instances where a jury trial was required and in instances where the creditor had not filed a proof of claim.

The Supreme Court has now held that, constitutionally, a creditor is always entitled to have a district court judge determine the bankruptcy trustee's claims against the creditor — so long as the trustee's "counterclaim" does not arise under bankruptcy law and does not necessarily have to be determined in the process of allowing or disallowing the creditor's claim against the estate. That the creditor's claim and the trustee's claim arose from a common set of facts is irrelevant.

The issue of bankruptcy judges' power arises because they are not lifetime appointees. Article III of the Constitution vests the judicial powers only in the Supreme Court, and such inferior courts created by Congress under that article that give lifetime appointments to federal judges. The bankruptcy judgeships were created by Congress under its Article I power to make bankruptcy laws, and those judges' powers historically have been limited to the administration of bankruptcy laws.

For many years before the enactment of the present Bankruptcy Code in 1978, bankruptcy judges (called referees until 1973) could issue orders within their "summary jurisdiction" over the administration of bankruptcy cases with no independent review by a district court judge. The areas of

jurisdiction within the bankruptcy judges' purview were the collection and liquidation of property; the recognition of property exemptions; the determination of the validity, priority and amount of secured and unsecured claims; and the approval of debt-composition arrangements and reorganization plans.

A litigant could appeal those decisions to the district court. However, fact findings by a bankruptcy judge could be reconsidered by a district court on appeal only if the findings were clearly erroneous.

The 1978 Code expanded bankruptcy judges' powers to include proceedings that were merely "related to" the bankruptcy case.

In 1982 the Supreme Court held in *Northern Pipeline Construction Co. v. Marathon Pipe Line Co.*² that the Code could not constitutionally authorize bankruptcy judges to enter final orders upon bankruptcy trustees' breach-of-contract claims where the only relationship of the claim to the bankruptcy process was that a recovery upon the claim would augment the estate.

In response, Congress amended the jurisdictional statutes in 1984.³ The new law reaffirmed that district courts had full authority over bankruptcy cases, including matters merely "related to" bankruptcy cases,⁴ but authorized the district courts to "refer" all bankruptcy matters to bankruptcy judges subject to a retained right to withdraw the reference.⁵

The district courts promptly issued general orders or local rules referring all bankruptcy matters to the bankruptcy courts. The same law provided that bankruptcy judges may not determine what are commonly called "non-core" matters. When a litigant demanded it, a bankruptcy judge had to report the proposed ruling on non-core matters to the district judge for de novo determination.⁶ This effectively gave any litigant the right to choose the district court forum over the bankruptcy court forum in a non-core proceeding.

Non-core proceedings are those that are related to a bankruptcy case but are not "core" to the case. Often they invoke state law, but may invoke a federal law other than bankruptcy law. "Core" proceedings are those that either arise under the Bankruptcy Code (invoke a substantive right created by the Code) or arise in a bankruptcy case (could not exist outside of bankruptcy). The 1984 law lists 16 examples of core proceedings.⁷

A debate immediately arose as to whether Congress had drawn the line properly between what a bankruptcy judge may finally determine and what the bankruptcy judge may merely hear but not determine — either referring it back to the district judge or sending the district court a recommended

ruling.

The Supreme Court in *Granfinanciera v. Nordberg*⁸ held that a jury trial right was available to a defendant in a fraudulent-conveyance and avoidable-preference action by a trustee, notwithstanding the 1984 law's designation of those proceedings as "core."

"Because [creditors] ... have not filed claims against the estate, [trustee's] fraudulent-conveyance action [against creditors] does not arise 'as part of the process of allowance and disallowance of claims.' Nor is that action integral to the restructuring of debtor-creditor relations," the *Granfinanciera* court said. "Congress therefore cannot divest [creditors] of their Seventh Amendment right to a trial by jury."⁹

In 1990 the Supreme Court ruled that a bankruptcy judge could decide an avoidable preference claim made by the trustee against a creditor who files a proof of claim.¹⁰

From those decisions, many practitioners have concluded that a creditor who does file a proof of claim submits to the "core" jurisdiction of the bankruptcy court to decide all manner of "counterclaims" against the creditor. This conclusion was bolstered by Congress' listing "counterclaim to a creditor's claim" as an example of core proceedings specified in Section 157(b)(2). But the Supreme Court had never decided that issue, until *Stern*.

The tortuous history of *Stern v. Marshall*, which Chief Justice John Roberts likened to the ceaseless litigation in Charles Dickens' "Bleak House," began in 1995, when Anna Nicole Smith filed suit in a Texas state court, asserting that Pierce Marshall had tortiously interfered with her elderly husband's intention to put his assets into a trust for her.

After her husband died, Smith commenced a Chapter 11 proceeding in the U.S. Bankruptcy Court for the Central District of California, even as her tortious-interference claim continued toward trial in Texas state court. Pierce filed a proof of claim in the bankruptcy case for defamation, as well as an adversary complaint seeking a determination that his claim was nondischargeable.

Because the defamation and tortious-interference claims arose from a common set of facts, Smith counterclaimed in the bankruptcy case for Pierce's alleged tortious interference. The Bankruptcy Court struck Pierce's defenses, citing his massive discovery abuses, awarded Pierce nothing, and awarded Smith a \$474 million judgment.

The U.S. District Court for the Central District of California reversed, holding that the Bankruptcy Court lacked authority to enter judgment on a state law cause of action, even though it was filed in response to a creditor's bankruptcy proof of claim. Nonetheless, under its own bankruptcy jurisdiction, the District Court entered judgment in favor of Smith for \$88.5 million.

The 9th U.S. Circuit Court of Appeals reversed the District Court. It agreed that the Bankruptcy Court lacked constitutional authority. However, noting that the Texas state court had entered judgment in favor of Pierce prior to the District Court's judgment, it held that the state court judgment should have been given preclusive effect. So it directed the District Court to enter judgment in favor of Pierce. Smith appealed.

In a 5-4 opinion, the Supreme Court affirmed on the basis that no federal court with authority to decide the case had yet entered judgment as of the time the Texas court ruled in favor of Pierce.

All nine justices agreed that the wording of Section 157(b) gave the Bankruptcy Court jurisdiction over state law counterclaims filed in response to a creditor's claim. However, the majority held that Congress was not empowered by the Constitution to provide such power to bankruptcy judges to render final determinations on a common-law cause of action when the action neither derives from nor depends upon the bankruptcy law and is not necessarily resolved in the process of ruling on a creditor's proof of claim.

First, the court agreed that "core" proceedings as described in Section 157 do not overlap with "related-to" proceedings described in 28 U.S.C. § 1334. The two are mutually exclusive. "Related-to" means "non-core."

Next, it noted that Congress' enumeration of examples of core proceedings in no way defines what is constitutionally within bankruptcy judges' powers, so a more searching inquiry must be made into what authority Congress has to give powers to specialized tribunals.

The dissenting opinion written by Justice Stephen Breyer favored a broad reading of the "public rights" exception by which the Supreme Court has historically approved of non-Article III adjudicators having authority to decide issues arising in particular proceedings ranging from federal land grant commissions to the Commodity Futures Trading Commission.

Justice Roberts' majority opinion rejects the notion that the public rights exception covers trustees' compulsory state law counterclaims in a bankruptcy case. It said:

Granfinanciera's distinction between actions that seek "to augment the bankruptcy estate" and those that seek "a pro rata share of the bankruptcy res" reaffirms that Congress may not bypass Article III simply because a proceeding may have some bearing on a bankruptcy case; the question is whether the action at issue stems from the bankruptcy itself or would necessarily be resolved in the claims allowance process.¹¹

The court looked to the nature of the debtor-in possession's claim against Pierce, saying, Smith's claim "is in no way derived from or dependent upon bankruptcy law; it is a state tort action that exists without regard to any bankruptcy proceeding."¹²

While Smith's counterclaim may have been a compulsory counterclaim, "there was never any reason to believe that the process of adjudicating Pierce's proof of claim would necessarily resolve [Smith's] counterclaim," the opinion said.¹³

The majority said:

[I]t is hard to see why Pierce's decision to file a claim should make any difference with respect to the characterization of [Smith's] counterclaim. "[P]roperty interests are created and defined by state law,' and '[u]nless some federal interest requires a different result, there is no reason why such interests should be analyzed differently simply because an interested party is involved in a bankruptcy proceeding.'" *Travelers Casualty & Surety Co. of America v. Pacific Gas & Elec. Co.*, 549 U.S. 443, 451 (2007) (quoting *Butner v. United States*, 440 U.S. 48, 55 (1979)). Pierce's claim for defamation in no way affects the nature of [Smith's] counterclaim for tortious interference as one at common law that simply attempts to augment the bankruptcy estate — the very type of claim that we held in *Northern Pipeline* and *Granfinanciera* must be decided by an Article III court.¹⁴

The majority rejected the dissenting justices' call for a more flexible analysis that takes into account the practical benefit of having the same adjudicator determine all issues that arise from a common set of facts.

Bankruptcy judges have one thing to be thankful for. The Supreme Court did not go so far as to adopt the suggestion in Justice Antonin Scalia's concurring opinion that the bankruptcy process is not a public right that can support any statutory jurisdiction for courts inferior to the Article III district courts to adjudicate any claim by a debtor or bankruptcy trustee.

Some support can be found in the *Stern* decision for the propositions that even fraudulent-transfer actions will not generally be considered to fall

within a bankruptcy judge's power to adjudicate them and that the prospect of a large recovery is irrelevant to the determination of whether a particular state law proceeding is necessarily involved in the claims adjudication process.

However, the principal significance of the Stern decision is that it will encourage a permissible type of forum-shopping. Just as trustees and Chapter 11 debtors-in-possession typically prefer to bring actions before a bankruptcy judge, creditor-defendants most often prefer the fact finder to be a district judge.

By its ruling in *Stern v. Marshall*, the Supreme Court has expanded the availability of the "district judge option" to all defendants facing trustees' state law claims that are not necessarily determined in the claims adjudication process.

Notes

1 *Stern v. Marshall*, 131 S. Ct. 2594 (June 23, 2011).

2 458 U.S. 50 (1982).

3 Bankruptcy Amendments and Federal Judgeships Act of 1984, 98 Stat. 333.

4 28 U.S.C. § 1334(a), (b).

5 28 U.S.C. § 157(a), (d)

6 28 U.S.C. § 157(c).

7 28 U.S.C. § 157(b)(2).

8 492 U.S. 33 (1989).

9 492 U.S. at 58-59 (quoting *Katchen v. Landy*, 382 U.S. 323, 336 (1966)).

10 *Langenkamp v. Culp*, 498 U.S. 42 (1990), citing *Katchen*, 382 U.S. 323.

11 *Stern*, majority opinion at 43.

12 *Id.* at 34.

13 *Stern*, J. Scalia, concurring, at 2; the majority opinion states this in the converse at 34.

14 Stern, majority opinion at 30.

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Bankruptcy Law Letter
August 2011

Article III's Bleak House (Part I): The Statutory Limits of Bankruptcy Judges' Core Jurisdiction

By Ralph Brubaker

Justice Roberts began his recent opinion in *Stern v. Marshall* [FN1] with a quotation from Dickens' Bleak House that aptly captures the tortuous and protracted dispute originating between Vickie Lynn Marshall and E. Pierce Marshall. Ironically, though, the kind of scathing commentary that Dickens visited upon English Chancery practice through Bleak House might just as easily be directed at the Supreme Court's exceedingly convoluted jurisprudence regarding the permissible adjudicatory authority of non-Article III tribunals. In *Stern v. Marshall*, the Supreme Court held that the Judicial Code provision granting our non-Article III bankruptcy judges core jurisdiction to enter final orders and judgments on "counterclaims by the estate against persons filing claims against the estate" [FN2] is unconstitutionally over-broad, at least as applied to the counterclaim at issue in the case, even though that counterclaim was compulsory and not permissive. Before reaching that constitutional issue, though, the Court had to grapple with a difficult interpretive issue regarding that statutory section, which itself was drafted in an attempt to toe the constitutional line limiting the extent of the non-Article III bankruptcy judges' adjudicatory authority.

This issue of Bankruptcy Law Letter, after summarizing the complex procedural posture producing the *Stern v. Marshall* decision and the jurisdictional history relevant to both the statutory and constitutional issues presented in *Stern v. Marshall*, will then analyze the Court's construction of the bankruptcy jurisdiction statute. Next month's issue of Bankruptcy Law Letter will be devoted to *Stern v. Marshall's* constitutional separation-of-powers holding and its implications, both modest and far-reaching.

J. Howard Marshall, II was an extremely successful oilman who led a very colorful life. [FN3] At the time of his death on August 4, 1995, Marshall was said to be either the richest or second-richest man in Texas, worth at least \$1.6 billion. He was survived by a young widow, Vickie Lynn Marshall, more famously known as Anna Nicole Smith, former Playboy Playmate and spokesmodel for Guess Jeans and TrimSpa, who was also the featured star of a television reality show, The Anna Nicole Show. The first lawsuit in an extremely contentious and protracted estate war between Anna Nicole and E. Pierce Marshall (J. Howard's second son from his first of three marriages) was filed even before J. Howard's death, and parallel proceedings in a Texas probate court and a federal bankruptcy court in California produced substantially contemporaneous and conflicting judgments, each of which refused to give any effect to the other: (1) a money judgment from the California bankruptcy court against E. Pierce awarding Anna Nicole damages of approximately \$475 million, which was reduced to approximately \$90 million by the California district court; and (2) a judgment from the Texas probate court that Anna Nicole was entitled to no distribution from J. Howard's estate and denying her any relief on her claim against E. Pierce.

The Ninth Circuit's initial solution to this deadlock opined that the federal courts below were without any subject matter jurisdiction to entertain Anna Nicole's action against E. Pierce by virtue of the exceedingly vague and perplexing "probate exception" to federal jurisdiction. [FN4] On certiorari review of that decision, though, the Supreme Court reversed, holding that the Ninth Circuit had read the probate exception too broadly, and that "narrow exception" to federal jurisdiction did not deprive the lower federal courts of jurisdiction to entertain Anna Nicole's claim against E. Pierce.

On remand to the Ninth Circuit, while that court attempted to sort out the difficult preclusion issues presented by the conflicting federal court and Texas state court judgments, tragically, both of the original litigants--E. Pierce and then Anna Nicole--died, and their respective executors, in turn, took up their litigation. The Ninth Circuit ultimately concluded that (1) the California bankruptcy court did not have core jurisdiction to enter a final judgment on Anna Nicole's counterclaim in that court against E. Pierce, and thus the first court to enter a final judgment was the Texas state court; and (2) the California district court should have given preclusive effect to the Texas state court's final judgment denying Anna Nicole any relief on her claim against E. Pierce. The Supreme Court again granted certiorari solely to review the Ninth Circuit's decision regarding the California bankruptcy court's core jurisdiction, and the Supreme Court affirmed, holding that "although the Bankruptcy Court had the statutory authority to enter judgment on [Anna Nicole]'s counterclaim [against E. Pierce], it lacked the constitutional authority to do so." [FN5]

J. Howard Marshall's Estate Plan and His Late-Life Relationship with Anna Nicole Smith

J. Howard's lengthy courtship of Anna Nicole began in 1991, after meeting at a burlesque bar in Houston where Anna Nicole was a dancer. Shortly after they met, Anna Nicole's modeling career was launched with her first appearance in Playboy magazine, and she quickly became one of the most recognized print models in the world. Within a week of their first meeting, J. Howard told Anna Nicole that he was going to marry her. He showered her with lavish gifts and made repeated proposals of marriage, which Anna Nicole rebuffed for almost three years before accepting. J. Howard and Anna Nicole were then married on June 27, 1994, when J. Howard was 89 years old and Anna Nicole was 26.

J. Howard's relationship with Anna Nicole produced a seemingly inevitable clash with E. Pierce, whom J. Howard had set up as the principal heir to his financial kingdom, having disinherited his eldest son (J. Howard Marshall, III) over a financial disagreement concerning Koch Industries, the privately held oil and gas company that was the primary source of J. Howard's vast wealth. The centerpiece of J. Howard's estate plan was an inter vivos trust, created in 1982, to which J. Howard conveyed and transferred most of his property (the "Living Trust"), and of which E. Pierce had been the sole trustee since 1991. J. Howard's will also named E. Pierce the executor of J. Howard's estate. During his lifetime, J. Howard retained the right to receive income from the Living Trust. The Living Trust also permitted J. Howard to borrow money using the trust's property as security, and upon his death, the Living Trust expressly assumed the obligation to pay all of J. Howard's debts. J. Howard's will contained so-called "pour-over" provisions, requiring distribution of all probate assets to the Living Trust, which in turn contained express provisions for the disposition of all of J. Howard's property. E. Pierce was the primary residual beneficiary of the Living Trust, and to a much lesser extent, various charities and family beneficiaries were to receive minor trust distributions.

On July 13, 1994, two weeks after his marriage to Anna Nicole, J. Howard executed the final modification of his Living Trust, irrevocably fixing the terms in a manner that left to E. Pierce the bulk of his assets. J. Howard died of heart failure on August 4, 1995, at the age of 90. Although J. Howard gave Anna Nicole lavish gifts and significant sums of money during their courtship and marriage (including properties valued at over \$6 million through a gift during the fall of 1994 memorialized in a formal document entitled "Act of Donation"), Anna Nicole was not named a legatee under J. Howard's will nor as a beneficiary of the Living Trust.

The Texas Probate and California Bankruptcy Litigation

After J. Howard's death, far-flung litigation between Anna Nicole and E. Pierce spun a tangled web of conflicting decisions from both a Texas probate court and two federal courts in California.

Commencement of the Texas Probate Litigation

In April 1995, even before J. Howard's death, Anna Nicole sued E. Pierce in the Texas probate court alleging that he was tortiously interfering with her statutory right to support from her husband and challenging the validity of the Living Trust. Three days after J. Howard's death, Anna Nicole filed a petition in the Texas probate court, seeking a declaration that J. Howard died intestate, at which point E. Pierce offered J. Howard's last will and testament for probate and sought a declaration that both the will and the Living Trust were valid instruments. By subsequent amendment to her petition, Anna Nicole asserted a claim against E. Pierce in his individual capacity, alleging that E. Pierce, his attorneys, and others had tortiously interfered with her expectancy of an inter vivos gift from J. Howard.

Commencement of the California Bankruptcy Litigation and Entry of a Money Judgment Against E. Pierce

On January 25, 1996, during the pendency of the Texas probate proceedings, Anna Nicole filed a voluntary Chapter 11 petition in the U.S. Bankruptcy Court for the Central District of California, a move apparently prompted by the fact that she was receiving no funds from J. Howard's estate and by the entry of a default judgment against her on claims brought by her former personal assistant/housekeeper. In May 1996, E. Pierce filed an adversary proceeding against Anna Nicole, alleging that she was liable to him for defamation based on statements that some of her lawyers made to the press intimating that E. Pierce had used forgery, fraud, and overreaching to gain control of J. Howard's assets, and E. Pierce asked the California bankruptcy court to declare this alleged defamation debt nondischargeable as one for "willful and malicious injury" under Code § 523(a)(6). One month later, E. Pierce filed an unliquidated proof of claim against Anna Nicole's bankruptcy estate, asserting the same defamation claim.

In response to E. Pierce's nondischargeability action and proof of claim, Anna Nicole filed counterclaims against E. Pierce presenting, inter alia, the same tortious interference claim that she asserted against E. Pierce in the Texas probate proceedings. While this action was pending, the California bankruptcy court confirmed Anna Nicole's plan of reorganization, which specifically provided that any proceeds from pending disputed claims against E. Pierce would be held by a disbursing agent to first satisfy creditors' claims and with any remaining funds to be paid to Anna Nicole. The California bankruptcy court eventually granted Anna Nicole summary judgment on E. Pierce's defamation claim, concluding that Anna Nicole did not publish or ratify any defamatory statements about E. Pierce. Anna Nicole's counterclaim for tortious interference then went to trial.

After trial, the California bankruptcy court concluded that (1) the Texas Supreme Court would recognize the tort of intentional interference with the expectancy of an inter vivos gift and (2) E. Pierce had tortiously interfered with Anna Nicole's expectancy of an inter vivos gift from J. Howard based upon (a) J. Howard's repeated promises to Anna Nicole that she would receive half of his assets, (b) his express instructions to his attorneys to arrange a gift to Anna Nicole from the Living Trust, and (c) extensive tortious conduct thereafter by E. Pierce and one of J. Howard's attorneys designed to ensure that no such gift would ever take place. Over the objection of E. Pierce, the California bankruptcy court concluded that it had "core" jurisdiction to enter a final judgment against E. Pierce and did so, awarding Anna Nicole approximately \$450 million in compensatory damages and \$25 million in punitive damages.

Trial of the Texas Probate Action and Entry of a Judgment Against Anna Nicole

Shortly after entry of the California bankruptcy court's judgment, Anna Nicole voluntarily dismissed all of her pending claims in the Texas probate proceedings, both those asserted against J. Howard's probate estate and those against E. Pierce personally. Anna Nicole's counsel in the Texas probate proceedings also presented the California bankruptcy court's judgment to the Texas probate court, requesting that court to accord it full faith and credit. The Texas probate court refused, however, reasoning that "I don't think I have an obligation to give full faith and credit to a court's jurisdiction after this [the Texas probate case] started." [FN6] Despite dismissal of Anna Nicole's claims against J. Howard's estate and against E. Pierce

personally, Anna Nicole remained a defendant in E. Pierce's declaratory judgment action seeking to establish the validity of the Living Trust and J. Howard's will.

The Texas probate court conducted a jury trial of this action, which lasted more than five months and which apparently covered much of the same ground as had the California bankruptcy court regarding Anna Nicole's claim of "tortious interference with an intent to give an inter vivos gift." [FN7] Anna Nicole's attorneys "presented her case in chief [regarding tortious interference with an intent to make an inter vivos gift] in great detail over approximately 60 hours." [FN8] The jury in the Texas probate court, however, returned a unanimous verdict rejecting Anna Nicole's contentions. Indeed, the jury unanimously answered a number of special verdict questions, including:

(1) the Living Trust and will were valid and had not been forged or altered; (2) J. Howard Marshall II had not been the victim of fraud or undue influence; (3) he had the requisite mental capacity when he executed his Living Trust; and (4) he did not have an agreement with [Anna Nicole Smith] that he would give her one-half of all his property. [FN9]

Moreover, the Texas probate court entered a judgment specifically ruling, inter alia, that "J. Howard Marshall did not intend to give [Anna Nicole] a gift or bequest... either prior to or upon his death." [FN10]

De Novo Review in the California District Court and Entry of Yet Another Judgment Against E. Pierce

Meanwhile, back in California, an appeal of the bankruptcy court's judgment against E. Pierce had been pending in the U.S. District Court for the Central District of California. The California district court, disagreeing with the bankruptcy court's conclusion that it had "core" jurisdiction to enter a final judgment against E. Pierce, held that the bankruptcy court had only non-core "related to" jurisdiction over Anna Nicole's tortious interference claim against E. Pierce. [FN11] The California district court, therefore, formally vacated the bankruptcy court's judgment, treated that judgment as proposed findings of fact and conclusions of law, and undertook a de novo review.

Upon entry of judgment in the Texas probate proceedings, E. Pierce moved for summary judgment in the California district court, contending that Anna Nicole's tortious interference claim was now barred by the issue and claim preclusion principles of res judicata. The California district court, however, denied this motion on various grounds. [FN12] The California district court, therefore, proceeded in earnest with its de novo review of the bankruptcy court's proposed findings and conclusions, including an additional evidentiary hearing on the merits of Anna Nicole's claim. Upon the conclusion thereof, the California district court issued an extensive opinion, and like the bankruptcy court, "the Court's best judgment [wa]s that Texas law recognizes a cause of action for tortious interference with an *inter vivos* gift," and Anna Nicole had established all of the elements thereof. [FN13] "J. Howard made numerous promises to [Anna Nicole] that she would receive half of what he owned," and the "evidence shows a high degree of probability that J. Howard would have made a gift to" Anna Nicole, were it not for the fact that "J. Howard placed a tremendous amount of trust in Pierce and Hunter [J. Howard's estate planning attorney] who participated in acts intentionally designed to prevent J. Howard from giving [Anna Nicole] a substantial gift," effectively frustrating J. Howard's "frequently stated wishes." [FN14] "The evidence shows that Pierce and Hunter began undertaking estate planning transactions for J. Howard soon after they learned that he was seeking to make a substantial gift to her." [FN15] "They presented documents for his signature which he was unable to read and signed documents on his behalf." [FN16] "[T]hey backdated documents, altered documents, destroyed documents, suborned falsified notary statements, presented documents to J. Howard under false pretenses, and committed perjury." [FN17] "All of these transactions were intended to drain J. Howard of his assets" and "were all made with the intention of preventing J. Howard from making a gift to" Anna Nicole. [FN18] "Evidence of Pierce's tortious conduct is legion." [FN19]

Thus, although the California district court arrived at a substantially lower assessment of Anna Nicole's

damages than had the bankruptcy court, the district court entered a judgment against E. Pierce, awarding Anna Nicole nearly \$90 million in compensatory and punitive damages.

Which Court Entered the First Final Judgment?

In resolving the conflicting judgments of the three courts that entertained Anna Nicole's tortious interference claims against E. Pierce, the Ninth Circuit concluded (contrary to the decision of the California district court) that all of the factual predicates of Anna Nicole's tortious interference claim had been "actually litigated" (for purposes of the issue preclusion principles of collateral estoppel) by both parties in each of those courts. Which court was compelled to give issue preclusion effect to a previous court's collateral decision, therefore, depends on which of the three sequential determinations-- (1) the California bankruptcy court judgment against E. Pierce, (2) the subsequent Texas probate court judgment against Anna Nicole, or (3) the subsequent California district court judgment against E. Pierce--was the first *final* judgment. If the California bankruptcy court did *not* have core jurisdiction to enter final judgment on Anna Nicole's tortious interference counterclaim, then the Texas probate court's judgment (denying Anna Nicole any relief on her tortious interference claim) would be the first final judgment, entitled to full collateral preclusive effect (via issue preclusion a/k/a collateral estoppel) in the California district court's subsequent adjudication of Anna Nicole's tortious interference counterclaim. If, however, the California bankruptcy court *had* core jurisdiction to enter final judgment on Anna Nicole's tortious interference counterclaim, then ultimately resolving the proper application of preclusion principles would have been much more complex. The Ninth Circuit, though, took the former position, holding that the California bankruptcy court did not have the authority to enter a final judgment on Anna Nicole's tortious interference counterclaim, and thus the California district court was bound to give preclusive effect to the Texas probate court's judgment that Anna Nicole was entitled to no relief on her tortious interference counterclaim against E. Pierce. The Supreme Court affirmed.

After making our way through the *Stern v. Marshall* procedural maze, therefore, we discover that the determinative issue at stake for the Supreme Court was the extent of a bankruptcy court's authority to enter final orders and judgments. That issue, of course, implicates the Court's infamous *Marathon* separation-of-powers holding concerning the constitutional limits of non-Article III bankruptcy judges' adjudicatory authority, as those limits are now codified in the core/noncore allocation of original federal bankruptcy jurisdiction as between the Article III district courts and the non-Article III bankruptcy courts.

The Historical Evolution of Bankruptcy Processes

The only way to fully understand federal bankruptcy jurisdiction-- including the current assignment of adjudicatory powers to non-Article III bankruptcy judges--is to understand the history of federal bankruptcy jurisdiction. To provide a context for analyzing the *Stern v. Marshall* decision, therefore, we must briefly review the history of which that decision is a product.

"Bankruptcy" Proceedings in England: Summary Bankruptcy Process Versus Plenary Assignee Suits

American bankruptcy jurisdiction developed, of course, from an English system, which itself had quite a history, and the English model of a jurisdiction in bankruptcy was, very explicitly, an in rem, property-based jurisdiction-- centered around the construct of a bankrupt's "estate." The English bankruptcy commissioners, who exercised bankruptcy jurisdiction under the supervision of the Lord Chancellor in Equity, had jurisdiction over administration of the bankrupt's estate for ultimate distribution to the bankrupt's creditors. As part of their administration of the estate, the commissioners could, inter alia, pass on the validity of creditors' claims. [FN20]

This English version of bankruptcy jurisdiction, however, was limited to jurisdiction over a debtor's property that actually found its way into the hands of the commissioners and the estate's representative, the

assignee in bankruptcy (who would now be known as the bankruptcy trustee). Thus if a determination were required to ascertain whether property belonged in the bankrupt's estate or not, there was no "bankruptcy" jurisdiction, as such, over the matter. For example, if an assignee sought to recover money or property from a third party, contending that the money or property was owing to or owned by the bankrupt and therefore should be included in the bankrupt's estate for the benefit of the bankrupt's creditors, bankruptcy jurisdiction did not extend to the assignee's action. The assignee could pursue such an action only through a formal complaint in a court of law or by a formal bill in equity, depending on the character of the action itself as either legal or equitable in nature. [FN21]

Vice-Chancellor Shadwell concisely summarized the reach of English bankruptcy jurisdiction this way:

[T]he jurisdiction in bankruptcy has authority to deal only with that which is the bankrupt's estate; but has no power to determine what *is* the bankrupt's estate. If the question be a legal one it must be tried at law; and if it be an equitable one, it must be decided in this Court. But when you have determined what is the property of the bankrupt, the whole administration of it falls under the jurisdiction of the Court in bankruptcy. [FN22]

So we see in the English model a bifurcation of jurisdiction. There was in rem jurisdiction over property rightfully in the possession of the estate, and bankruptcy jurisdiction extended to administration of that property for the benefit of the bankrupt's creditors, and all such matters were resolved by summary equitable proceedings. [FN23] Moreover, the first-instance adjudicators in these summary bankruptcy proceedings were bankruptcy commissioners, whose decisions were subject to revision through a petition for review of the commissioners' determinations filed with the Lord Chancellor. [FN24] If an assignee were required to sue someone to recover money or property *for* the estate, however, there was no "bankruptcy" jurisdiction at all; such an action required an ordinary formal suit in the appropriate court.

Allocation of Federal Bankruptcy Jurisdiction Under Early American Bankruptcy Statutes: Summary Bankruptcy Proceedings Versus Plenary Assignee Suits

Bankruptcy would not become a permanent institution in this country until 1898. Earlier legislation proved sporadic and short-lived but nonetheless contained jurisdictional provisions that elucidate the nature of "bankruptcy proceedings" in federal court. Operative language in both the Bankruptcy Act of 1841 and the Bankruptcy Act of 1867 contained nearly identical grants of federal jurisdiction over "all matters and proceedings in bankruptcy." [FN25] Of course, if that statutory reference to "bankruptcy proceedings" were limited to the English notion of "bankruptcy proceedings," it would exclude an assignee's suit to recover money or property for the estate. Determining the scope of federal bankruptcy jurisdiction (vis-à-vis the jurisdiction of state courts), however, implicates an issue of judicial federalism that was unknown to the English system, [FN26] and Justice Story placed a uniquely American spin on the idea of a jurisdiction over "bankruptcy proceedings" in a couple of early opinions construing the 1841 Act. [FN27]

For Justice Story, the construct of the bankrupt's "estate" remained central to bankruptcy jurisdiction, just as it had in England. However, Justice Story's concept of federal bankruptcy jurisdiction was not the equivalent of English bankruptcy jurisdiction. Justice Story construed federal jurisdiction over "proceedings in bankruptcy" to encompass "all cases where the rights, claims, and property of the bankrupt, or those of his assignee, are concerned, since they are matters arising under the act, and are necessarily involved in the due administration and settlement of the bankrupt's estate." [FN28] According to Justice Story, then, federal jurisdiction over "bankruptcy proceedings" extends to "the ascertainment and adjustment of all claims and rights in favor of or against the bankrupt's estate." [FN29] In like manner, the 1867 Act's general federal jurisdiction over "all matters and proceedings in bankruptcy" was also construed to include any action to which the estate was a party, including an assignee's suits to recover money or property for the estate. [FN30]

Thus in our federal system of dual sovereigns with both state and federal courts, the American model of

“bankruptcy” jurisdiction, as established in the early American bankruptcy statutes, was that of a general federal bankruptcy jurisdiction over any claim to which a bankruptcy estate is a party, whether that claim is made by or against the estate. [FN31] The manner of proceeding, though, reflected the English division between summary bankruptcy proceedings and plenary assignee suits.

Both the 1841 and 1867 Acts not only granted the federal district courts general jurisdiction over “all matters and proceedings in bankruptcy,” each Act also contained a separate statutory provision specifically granting the old federal circuit courts jurisdiction over assignee “suits at law and in equity” to recover money or property from a so-called “adverse claimant.” [FN32] Because circuit court jurisdiction under the 1841 and 1867 Acts was over assignee “suits at law or in equity” [FN33] against an adverse claimant, this required an independent plenary suit in the circuit court, commenced by a formal bill or complaint. [FN34] In contrast, the district court’s general federal jurisdiction over “all matters and proceedings in bankruptcy” under the 1841 Act, by its terms, was “to be exercised summarily, in the nature of summary proceedings in equity.” [FN35] The 1867 Act did not specify the process (summary or plenary) for district courts to use in exercising their general federal bankruptcy jurisdiction, but the Supreme Court held that actions against adverse claimants required a plenary suit, whether in district court or circuit court. [FN36] All other bankruptcy proceedings in the district court, though, were resolved summarily. [FN37]

The procedural divide established under the early American bankruptcy statutes, therefore, simply adopted the English practice requiring a formal plenary suit in assignee actions to recover money or property from an adverse claimant. [FN38] As in England, American assignees had to pursue adverse claimants through formal plenary suits commenced in either a federal district or circuit court. All other “bankruptcy proceedings,” however, were conducted by summary processes in the federal district court, and as in England, early Congresses also authorized (non-Article III) bankruptcy commissioners to act as first-instance adjudicators in summary bankruptcy proceedings. For example, in the very first federal bankruptcy statute, the Bankruptcy Act of 1800, bankruptcy commissioners were given powers very similar to those of English bankruptcy commissioners, and similar to the relationship between English commissioners and the Lord Chancellor, decisions by the 1800 Act commissioners were subject to revision only through a petition for review of the commissioners’ determinations filed with the federal district court. [FN39]

Allocation of Federal Bankruptcy Jurisdiction Under the Bankruptcy Act of 1898

The more expansive model of a general federal bankruptcy jurisdiction over all claims by and against a bankruptcy estate, under the 1841 and 1867 Acts, was seen as a concomitant to effectual and efficient administration of bankruptcy estates. This jurisdictional scheme, however, produced a persistent tension between the federal interest in estate administration and the localized interests of particular litigants, witnesses, and attorneys, who often found the federal forum inconvenient as compared with state courts. [FN40] In the making of the first bankruptcy statute in the era of “permanent” bankruptcy law, the 1898 Act, there were widely held misgivings about conferring too much power on the federal courts. [FN41] The 1898 Act, therefore, responded to this animosity toward a general federal jurisdiction over “all matters and proceedings in bankruptcy” by narrowing the compass of federal bankruptcy jurisdiction.

Summary Versus Plenary Jurisdiction. The 1898 Act reduced the sweep of federal bankruptcy jurisdiction essentially through a return to the English in rem model of bankruptcy jurisdiction, in the now-infamous summary/plenary jurisdictional dichotomy erected by the 1898 Act. [FN42] The 1898 Act also introduced an inferior judicial officer, analogous to English and 1800 Act bankruptcy commissioners, to exercise in rem bankruptcy jurisdiction in summary proceedings. [FN43]

Under the 1898 Act, there was summary in rem jurisdiction in the federal courts to adjudicate all disputes incident to administration of property in the actual or constructive possession of the court (through its officer, the bankruptcy trustee), and this summary in rem jurisdiction included adjudication of all creditors’ claims against the estate. [FN44] There was no summary in rem jurisdiction, however, over trustees’ suits to

recover money or property for the estate--so-called plenary suits against "adverse claimants"--and that is the means by which the 1898 Act curtailed federal bankruptcy jurisdiction. The 1898 Act restricted federal jurisdiction over a trustee's plenary in personam suits. [FN45] That was not universally true, though, because there were limited instances in the 1898 Act in which Congress expressly granted the federal courts bankruptcy jurisdiction over a trustee's plenary in personam suits. [FN46] For example, a trustee's avoidance actions could be brought in federal court. [FN47] Moreover, in corporate reorganization proceedings, any plenary suit--even on a debtor's state-law cause of action to which the trustee merely succeeded as property of the estate--could be pursued in federal court as part of the "bankruptcy proceedings." [FN48]

Summary Versus Plenary Process. Of course, the summary/plenary dichotomy also implicated differing procedural modes, as it had in England and under earlier American bankruptcy statutes. "Summary" jurisdiction accurately connoted the more informal and expeditious nature of the proceedings, initiated by a motion, petition, or application, with a relatively short notice period before a hearing, where the evidence would often be presented through affidavits. Exercises of "plenary" jurisdiction, by contrast and as the name also indicates, required a full plenary suit: an ordinary civil action in federal court conducted according to normal rules of civil procedure, including summons and complaint, formal pleadings, discovery, and trial, all according to the timetables for and in precisely the same manner as a normal civil action. [FN49] Most significantly, jury trial rights attached to any plenary legal action by the trustee against an adverse claimant, [FN50] but the litigants had no jury trial rights (either statutory or under the Seventh Amendment) in summary proceedings. [FN51]

Referees' Jurisdiction in Summary Proceedings. The 1898 Act vested bankruptcy jurisdiction over both summary and plenary proceedings, as an initial matter, in the U.S. district courts, sitting as "courts of bankruptcy." [FN52] However, officers of the district courts, entitled bankruptcy referees, [FN53] were authorized to exercise most of the district court's summary jurisdiction through a referral system. [FN54] Nonetheless, a referee's jurisdiction over proceedings in referred cases was limited not only by some specific exceptions in the 1898 Act itself but also by a Supreme Court interpretation of the Act that limited a referee to the exercise of summary jurisdiction. Indeed, as the Court expressly acknowledged in *Katchen v. Landy*, the Court itself was the principal architect of the full extent of referees' summary jurisdiction: "Congress has often left the exact scope of summary proceedings in bankruptcy undefined, and this Court has... recognized that in the absence of congressional definition this is a matter to be determined by decisions of this Court." [FN55] Pursuant to the Court's decisions, a referee had no jurisdiction over plenary matters; [FN56] but the referee's summary jurisdiction was indistinguishable from that of the district court, including the power to enter orders reviewable only by appeal [FN57] and carrying the full collateral preclusiveness of *res judicata*. [FN58]

The 1978 Bankruptcy Reform Act and the Marathon Decision

The Bankruptcy Reform Act of 1978 brought sweeping changes to bankruptcy law, repealing the 1898 Act and enacting the Bankruptcy Code. Undoubtedly, one of the most significant changes came through an expansive grant of federal bankruptcy jurisdiction.

The Reform Act created federal bankruptcy jurisdiction over all matters "related to" a bankruptcy case. The statutory grant was of "original and exclusive jurisdiction of all [bankruptcy] cases" and "original but not exclusive jurisdiction of all civil proceedings arising under [the Bankruptcy Code] or arising in or related to [bankruptcy] cases." [FN59] The Reform Act also created a new court to exercise this broad bankruptcy jurisdiction: a unit of each federal district court, denominated the "United States Bankruptcy Court for the district." [FN60] Although bankruptcy jurisdiction was initially vested in federal district courts, the Reform Act provided that "the bankruptcy court for the district in which a [bankruptcy] case is commenced shall exercise all of the jurisdiction conferred by this section on the district courts," [FN61] with review only through ordinary appellate procedures. Thus the new jurisdictional scheme removed the summary in rem strictures that confined the power of the former referees and gave the newly created bankruptcy courts both in rem and full

in personam jurisdiction over any controversy related to a bankruptcy case.

The bankruptcy courts created by the 1978 Reform Act exercised all of the expanded federal bankruptcy jurisdiction, yet the Reform Act bankruptcy judges were not given Article III status, with its protections of lifetime tenure and undiminished compensation. [FN62] Specifically, the bankruptcy judges were to be appointed by the President for only 14-year terms, and they were subject to removal during their terms by their circuit judicial councils. [FN63] In addition, the Reform Act set bankruptcy judges' salaries but made them subject to adjustment under the Federal Salary Act. [FN64] The congressional decision to deny bankruptcy judges Article III status proved catastrophic for the bankruptcy system.

In the momentous case of *Northern Pipeline Construction Co. v. Marathon Pipe Line Co.*, [FN65] the Supreme Court held that the 1978 Reform Act's jurisdictional design violated Article III as applied to the case before it, a suit by a Chapter 11 debtor-in-possession to recover damages from a third party for a prepetition breach of contract. Of course, under the 1898 Act, such a suit would have been a plenary action against an adverse claimant, outside the summary jurisdiction of a bankruptcy referee, requiring plenary suit in state court or a federal district court. Under the 1978 Reform Act, however, this suit fell within the jurisdiction of the new bankruptcy courts. A plurality of the Supreme Court, in an opinion authored by Justice Brennan, concluded that this grant of jurisdiction to bankruptcy judges had "impermissibly removed most, if not all, of 'the essential attributes of the judicial power' from the Art. III district court, and ha[d] vested those attributes in a non-Art. III adjunct." [FN66] The concurring justices agreed that jurisdiction to adjudicate the debtor's action, which would exist in essentially the same form even if the debtor had not filed bankruptcy, could only be vested in an Article III judge. [FN67] Perhaps the broadest proposition on which both the plurality and concurrence agreed was this: "It is clear that, at the least, the new bankruptcy judges cannot constitutionally be vested with jurisdiction to decide this state-law contract claim against [defendant] Marathon." [FN68] Moreover, the Court has subsequently characterized the *Marathon* holding as "establish[ing] only that Congress may not vest in a non-Article III court the power to adjudicate, render final judgment, and issue binding orders in a traditional contract action arising under state law, without consent of the litigants, and subject only to ordinary appellate review." [FN69]

The 1984 BAFJA Amendments' Core/Noncore Allocation of Federal Bankruptcy Jurisdiction

Congress's response to the *Marathon* holding was the Bankruptcy Amendments and Federal Judgeship Act (BAFJA) of 1984, which put in place the current bankruptcy court and jurisdictional structure. The 1984 BAFJA amendments enacted what is essentially a return to a system of jurisdiction by referral, similar to that of the 1898 Act. The BAFJA amendments retained the bankruptcy courts for each district. A bankruptcy judge is a non-Article III "unit of the district court," with the bankruptcy judge serving "as a judicial officer of the district court." [FN70] Bankruptcy judges are appointed by the circuit courts of appeals for 14-year terms. [FN71]

The 1984 BAFJA amendments also retained the 1978 Reform Act's broad grant of bankruptcy jurisdiction over any matter "related to" a bankruptcy case. As under both the 1898 Act and the Reform Act, federal district courts continue to be the initial repositories of bankruptcy jurisdiction, with the BAFJA jurisdictional grant being exactly the same as that of the Reform Act: "original and exclusive jurisdiction of all [bankruptcy] cases" and "original but not exclusive jurisdiction of all civil proceedings arising under [the Bankruptcy Code], or arising in or related to [bankruptcy] cases." [FN72] Unlike the Reform Act, however, the BAFJA amendments do not commit all of this jurisdiction to bankruptcy judges.

The BAFJA amendments permit the district courts to refer to bankruptcy judges all bankruptcy cases and proceedings within the district court's broad bankruptcy jurisdiction. [FN73] Every judicial district, by local rule, has provided that all bankruptcy cases and proceedings will be referred automatically to the bankruptcy court. Yet, the power of a bankruptcy judge with respect to a referred proceeding differs markedly depending upon whether the proceeding constitutes what the statute denominates a "core proceeding