

Consumer Update 2013

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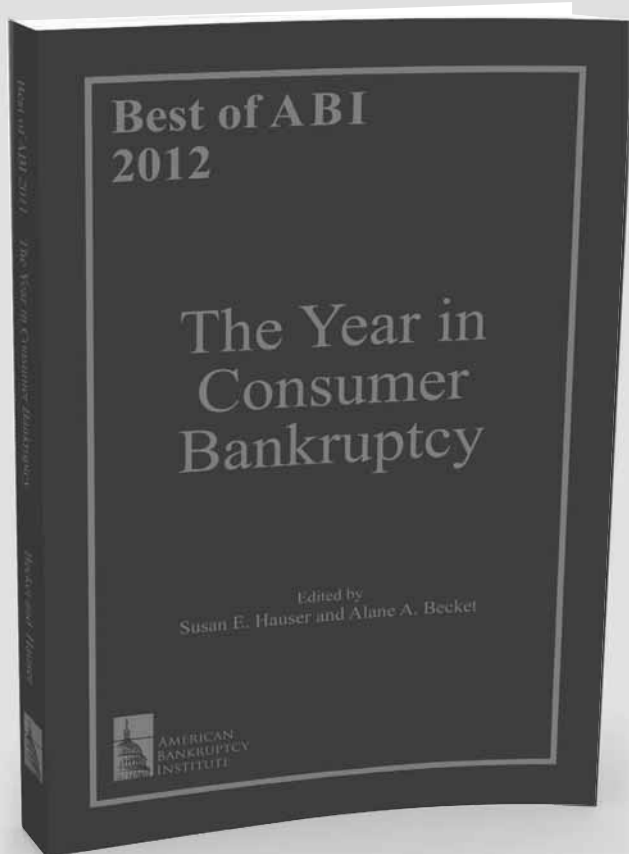
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CONSUMER LAW UPDATE

**Cases reported from January 1, 2012 through
December 31, 2012**

Prepared for Federal Judicial Center

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Jurisdiction

***Stern* applied to withdraw reference.** The district court withdrew the reference of the Chapter 13 debtor's adversary proceeding challenging a foreclosure sale, holding that under *Stern v. Marshall*, 131 S.Ct. 2594 (2011), the bankruptcy court did not have authority to enter a final order. "Debtor's adversary complaint is a state law wrongful foreclosure action which clearly could have been filed in state court and would not be 'resolved in the process of ruling on a creditor's proof of claim.'" *Salazar v. U.S. Bank Nat'l Assoc. (In re Salazar)*, 2012 WL 280759 (S.D. Cal. Jan. 31, 2012).

Bankruptcy court had authority to submit proposed findings and conclusions in core proceeding, involving proof of claim issue. In a proceeding remanded by the circuit court, 665 F.3d 906, after which the bankruptcy court revised its summary judgment decision into a recommended one, 464 B.R. 807, the district court held that, although the proceeding was core, as found by the circuit court, and 28 U.S.C. § 157(c)(1) does not explicitly authorize proposed findings and conclusions in core proceedings, the bankruptcy court did not exceed its statutory authority in such a recommendation. "When § 157 is read in light of *Stern*, it seems obvious that bankruptcy courts have authority to issue proposed findings of fact and conclusions of law in core proceedings in which they lack authority to enter final judgments." The proceeding involved Aurora Health Care's violation of a state statute when it attached unredacted medical information to its proofs of claim. The district court denied the recommended summary judgment and withdrew the reference. *Ortiz v. Aurora Health Care, Inc. (In re Ortiz)*, 477 B.R. 714 (E.D. Wis. 2012).

***Stern* didn't prevent liquidation of claim and determination of discharge exception.**

The bankruptcy court concluded that it had subject matter jurisdiction and constitutional authority to determine § 523(a)(2) exception from discharge, which required liquidation of the debt and consideration of Texas Deceptive Trade Practices Act damages, which could be trebled. *Stern v. Marshall*, 131 S.Ct. 2594 (2011) "did not implicate this Court's authority to hear and finally determine whether a creditor's claim is excepted from a debtor's discharge . . ., even if the Court is required to first liquidate the creditor's claim in that process." Citing *In re Morrison*, 555 F.3d 473 (5th Cir. 2009), for authority of the bankruptcy court to enter judgment on unliquidated claim as part of discharge determination. Debtor fraudulently made misrepresentations to franchisee to induce purchase of restaurant franchise. Damages were down payment and loan application costs, trebled under Texas Act. *Farooqi v. Carroll (In re Carroll)*, 464 B.R. 293 (Bankr. N.D. Tex. 2011).

Appeals

Certified appeal of interlocutory order discussed. In a decision rejecting use of § 506(d) as a means to void an unsecured junior mortgage, the Tenth Circuit discussed its jurisdiction over an appeal from a district court order in an interlocutory appeal from the bankruptcy court. The bankruptcy court had denied confirmation of a plan that proposed to use § 506(d) to void the second mortgage, and that denial was not a final order. On

interlocutory appeal, the district court affirmed and “purported to certify its interlocutory appeal for a further interlocutory appeal to the [circuit] court under 28 U.S.C. § 158(d)(2)(A).” Although the circuit panel questioned whether that could be done, and engaged in an interesting discussion of interlocutory appeals, the panel ultimately reached the merits, because subsequent to the original appeal, the bankruptcy court had confirmed another plan, putting finality on the disputed confirmation issue. *Woolsey v. Citibank, N.A. (In re Woolsey)*, 696 F.3d 1266 (10th Cir. 2012).

Automatic Stay

IRS did not violate stay by delay in refund. The temporary “freeze” by IRS in manually processing a refund, while it decided whether to file a motion concerning plan default or setoff, and to determine if the refund would be payable to anyone except the debtors, did not violate §§ 362(a)(3) or (6). Also, the hold by IRS did not violate the confirmed plan’s provision concerning payment of creditors, including IRS. “This is not a case where the IRS sought to unilaterally vary the plan’s terms; it is a case where the IRS halted automatic payment of the refund to consider its rights and responsibilities with regard to the Harchar’s bankruptcy, and then filed a motion for relief in the bankruptcy court, as it was expressly permitted to do.” The court also cited *Pertuso v. Ford Motor Credit Co.*, 233 F.3d 417 (6th Cir. 2000), to support its conclusion that there was no private right of action for damages under § 1327. *Harchar v. United States of America (In re Harchar)*, 694 F.3d 639 (6th Cir. 2012).

Chapter 7 debtor had standing for fees as stay violation damages. The Chapter 7 debtor’s former spouse and her attorney willfully violated the stay by pursuing state court enforcement of spousal support, and the bankruptcy court awarded the debtor \$42,358.36 damages, primarily attorney fees. The Fifth Circuit held that the debtor had standing to bring the stay violation action, and §§ 362(b)(1) and (2) exceptions did not protect the creditor and her attorney, since the state action was a collection action, and it was pursued without regard to whether there was non-bankruptcy estate property from which collection could be made. The fee award was affirmed under § 362(k), since it was for violation of the stay. *MacMaster v. Small (In re Small)*, 2012 WL 3531516 (5th Cir. Aug. 16, 2012), slip copy.

Stay did not preclude entry of contempt related to injunction enforcement. Although the debtor had filed Chapter 13, the district court was not stayed from contempt proceedings in a suit in which an injunction had been entered, preventing the debtor’s trademark infringement and other torts, related to a restaurant name. “Because this matter involves [the debtor’s] use of the restaurant to commit a tort, specifically the tort of trademark and service mark infringement, application of the automatic stay would permit [the debtor] to continue to commit this tort. [C]ommission of a tort is not protected by the Bankruptcy Code.” The opinion relies on this policy statement, without reference to any specific Code exception from the stay. *Dominic’s Restaurant of Dayton, Inc. v. Mantia*, 683 F.3d 757 (6th Cir. 2012).

Stay relief appropriate when bankruptcy court deferred to state court. Under factors of *In re Robbins*, 964 F.2d 342 (4th Cir. 1992), the bankruptcy court properly abstained, deferring to state court with expertise in a real property dispute, and after stay relief was granted, the state court appeals process was completed. The bankruptcy court also properly dismissed the debtor's adversary proceeding, without deciding whether the Chapter 13 debtor had standing to pursue § 522(a)(3) avoidance, since collateral estoppel applied to the state court judgment. *Lee v. Anasti (In re Lee)*, 2012 WL 29185 (4th Cir. 2012), slip copy.

Rooker-Feldman and issue preclusion did not prevent bankruptcy court from deciding creditor's standing for stay relief. Reversing and remanding the BAP's decision, 2011 WL 1807015, the Circuit panel held that while the debtors had lost on their standing argument in state court, it was now Deutsche Bank seeking affirmative stay relief, and its standing issue was not precluded by the state-court's decision. Neither did Rooker-Feldman prevent the bankruptcy court from deciding whether the Bank had standing to seek stay relief. Although the Bank had presented proof that its predecessor had endorsed a note in blank, under Colorado's UCC, the Bank must also prove that it had physical possession of that note. Col. Rev. Stat. § 38-38-100.3(b) defines a "holder of an evidence of debt" as a person "in actual possession of" or "entitled to enforce an evidence of debt." Remand was required to see if the Bank could prove physical possession of the note. *Miller v. Deutsche Bank (In re Miller)*, 666 F.3d 1255 (10th Cir. 2012).

Stay was not in effect in gap period between case dismissal and district court's vacating of dismissal. Notwithstanding the district court's vacating of dismissal of the Chapter 13 case, during the gap period between dismissal and vacating, the automatic stay had terminated and was not retroactively reinstated. The mortgage creditor did not violate the stay by proceeding with foreclosure during the extended gap period. *In re Scarborough*, 2012 WL 70638 (3d Cir. 2012), slip copy.

After plan's surrender of home, debtors lacked standing to appeal stay relief. The confirmed plan surrendered the home to a specific mortgage creditor, but another mortgage creditor then moved for and was granted stay relief. The debtors lacked standing to appeal the stay relief order, since they had surrendered their interest in the property, and they lacked standing to pursue any objections on behalf of the creditor to whom they had surrendered. *Tikhonov v. The Bank of New York Mellon Trust Co. (In re Tikhonov)*, 2012 WL 6554742 (BAP 9th Cir. Dec. 14, 2012), slip copy.

Mortgagee had colorable standing for stay relief. Under California law, party with right under nonbankruptcy law to commence foreclosure may have prudential standing—colorable claim to the property sufficient to seek stay relief. It was not necessary to show possession of the note to have such a colorable claim. Failure of the debtor to make eleven postpetition payments was cause for stay relief. *Marks v. Dockery (In re Marks)*, 2012 WL 6554705 (BAP 9th Cir. Dec. 14, 2012), slip copy.

Factors for annulment of stay. Applying the factors for consideration in annulling the automatic stay, from *In re Fjeldsted*, 293 B.R. 12 (BAP 9th Cir. 2003), the debtor's remaining silent about bankruptcy filing for a long period while state court jury trial went to judgment was cause for denial of annulment of the stay. *Rodarte v. Estates at Monarch Community Assoc. (In re Rodarte)*, 2012 WL 6052046 (BAP 9th Cir. Dec. 6, 2012).

State court clerk did not violate stay by ministerial act. Prior to filing bankruptcy, the debtor had been declared a vexatious litigant by the state court, and the state court clerk's failure to change the designation on a suit in which the person was a defendant rather than plaintiff was a ministerial act that did not violate the automatic stay, and that failure did not deprive the debtor of Due Process rights. The Rooker-Feldman Doctrine prevented the federal court from setting aside the vexatious litigant label that had been imposed three years before the bankruptcy filing. *Beste v. Lewin*, ___ B.R. ___, 2012 WL 5877483 (N.D. Cal. Nov. 20, 2012).

Automatic stay and restitution. The government sought a declaratory judgment that the stay did not prevent enforcement of prepetition restitution judgment. Although the automatic stay did not prevent the federal government from pursuing a criminal action against the debtor, it did prevent proceeding against property of the Chapter 13 estate. The government could proceed in prepetition restitution judgment against an IRA that the debtor claimed as exempt and against two vehicles that were unnecessary, but not against a vehicle that was necessary for the debtor's employment, since wages were necessary to fund the plan. *United States v. Robinson (In re Robinson)*, ___ B.R. ___, 2012 WL 5898497 (Bankr. W.D. Tenn. Nov. 21, 2012).

Contempt sanctions required adversary proceeding. The debtors had filed a motion for contempt sanctions for a stay violation, rather than seeking damages under § 362(k), and the Bankruptcy Appellate Panel held that an adversary proceeding was required, since the underlying issue was whether the vehicle that the creditor had repossessed was property of the estate. Once the creditor took the position that the vehicle was never property of the estate, the bankruptcy court should not have determined the estate's interest outside of an adversary proceeding, but the BAP expressed puzzlement over why the debtors chose to proceed with contempt rather than under § 362(k). *Jahr v. Frank (In re Jahr)*, 2012 WL 3205417 (BAP 9th Cir. Aug. 1, 2012), slip copy.

Debtor entitled to attorney fees on appeal. Distinguishing *Sternberg v. Johnston*, 595 F.3d 937 (9th Cir. 2010), the Bankruptcy Appellate Panel held that attorney fees under § 362(k) were allowable when the debtor defended the damages for stay violation on appeal by the creditor. Defending the appeal was necessary, not only to preserve the damage award, but to "uphold the bankruptcy court's decision that [the creditor] had, indeed, violated the stay. . . . Simply put, Debtor's defense of the bankruptcy court's decision was an extension of her efforts to enforce her automatic stay." In *Sternberg*, the point at which the stay violation had been remedied was clear, but in the current case, the debtor's attorney fees on appeal were part of the enforcement of the stay. *Schwartz-*

Tallard v. America's Servicing Co. (In re Schwartz-Tallard), 473 B.R. 340 (BAP 9th Cir. 2012).

Service of foreclosure complaint was void, but stay violation was not willful. It was undisputed that the mortgage creditor did not have knowledge that the debtor had filed Chapter 13 when it served an amended foreclosure complaint. Although the service was a technical violation of the stay, it was not willful, and the creditor moved for, and obtained, stay relief to foreclose. The debtor was prevented by the *Rooker-Feldman* Doctrine from re-litigating the state court's foreclosure judgment, which was obtained after stay relief had been granted and after the case was dismissed. *In re Kline*, 472 B.R. 98 (BAP 10th Cir. 2012).

"Colorable claim" requirement enforced for § 362(j). The bankruptcy court should not have reached the substantive issue of whether the automatic stay was in effect in a successive Chapter 13, without first determining that the party moving for comfort order that the stay was not in effect had the required standing to seek stay relief. Citing the Tenth Circuit's recent decision, *In re Miller*, 666 F.3d 1255 (10th Cir. 2012), which addressed standing under § 362(d), the BAP held that a movant for an order under § 362(j) must prove that it has a "colorable claim," in this case, a "facially valid security interest," under applicable state law, and the bankruptcy court must determine standing before reaching the substantive issue. *In re Thomas*, 469 B.R. 915 (BAP 10th Cir. 2012).

For discussion of standing for stay relief, see also *In re Lee*, 467 B.R. 906 (BAP 6th Cir. 2012) (In Chapter 11 case, J.P. Morgan Chase Bank and Chase Home Finance merged into one entity, allowing Bank to step into shoes of Chase Home Finance, with right to enforce mortgage, and giving Bank standing to move for stay relief.). See also *In re Balderrama*, 473 B.R. 823 (Bankr. M.D. Fla. 2012) (Discussing person entitled to enforce negotiable instrument under Florida law, when note was payable to specific party, it became a "special instrument," and possession alone would not confer standing to enforce. The party claiming standing must show evidence of valid assignment, proof of debt purchase, or evidence of effective transfer.). See also *In re McFadden*, 471 B.R. 136 (Bankr. D. S.C. 2012) (Discussing satisfaction of business records exception to hearsay rule by servicer's electronic business records, and finding note negotiable under South Carolina's UCC, with stapling of allonges to note sufficient to "affix" them to note. Holder of negotiable note had standing to enforce note and to move for stay relief.).

Foreclosure sale purchaser was party in interest for stay relief. A junior lienholder purchasing property at prepetition foreclosure sale was a party in interest, with standing to move for stay relief to seek possession. It did not matter that the purchaser was not a creditor; its interest in the property was adversely affected by the stay. *In re Bushnell*, 469 B.R. 306 (BAP 8th Cir. 2012).

"Colorable claim" defined for stay relief standing. Citing the Cornell University Law School's Legal Information Institute, a "colorable claim" is "a plausible legal claim. In other words, a claim strong enough to have a reasonable chance of being valid if the legal basis is generally correct and the facts can be proven in court. *The claim need not actually result in a win.*" The Federal National Mortgage Association established a

colorable claim, for constitutional and prudential standing, when it had purchased at foreclosure and timely recorded the trustee's deed. Under California law, once a foreclosure occurs and the trustee's deed is recorded, title is transferred and the original owner has no interest in the property. *Elstner-Bailey v. Federal National Mortgage Assoc. (In re Elstner-Bailey)*, 2011 WL 6934490 (BAP 9th Cir. Oct. 4, 2011), slip copy.

Good faith not in play under § 362(c)(3)(A). When first case had been dismissed, for failure to provide required tax returns, second case filed within one year was properly dismissed under § 362(c)(3)(A). Since debtor had not moved to extend stay, the good faith element of § 362(c)(3)(B) did not become a factor, and any motion to extend the stay would have been untimely by the time the bankruptcy court granted relief under (c)(3)(A). The court did not err in retroactively applying *In re Resnick*, 446 B.R. 362 (BAP 9th Cir. 2011), holding that the stay had terminated thirty days from the second filing as to the debtor and property of the estate. *Ortola v. Ortola (In re Ortola)*, 2011 WL 7145793 (BAP 9th Cir. Dec. 16, 2011), slip opinion.

Discrimination

Refusal to grant additional student loan was not discrimination. The Chapter 13 debtor filed an adversary proceeding alleging that Sallie Mae had discriminated and interfered with her fresh start by refusing to grant additional student loans, but the lender's policy of not granting additional loans when existing loans were in default did not improperly interfere with the fresh start, nor did the refusal violate the automatic stay or improperly discriminate. Discussing § 525(c), the court found that Sallie Mae declined another student loan because the debtor was in default of existing loans, not because the debtor had filed Chapter 13. The debtor's plan proposed to pay 1% of the existing student loan debt, but the debtor had not filed an adversary proceeding to determine undue hardship. *In re Moss*, 470 B.R. 505 (Bankr. E.D. Wisc. 2012).

Avoidance actions

Forged document deprived assignee of equitable mortgage. Applying Michigan law, the assignee inherited the mortgage subject to all equitable defenses, and the debtors established that their signatures to the mortgage had been forged. Although an assignee may be entitled to an equitable mortgage under some circumstances, here the forged mortgage was void ab initio. The assignee was not entitled to an equitable mortgage. *Sutter v. U.S. Nat'l Bank (In re Sutter)*, 665 F.3d 722 (6th Cir. 2012).

Partial avoidance of judgment lien affirmed. A judgment creditor paid off a prior lien on a vehicle and the BAP affirmed the holding that the satisfaction of the debtors' consensual lien with the bank was not avoidable, although the separate judgment lien was avoidable. Although the judgment lien creditor paid off the bank after its lien was fixed, it held two liens—the judgment lien and the consensual lien, with the creditor stepping into the shoes of the bank. *Carter v. Estate of Heimer (In re Carter)*, 466 B.R. 468 (BAP 8th Cir. 2012).

Judicial lien avoidance order not entered until debtors obtained discharge.

Although a judicial lien was avoidable, as impairing the debtors' exemptions, an avoidance order would not be entered until the Chapter 13 debtors received discharge, with the court finding that § 349(b)'s provision that a lien was reinstated upon case dismissal was not total protection for the creditor, and the practical difficulty of reinstating a lien was noted. For example, if a debtor sold the property after lien avoidance and the case were then dismissed, lien reinstatement would be meaningless. The court found delay of avoidance to be the majority view, but noted the minority view that 522(f) lien avoidance is not subject to a subsequent event. *In re Harris*, 482 B.R. 899 (Bankr. N.D. Ill. 2012).

Trustee failed to prove actual or constructive fraud in marital dissolution property division.

Although the Chapter 7 debtor was insolvent when Illinois divorce court approved property division, the trustee failed to prove that the property debtor received was not reasonable equivalent value for what he would have received under the Illinois Dissolution Act, and the trustee did not prove that the debtor had acted with intent to defraud creditors. Also, there was no proof of an actual creditor in existence at the time of division of proceeds from sale of the marital home, preventing the trustee from using the strong-arm avoidance under state law. *Voiland v. Kimmell (In re Kimmell)*, 480 B.R. 876 (Bankr. N.D. Ill. 2012).

Lien avoidance denied when debtor not entitled to homestead exemption.

Applying *In re Morgan*, 149 B.R. 147 (BAP 9th Cir. 1993), at the petition date the debtor was not entitled to a homestead exemption in property located in Montana, when the debtor was living and working in California. With no exemption entitlement, the debtor's motion to avoid judicial liens was denied. *In re Anderson*, 2012 WL 1110056 (Bankr. D. Mont. Apr. 2, 2012), slip copy.

Homestead exemption applied to real property as a whole, permitting lien avoidance against the real property and all structures.

Applying Tennessee's homestead exemption, which protected the real property, not just the debtors' principal residence, the debtors could avoid a judicial lien as to the real property, their residence, and a separate farmhouse. *In re Young*, 471 B.R. 715 (Bankr. E.D. Tenn. 2012).

Property of Estate

Judicial estoppel did not bar trustee's pursuit of negligence claim.

The Chapter 7 debtor did not schedule a prepetition claim for negligence related to an automobile accident, but judicial estoppel did not prevent the trustee's substitution as the real party in interest, agreeing with other circuit authority reaching this conclusion. Moreover, the debtor had told the trustee of the cause of action, and his attorney communicated with the trustee about how to handle the litigation, causing the panel to find that the debtor's omission was inadvertent, and that judicial estoppel did not bar the prepetition suit filed by the debtor. *Stephenson v. Malloy*, 700 F.3d 265 (6th Cir. 2012).

Chapter 7 debtor lacked authority to pursue age discrimination suit. The debtor was fired four days before filing Chapter 7, and her age discrimination cause of action became property of bankruptcy estate, depriving the debtor of authority to pursue the action after her discharge, when the trustee had not abandoned it. The trustee knew of the cause of action, but the schedules were never amended to disclose it, and the trustee hired counsel to pursue the action after discharge was entered. Without reaching the issue of judicial estoppel, the panel held that the former debtor simply had no authority over an estate asset. The district's court's dismissal was vacated, with substitution of the trustee as plaintiff ordered. *Auday v. Wet Seal Retail, Inc.*, 698 F.3d 902 (6th Cir. 2012).

Judicial estoppel didn't prevent debtor's pursuit of action for benefit of creditors. Although the Chapter 13 debtor did not disclose a cause of action in the original case, it had now been reopened and schedules amended to disclose the action. The trustee either could litigate the cause of action, or the debtor could pursue it for benefit of creditors. To prevent pursuit of the action would "undermine the interests of creditors." *Rainey v. United Parcel Service, Inc.*, 2012 WL 753680 (7th Cir. Mar. 9, 2012), slip copy.

Trustee's sale of tenants in common home properly denied. The Chapter 7 trustee attempted to sell a residence owned as tenants in common by the debtor and estranged spouse, free and clear of spouse's interest, but the bankruptcy court found that the equity in the property was solely attributable to the spouse's financial contributions. The benefit to the estate did not outweigh the detriment to the spouse, and the bankruptcy court did not err in denying the sale under § 362(h)(3). *Lovald v. Tennyson (In re Wolk)*, 686 F.3d 938 (8th Cir. 2012).

Turnover to trustee was not allowed on unjust enrichment theory. The Chapter 7 trustee sued defendants for recovery of money owed to the debtor, on a theory of unjust enrichment, but such a cause of action is not available under § 542. *Lovald v. Falzerano (In re Falzerano)*, 686 F.3d 885 (8th Cir. 2012).

Judicial estoppel barred employment cause of action. With a dissent, the Fifth Circuit's panel found no abuse of discretion by the district court's dismissal of a Chapter 13 debtor's suit alleging wrongful employment termination, on grounds of judicial estoppel. The cause of action was not disclosed in the schedules, and there was no factual support for the debtor's argument that the failure to disclose was inadvertent. The dissent asserted that the district court could have estopped recovery for the debtor personally, while allowing recovery for the benefit of the bankruptcy estate. *Love v. Tyson Foods, Inc.*, 677 F.3d 258 (5th Cir. 2012). See also *Guay v. Burack*, 677 F.3d 10 (1st Cir. 2012) (Chapter 7 debtor was judicially estopped from pursuing claims that were not disclosed by amending schedule prior to receiving discharge.).

Levied funds became property of estate, subject to turnover. Prior to the Chapter 7 filing, the debtor's account had been levied upon, but the applicable California statute did not specify that ownership interest in the funds had been transferred upon levy, and the debtor continued to have an exempt property interest in the levied funds. There was still an interest that became property of the bankruptcy estate, and the turnover order enabled

the debtor to exercise the exemption right. *Collect Access LLC v. Hernandez (in re Hernandez)*, ___ B.R. ___, 2012 WL 6522748 (BAP 9th Cir. Dec. 14, 2012).

Abandonment under § 554(c) and (d)’s “unless the court orders otherwise.” Although an unscheduled receivable had not been abandoned formally, the bankruptcy court properly exercised its discretion in deeming the receivable abandoned under the “unless the court orders otherwise” language of § 554(c) and (d). The receivable was a debt owing from the Chapter 7 debtor’s former spouse, and, although not scheduled, the trustee had been told of the receivable at the § 341 meeting, as well as advised of competing claims for unpaid child support, but the trustee did not administer the asset and then filed a no asset report. The debtor and former spouse had entered into a settlement of contested proceedings in the divorce court, and abandonment of the receivable to the former spouse was ordered by the bankruptcy court to avoid a miscarriage of justice. *In re DeGroot*, ___ B.R. ___, 2012 WL 6719113 (BAP 6th Cir. Dec. 27, 2012).

Which state’s law controls validity of spendthrift trust? In a Chapter 7 case filed in California, the Bankruptcy Appellate Panel examined choice of law rules for a spendthrift trust created under Hawaii law, which fully recognized validity of the trust if not self-settled, while California law allows a judgment creditor to obtain up to 25% of funds otherwise available to the trust beneficiary. California had no greater interest than Hawaii in whether the spendthrift provision was valid and the trust corpus was excluded from the bankruptcy estate, under Hawaii’s law. The panel also affirmed the conclusion that § 541(a)(5)(A) did not apply to inter vivos trusts; therefore, postpetition distributions to the debtor did not become property of the estate. *Green v. Zukerkorn (In re Zukerkorn)*, ___ B.R. ___, 2012 WL 6608887 (BAP 9th Cir. Dec. 19, 2012).

Spendthrift trust principal protected. A Chapter 7 trustee, through strong-arm power, was in the position of judgment creditors, who under the California Probate Code could access amounts payable, not yet distributed, to a spendthrift trust beneficiary, but the Probate Code placed a restriction, limiting the trustee to 25% of the amount payable, to the extent it was not necessary for support of the debtor/ beneficiary. *Bendon v. Reynolds (In re Reynolds)*, 479 B.R. 67 (BAP 9th Cir. 2012).

Tax refund not property of Chapter 7 estate. During Chapter 13 phase of case, debtors received and spent tax refunds that were property of the estate, but the case was converted before confirmation to Chapter 7, and under § 348(f)(1)(A), the tax refunds were not subject to turnover to the Chapter 7 trustee because the debtors no longer had possession of those funds. If the debtors had remained in Chapter 13, they would have been required to account for the refunds, which would have been available to creditors under the hypothetical Chapter 7 liquidation test, but under the plain language of § 348(f)(1)(A), the refunds which were spent for the debtors’ normal living expenses, were not property of the Chapter 7 estate. The opinion discusses the range of opinions interpreting § 348(f)(1)(A). *Warfield v. Salazar (In re Salazar)*, 465 B.R. 875 (BAP 9th Cir. 2012).

Lis pendens did not prevent bankruptcy estate from having interest in property. When the Chapter 13 debtor had acquired property by prepetition quit claim deed from his mother, who was subject of a lis pendens lien under Ohio law, the bankruptcy estate had an interest in the property, subject to the lien; the lien's existence did not prevent the automatic stay's prohibition of a foreclosure. Continuing with the scheduled foreclosure was a willful stay violation, and the bankruptcy court did not abuse its discretion in awarding reasonable attorney fees and costs as damages under § 362(k). *In re Webb*, 2012 WL 2329051 (BAP 6th Cir. 2012), slip copy.

Chapter 7 debtor's tax refund was property of estate. Finding that the debtor's tax refund was based solely on his prepetition earnings, the refund became property of the estate and was subject to turnover to the trustee. The interest in the refund was determined under the IRS Code and Illinois law, under which there was no marital property concept that would give the spouse an interest in the refund, unless the spouses were in a marital dissolution or separation proceeding. *In re Ruhl*, 474 B.R. 596 (Bankr. N.D. Ill. 2012).

Exemptions

Debtors not entitled to exempt portion of federal child tax credit. Construing the Colorado exemption for "the full amount of any federal or state income tax refund attributed to an earned income tax credit or child tax credit," the Tenth Circuit reversed its BAP, holding that the state exemption applied only to "refunds" and not to a nonrefundable portion of the child tax credit. The nonrefundable portion of the credit on tax form 1040 never gave rise to a refund. Only items treated as a payment, including the earned income tax credit, produced a refund, to the extent they exceeded tax liability. Since no refund was triggered by the child tax credit, there was no exemption under the state law. *Cohen v. Borgman (In re Borgman)*, 698 F.3d 1255 (10th Cir. 2012).

Surcharge of exempt assets approved. The First Circuit approved use of § 105(a) by the bankruptcy court in surcharging exempt assets, when the debtor had concealed non-exempt assets from the trustee. Allowing the surcharge for the trustee's expenses was necessary when the debtor acted fraudulently in concealing assets, "both to protect the integrity of the bankruptcy process and to ensure that a debtor exempts an amount no greater than . . . the Bankruptcy Code permits." In so holding, the First Circuit agreed with the Ninth, *Latman v. Burdette*, 366 F.3d 774 (9th Cir. 2004), that an equitable remedy was appropriate, but the Tenth Circuit held in *In re Scrivner*, 535 F.3d 1258 (10th Cir. 2008), *cert. denied*, 556 U.S. 1126 (2009), that a surcharge was inconsistent with the Code's exemption provisions and beyond the bankruptcy court's equitable authority. *Malley v. Agin*, 693 F.3d 28 (1st Cir. 2012).

Michigan's bankruptcy-specific exemptions are constitutional. Reversing its Bankruptcy Appellate Panel, 455 B.R. 590 (BAP 6th Cir. 2011), the Sixth Circuit panel agreed with the bankruptcy court that Michigan's law was constitutional, in permitting debtors to choose between the § 522(d) exemptions and state exemptions that were available only to debtors in bankruptcy. The bankruptcy-specific homestead exemption,

for example, is more generous than § 522(d)(1) and the state's non-bankruptcy homestead, so it was the trustee who objected to the debtor's choice of the more generous exemption. Under the Uniformity Clause of the Constitution, § 522 and the Michigan statute operated uniformly, with "Michigan's decision to distinguish between debtors in bankruptcy and those outside of bankruptcy mak[ing] sense." *Richardson v. Schafer (In re Schafer)*, 689 F.3d 601 (6th Cir. 2012). *Accord Williamson v. Westby (In re Westby)*, BAP No. KS-12-027 (BAP 10th Cir. Feb. 4, 2012) (Kansas' bankruptcy-only exemption for tax refunds attributable to earned income credit was constitutional.).

Retirement account not exempt under California exemption. The Chapter 7 debtor claimed exemption in a Met-Life Non-qualified Retirement Account that she had received as a part of the marital settlement agreement with her former spouse, claiming the exemption under California's exemption for alimony, support or maintenance to the extent reasonably necessary. The trustee objected to the exemption, and the disallowance of the exemption was affirmed, without deciding whether the § 523(a)(5) criteria should be applied to the exemption analysis. Instead, the panel found the marital settlement agreement's language to be clear and that the retirement account was intended to be a part of property division, rather than for support. *Diener v. McBeth (In re Diener)*, 483 B.R. 196 (BAP 9th Cir. 2012).

State common law did not create exemption under opt out. The fact that Missouri had opted out of the federal bankruptcy exemptions did not mean that the debtors could rely on state common law to exempt a personal injury claim. The state's opt out statute refers to other state statutes. *Abdul-Rahim v. LaBarge (In re Abdul-Rahim)*, 477 B.R. 747 (BAP 8th Cir. 2012).

Kansas bankruptcy-only exemption was constitutional. Chapter 7 trustees objected to debtors' use of a Kansas exemption, contending that the exemption, which was only available in bankruptcy, was unconstitutional. At issue was an exemption in the earned income tax credit, which the 2011 Kansas legislature allowed as exempt for those Kansans filing for bankruptcy relief. Engaging in an analysis of constitutional issues, the court concluded: "Because the Bankruptcy Code expressly accommodates the several states' exemption schemes by allowing states to 'opt out' of the federal exemptions in 11 U.S.C. § 522(b) and because this exemption will apply uniformly to all Kansas debtors in bankruptcy, the Act does not violate either the Bankruptcy or Supremacy Clauses." *In re Earned Income Tax Credit Exemption Constitutional Challenge Cases*, 477 B.R. 791 (Bankr. D. Kan. 2012), *aff'd*, *Williamson v. Westby (In re Westby)*, BAP No. KS-12-027 (BAP 10th Cir. Feb. 4, 2012).

Debtors entitled to exemptions in cash surrender values of life insurance and annuity contracts under Arizona law. Reversing its Bankruptcy Appellate Panel, at 440 B.R. 814, and agreeing with the bankruptcy court, Chapter 7 debtors were entitled to Arizona's exemptions in cash surrender value of life insurance policies and proceeds of annuity contracts. The court construed the Arizona statute to allow exemption by the debtors under the statutory language that the contracts either named as beneficiary the debtor's surviving spouse, child, parent, brother or sister, or "any other dependent family

member.” The word “other” was construed to be a “word of differentiation, establishing that a beneficiary can be either a listed beneficiary or some ‘other’ family member who is dependent.” Both debtors involved in the appeals had a life insurance policy or annuity naming an adult, non-dependent child as beneficiary, and under the court’s construction of the statute, a debtor’s child did not need to be a beneficiary. The cash values were exempt. *Tober v. Lang, et al. (In re Tober)*, 688 F.3d 1160 (9th Cir. 2012).

Trustee, not debtor, entitled to appreciation of oil and gas royalty value. Applying *Schwab v. Reilly*, 130 S.Ct. 2652 (2010), the Chapter 7 debtor was not entitled to the appreciated value of oil and gas lease royalties, after the debtor claimed on Schedule C specific dollar amounts under the § 522(d)(5) wildcard, under which exemptions are for a debtor’s interest in assets, rather than the assets. The claimed exemption was below § 522(d)(5)’s dollar cap, and the debtor did not claim “full” or “100%” interest, only the same dollar amount shown on Schedule B for the asset’s value, with the court noting that *Schwab*’s reference to “FMV” in claiming exemptions was dicta. Here, the debtor’s dollar amount exemption did not give notice to the Chapter 7 trustee that the debtor was attempting to exempt the entire royalty interest, and the “trustee need not have objected to Orton’s exemptions to retain the ability to except the lease from abandonment,” with the trustee entitled to appreciated value of the lease royalties. *In re Orton*, 687 F.3d 612 (3d Cir. 2012).

Trustee’s avoidance of second mortgage prevailed over exemption claim. At the petition date, the debtors had no equity in their home, because of two mortgages, but they scheduled the second mortgage as unsecured and notified the trustee of a defect in its acknowledgement. The Chapter 7 trustee did not object to the exemption claims on the residence, under §§ 522(d)(1) and (5), but the trustee was successful in avoiding the second lien against the home, then moving to value the exemptions on the home at zero, since the avoided lien was for the benefit of the estate under § 551. The property had been sold by the trustee, with some proceeds left after paying the first mortgage. Under *Schwab v. Reilly*, 130 S.Ct. 2652 (2010), the trustee was not required to object to the exemptions, when the debtors had no equity at the time of filing their petition. The debtors’ interests were determined as of the filing date, because at that point the second mortgage had not been avoided, and the debtors were not entitled to benefit from the trustee’s avoidance. The avoidance recovery was a separate asset from the home, in which the debtors had claimed exemption. *In re Messina*, 687 F.3d 74 (3d Cir. 2012).

Inherited IRA exempt under § 522 (d)(12). Affirming the district court and agreeing with *In re Nessa*, 426 B.R. 312 (BAP 8th Cir. 2010), an IRA that the debtor had inherited from her mother was exempt under § 522(d)(12), concluding that the IRA was still a “retirement fund” notwithstanding that it was not directly the debtor’s retirement to which it was tied. The majority of other courts have held that it is not necessary that the IRA be retirement funds belonging to the debtor. The statute is referring to funds that have been set aside for retirement, and an inherited IRA is still exempt from taxation under 26 U.S.C.A. § 408(e), which exempts any individual retirement account. Section 408 is one of the sections referred to in § 522(d)(12). *Chilton v. Moser (In re Chilton)*, 674 F.3d 468 (5th Cir. 2012). *See also Mullen v. Hamlin (In re Hamlin)*, 465 B.R. 863

(BAP 9th Cir. 2012), allowing exemption in an IRA inherited from the debtor's grandmother under § 522(b)(3)(C), which contained the same language as § 522(d)(12). Hamlin had claimed exemption under Arizona statutes, and Arizona had opted out of the § 522(d) exemptions. Section 522(b)(3)(C) has only two requirements: the amount must be retirement funds, and the funds must be in an account that is exempt from taxation under one of the Internal Revenue Code sections specified in § 522(b)(3)(C). The court found support for its conclusion in § 522(b)(4)(C)'s provision that direct transfer of retirement funds from one account to another does not end qualification for exemption.

IRA inherited from relative was exempt. The Chapter 7 debtor had inherited an IRA, which was established by a relative, and the bankruptcy court agreed with the emerging consensus, including the Fifth Circuit's *In re Chilton*, 674 F.3d 486 (5th Cir. 2012), holding that an inherited IRA that was tax exempt under 26 U.S.C. § 408, was exempt under § 522(d)(12). "The Bankruptcy Code requires no forensic analysis in order to determine from where those funds arose. All that the Bankruptcy Code requires is that the funds sought to be invested have been placed in a particular form of a retirement investment vehicle in order to be exempt from taxation." *In re Seeling*, 471 B.R. 320 (Bankr. D. Mass. 2012). See also *In re Reinhart*, 267 P.3d 895 (Utah 2011) (On certification from the Tenth Circuit, the Utah Supreme Court held that strict compliance with IRC qualification of retirement plans was not required for exemption; rather, a retirement plan (here a Keogh) qualified as exempt under state law so long as it substantially complied with IRC requirements.).

Section 522(o)'s term "interest" refers to equity. The phrase in § 522(o) "value of an interest. . .in real property" refers to any increase in monetary value of the real property claimed as the homestead, rather than to a title interpretation of "interest." The Chapter 7 trustee argued that even when there was no equity in the homestead property, the trustee was entitled to an equitable lien, but the BAP affirmed the bankruptcy court's interpretation, holding that § 522(o) was added by BAPCPA "to prevent the fraudulent attempt to build up equity in a homestead." If there is no equity in the property, "there is no value subject to reduction." *In re Willcut*, 472 B.R. 88 (BAP 10th Cir. 2012).

Based on debtors' credibility, homestead exemption was properly denied. The bankruptcy court made a factual determination that the debtors did not intend to reside at a specific property, and the Bankruptcy Appellate Panel deferred to that finding, which was based on credibility of the debtors. *Banks v. Washington Trust Bank, et al. (In re Banks)*, 2012 WL 3205169 (BAP 9th Cir. July 31, 2012), slip copy.

Under Nevada law, mobile kitchen was a vehicle. The Chapter 13 debtors' mobile kitchen, which was used in their barbeque business, was registered with the Nevada Department of Motor Vehicles and had a vehicle identification number, and the bankruptcy court did not err in allowing the vehicle exemption, over the trustee's objection. Nevada is an opt out state, with an exemption for one "vehicle," a term that was distinct from "motor vehicle." *Leavitt v. Alexander (In re Alexander)*, 472 B.R. 815 (BAP 9th Cir. 2012).

Exemption claim of full fair market value invalid. The First Circuit BAP joined other courts in holding that the debtors’ claims of exemptions under § 522(d) for full market value (FMV), without specifying a dollar amount under statutes with monetary caps, were invalid on their face. The trustee’s objections were sustained. The debtors misread *Schwab v. Reilly*, 130 S.Ct. 2652 (2010), which held that if the exemption claim is valid on its face, the trustee would not have to object, so long as the exemption claim was within the statutory cap amount, but the asset itself remained in the estate, subject to sale and paying the debtor’s exemption. No court had construed *Schwab* as allowing the debtor “unfettered authorization. . . to exempt assets in-kind.” *Massey v. Pappalardo (In re Massey)*, 465 B.R. 720 (BAP 1st Cir. 2012). The *Massey* court commented that the proposed amendment to Schedule C is consistent with its opinion.

Claim of 100% equity doesn’t survive trustee objection. Joining other courts, the bankruptcy court held that the debtors’ claim of exemption in “100% of equity” or “100% of FMV” in their residence under § 522(d)(1) did not survive the trustee’s objection; “by claiming a *percentage* of value as exempt, as opposed to an actual dollar figure, [the debtors] were essentially saying ‘Trustee, you figure out what [the dollar amount of the exemption] is supposed to be.’” To satisfy the best interests of creditors test, the trustee must be able to calculate the value of assets, less any exemption. Limited asset exemptions, such as § 522(d)(1) permit an exemption only in the debtor’s “interest” in the asset, up to a dollar limitation. “As the *Schwab* court explained, and repeatedly emphasized, where the exemption statute provides a limited-interest exemption, only a defined monetary interest in the property is removed from the bankruptcy estate—not necessarily the value of the entire property.” For the § 522(d)(1) exemption, a claim of “100% of equity” or “100% of FMV” does not adequately describe the allowed exemption. “At its core, *Schwab* was not about the validity of any particular exemption claim, . . .but about *notice* to interested parties as to what exemption in particular property the debtor had actually claimed, and, consequently, whether it ‘constitute[d] a claim of exemption to which an interested party must object under § 522(l).’” The *Schwab* Court’s example of “100% of FMV. . .has nothing to do with the ‘proper’ way to claim a particular exemption under a particular exemption statute. The Court was merely demonstrating the type of language that may be used to show the world that the debtor is attempting to exempt an asset in its entirety, regardless of its actual value. . . .The *Schwab* Court was *not*, as the Debtors have argued, outlining a procedure by which an exemption claimed under a limited-interest exemption statute could be legitimately converted into an exemption in-kind. Thus, to require the Debtors here to amend Schedule C to state a specific dollar value for their claimed (d)(1) exemption does not ‘eviscerate’ any ‘rights’ established under *Schwab* and does not prevent the Debtors from ‘employing’ any legitimate ‘strategy’ suggested by the Supreme Court.” In footnote 14, the court discusses the preliminary draft of the proposed amended Schedule C, and finds it consistent with its opinion. *In re Luckham*, 464 B.R. 67 (Bankr. D. Mass. 2012).

Cap under state statute prevents exemption for more. The debtor’s reliance on *Schwab* was misplaced when she claimed 100% fair market value of her vehicle, \$12,000, as exempt, but the applicable Arizona statute had a cap of \$5,000. *Schwab*’s suggestion of claiming 100% FMV did not mean that such an exemption would be valid

if the applicable statute had a cap and fair market value exceeded that cap. Also, the debtor's claim that an annuity was excluded from the estate under § 541(c)(2) was invalid, when there was no support in the annuity documents that it was a trust under applicable Arizona law. *Messer v. Maney (In re Messer)*, 2012 WL 762828 (BAP 9th Cir. Mar. 9, 2012), slip copy.

Res judicata effect of first order barred exemption. The debtor claimed exemption in an annuity under various Missouri statutes and the bankruptcy court sustained the Chapter 7 trustee's objection; rather than appeal, the debtor amended Schedule C again, claiming exemption in the same annuity under other state statutes. The BAP held that the debtor should have litigated issues about her exemptions under all of the state statutes before allowing a final order to go down. Despite the amended Schedule C, "these claims share a common nucleus of operative fact in that they involve an interpretation of the Annuity and the Debtor's rights thereunder." The annuity had not changed, and the same parties were involved in both hearings. Even if res judicata had not applied, the BAP held the insurance statutes the debtor tried to use for exemption did not apply to the annuity. *Bryan v. Staton (In re Bryan)*, 466 B.R. 460 (BAP 8th Cir. 2012).

Section 522(p) applied to interest re-conveyed within 1215 days. The Chapter 7 debtor had acquired an interest in his residence, when the trust over which debtor acted as trustee re-conveyed residential property to the debtor within the 1215 days before bankruptcy filing. The debtor had previously conveyed the property to the trust to protect it from creditors and for the benefit of his sons. Although during the trust's recorded ownership of the property the debtor acted as if he owned the property, paying all expenses, mortgage and taxes from a personal account, the debtor had acquired an interest in the property upon its re-conveyance to him within the 1215 days, for purposes of § 522(p)'s cap on the homestead exemption. *In re Stella*, 470 B.R. 1 (Bankr. D. Mass. 2012).

Debtor ineligible for state exemptions may claim under § 522(d) and federal law did not preempt state exemption law. The debtor filing in Kansas was not eligible for Kansas exemptions because she had not lived there the required 730 days, and she was not eligible for Nebraska exemptions, which were restricted to use by its residents. The trustee objected to use of the more generous § 522(d) exemptions, asserting that federal law preempted Nebraska's territorial limitation, but the court could not "conclude that Congress intended to preempt state exemption law when it enacted a statute that expressly provides for state law to apply when the debtor chooses, and, indeed, to apply exclusively when the state opts out of the federal exemption scheme. That is the antithesis of preemption." Since both Kansas and Nebraska exemptions were unavailable, the debtor could use the § 522(d) exemptions, under § 522(b)'s hanging paragraph. *In re Long*, 470 B.R. 186 (Bankr. D. Kan. 2012).

Transfer of homestead between debtors within 1215 days triggered cap. When the Chapter 7 debtors had transferred their homestead property between themselves within the 1215 days before filing, the exemption was subject to § 522(p)'s \$146,450 cap, but each debtor was entitled to the capped exemption under § 522(m). The fact that the

debtors had continually resided in the residence as their homestead did not overcome the effect of the transfer between spouses. After transfer to the wife, the property had been transferred back as tenants by entirety. *In re Gentile*, 483 B.R. 50 (Bankr. D. Mass. 2012).

Kansas law permitted homestead exemption after transfer to self-settled trust, and § 522(p) was not triggered. Under Kansas law, a debtor may claim residential exemption in an equitable interest in land, after transfer of the legal title to a self-settled, living, revocable trust. Here, the trust had transferred legal title back to the debtor within 1215 days, to enable the debtor to mortgage the property. When the trust deeded the property back, the debtor acquired no equity value that he did not already have under his equitable interest; therefore, § 522(p)'s cap was not triggered. The court distinguished a First Circuit opinion, *Aroesty v. Bankowski (In re Aroesty)*, 385 B.R. (BAP 1st Cir. 2008), on the basis of difference in Massachusetts and Kansas homestead law. *In re Peake*, 480 B.R. 367 (Bankr. D. Kan. 2012).

Eligibility—Credit Counseling

Completion of credit counseling day after filing was cause for dismissal. Affirming the bankruptcy court, the BAP held that when the debtor did not complete the required credit counseling until the day after filing Chapter 13, the debtor was ineligible. The case was properly dismissed. The debtor had completed an online portion of the counseling but did not complete the telephonic portion before commencement of the case. *In re Ingram*, 460 B.R. 904 (BAP 6th Cir. 2011). See also *Gibson v. Dockery (In re Gibson)*, 2011 WL 7145612 (BAP 9th Cir. 2011), slip opinion. Section 109(h) requirement is clear; unless one of stated exceptions apply, individual may not be debtor unless she has received credit counseling prior to filing. Completion of counseling four days after filing meant debtor was not eligible and case was properly dismissed. Even though court dismissed sua sponte, the debtor had sufficient notice of consequences, including through the warning in Exhibit D to Official Form 1. The debtor was also told by court clerk staff that prepetition counseling was essential.

Chapter 7 Issues

Attorney Issues

Permanent disbarment was within bankruptcy court's power. An attorney representing Chapter 7 and 13 debtors was permanently disbarred by the bankruptcy court for multiple causes, including false statements in petitions concerning debtors' county of residence, failure to timely pay filing fees, the attorney's own pro se Chapter 7 containing false statements and incomplete disclosures (including transposing first and middle names to mislead creditors), misappropriating client funds, and "widespread" ethical violations. The bankruptcy court had authority to permanently disbar the attorney from practice in that district, including under Rule 9011(c), § 526(a)(5), and inherent authority. There was no abuse of discretion. *Parker v. Jacobs (In re Parker)*, 466 B.R. 542 (M.D. Ala. 2012).

Debtor's attorney sanctioned for filing for improper purpose. The Chapter 13 debtor's attorney was sanctioned \$10,000 fees, payable to the mortgage creditor's attorney, when the case was filed solely to frustrate and stall the creditor. The attorney had represented the debtor in a prior Chapter 7 and had represented her husband in another filing, with the current filing made when eviction proceedings were about to begin in state court. A reasonable inquiry was not made under Rule 9011, the debtor had insufficient income to treat the mortgage claim, the debtor was not the owner of the property at issue, the petition improperly listed a d/b/a name as co-debtor, the case involved a two-party dispute, and the petition and Form B22C misrepresented the debtor's employment and income. Sanctions were appropriate under Rule 9011(c), as well as under § 105(a) and 28 U.S.C. § 1927 (under the latter, the court found that the debtor's attorney had multiplied proceedings unreasonably and vexatiously, causing larger fees to the objecting creditor). *In re Antonelli*, 2012 WL 280722 (Bankr. D. N.J. Jan. 30, 2012), slip copy.

Chapter 7 Trustee Fees

Statutory trustee fee should not be reduced, absent extraordinary circumstances. The bankruptcy court reduced the Chapter 7 trustee's fees, based on the time spent and lack of complexity in collecting state tax refunds, but the Bankruptcy Appellate Panel reversed, holding that the statutory fee, which was based on distributions in the case, should not be reduced, absent a showing of extraordinary circumstance. By adding § 330(a)(7) in BAPCPA, Congress treated the § 326 fee as a commission, presumed to be reasonable, if requested by the trustee at the statutory rate. *Hopkins v. Asset Acceptance LLC (In re Salgado-Nava)*, 473 B.R. 911 (BAP 9th Cir. 2012).

Means Test

Debtors could not deduct contractual secured payments for home to be surrendered. The above median Chapter 7 debtors were not permitted to deduct mortgage payments on real estate that they intended to surrender. The phrase "scheduled as" in § 707(b)(2)(A)(iii)(I) has been interpreted in different ways, but this court adopted the position that the phrase is "a term of art in bankruptcy parlance that refers to a debtor placing information on the bankruptcy schedules. . . . For a debt to be 'scheduled as contractually due to secured creditors in each month of the 60 months following the date of the filing of the petition,' a debtor's schedules must show a secured payment arising out of a contractual relationship that is due and being paid post-petition. In other words, Schedule J and the Statement of Intention must reflect that the debtor intends to pay the secured creditor on the contractual obligation." Also, applying *Lanning*, a debtor's decision to surrender is "known or virtually certain." A presumption of abuse was also not overcome. *In re Fredman*, 471 B.R. 540 (Bankr. S.D. Ill. 2012). See also *In re Sterrenberg*, 471 B.R. 131 (Bankr. E.D. N.C. 2012) (Debtor could not deduct secured payments on residence, boat and vehicle to be surrendered.).

Dismissal

Ability to pay debts may be considered in abuse dismissal. In applying the § 707(b)(3) totality-of-circumstances test, the bankruptcy court properly considered the debtors' ability to pay debts. "Congress was doubtless aware when it codified the totality-of-circumstances standard that the relevant pre-BAPCPA jurisprudence took into consideration a debtor's ability to pay his or her debts." The court found only one judicial opinion going the other way. *Witcher v. Early (In re Witcher)*, ___ F.3d ___, 2012 WL 6200619 (11th Cir. Dec. 13, 2012).

Case was properly dismissed under totality of circumstances. Although the bankruptcy court denied the U.S. trustee's motion to dismiss on the presumption of abuse standard, it dismissed the case under a totality of circumstances analysis, which was affirmed. The bankruptcy court examined the debtors' income and expenses, finding that voluntary contributions to a 401(k) plan were not reasonably necessary for the debtors' support, that \$238.68 ongoing monthly repayment to a pension loan was disallowed as an expense, and that \$400 monthly payments on a prepetition tax debt were subject to reduction for purposes of the ability-to-pay creditors' evaluation. The bankruptcy court did not err in finding that the debtors had ability to pay creditors over time, and consideration of the debtors' improvement in income postpetition was not error. The case was properly dismissed under § 707(b)(3)(B). *Ng v. Farmer (In re Ng)*, 477 B.R. 118 (BAP 9th Cir. 2012).

Court was not required to dismiss case. The Chapter 7 debtors had filed to stop foreclosure, and the debtors subsequently filed a pleading in a pending state court foreclosure action, alleging lender liability and discrimination. When the debtors then moved to dismiss the Chapter 7 petition, the United States Trustee and secured lender objected, with the bank and Chapter 7 trustee agreeing to settle the debtors' claims against the bank for \$5,000. Under *In re Asbury*, 423 B.R. 525 (BAP 8th Cir. 2010), there is no absolute right to dismiss a Chapter 7 case, with the debtor required to show cause for dismissal. The bankruptcy court found that the debtors' claims against the bank were speculative, and the debtors' schedules had valued the claims at zero. The cause of action belonged to the Chapter 7 trustee, who lacked funds to pursue litigation, and the settlement was within the range of reasonable compromise. *In re Cockhren*, 468 B.R. 838 (BAP 8th Cir. 2012).

Priority Claims

Obligation to former spouse for twenty years was domestic support priority claim. Looking to the law in the circuit where the debtor filed Chapter 7, rather than the law of the circuit where the marital obligation was created, the Eleventh Circuit required the focus to be on the parties' intent at the time the obligation was created, rather than on labels in the agreement, and the intent was that the debtor's obligation functioned as support. Under the "property" section of the marital dissolution agreement was a requirement that the debtor pay \$7,490,000 without interest, with \$31,000 monthly payments over twenty years or so long as the former spouse lived. The spouse had not

worked outside the home for the thirty-seven years of marriage. There was no separate alimony award, there was a significant disparity in the parties' financial position and earning capacity, and the obligation was intended to provide continuing support. *In re Throgmartin*, 462 B.R. 836 (Bankr. M.D. Fla. 2012).

Discharge, Exceptions and Objections

Creditors could not compel arbitration of dischargeability issues. The Ninth Circuit held that the bankruptcy court did not err in refusing to compel arbitration of §§ 523(a)(2), (4) and (6) claims. Noting that the dischargeability claims at issue were within the bankruptcy court's exclusive jurisdiction under § 523(c), the court distinguished the general recognition of arbitration under the Federal Arbitration Act. The court agreed with the district court's conclusion "that allowing an arbitrator to decide issues that are so closely intertwined with dischargeability would 'conflict with the underlying purpose of the Bankruptcy Code.'" *Ackerman v. Eber (In re Eber)*, 687 F.3d 1123 (9th Cir. 2012).

Fees under § 523(d) affirmed. When the plaintiff, assignee of mortgage loan, did not appeal summary judgment for the debtor on its § 523(a)(2) complaint, it was collaterally estopped from arguing that summary judgment was in error when it appealed a \$9,000 fee award under § 523(d). The panel reviewed the statutory development of § 523(d) and what a creditor must show to establish substantial justification for filing the complaint—"a reasonable factual and legal basis for its claim." *Heritage Pacific Financial, LLC v. Machuca (In re Machuca)*, ___ B.R. ___, 2012 WL 6523187 (BAP 9th Cir. Dec. 14, 2012).

Nonlawyer attorney-in-fact lacked authority to sign complaint for claimant. Discussing California's and other jurisdictions' authority, the nonlawyer, who was attorney in fact for a claimant, could not sign the dischargeability complaint on behalf of the true plaintiff, but the complaint should have been dismissed without prejudice, giving opportunity for the plaintiff to amend the complaint with her signature or to obtain an attorney to represent her. *Foster v. Sligar (In re Foster)*, 2012 WL 6554718 (BAP 9th Cir. Oct. 19, 2012), slip copy.

Willful attempt to evade or defeat tax payment or collection affirmed. Reviewing § 523(a)(1)(C), the Fifth Circuit agreed with the Eleventh Circuit, in *In re Fretz*, 244 F.3d 1323 (11th Cir. 2001), that "the plain language of 'willfully attempted. . .contains a mental state requirement (that the attempt was done 'willfully')." Also, the conduct requirement in § 523(a)(1)(C) "applies equally to attempts to evade or defeat the collection and payment of tax," and not simply to assessment of a tax. "All the Government has to establish in order to satisfy § 523(a)(1)(C)'s mental state requirement is that the debtor (1) had a duty to pay taxes under the law, (2) knew he had that duty, and (3) voluntarily and intentionally violated that duty." *United States v. Coney*, 989 F.3d 365 (5th Cir. 2012).

Late returns were not tax returns for purposes of § 523(a)(1) exception. A late-filed state tax return did not qualify as a "return" for exception from discharge purposes. In a

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paragraph added by BACPA to the end of § 523(a), “return” is defined for discharge purposes as “a return that satisfies the requirements of applicable nonbankruptcy law (including applicable filing requirements).” The Mississippi tax code required tax returns to be filed by April 15 for calendar-year taxpayers, and the Chapter 7 debtor had filed two years of pre-bankruptcy tax returns late. Those taxes were excepted from discharge. *McCoy v. Mississippi State Tax Com’n (In re McCoy)*, 666 F.3d 924 (5th Cir. 2012).

Unpaid unemployment insurance taxes were dischargeable. The Chapter 7 debtor was allegedly a responsible person, obligated to pay unemployment insurance taxes that were not in the nature of withholding taxes, and the BAP held that the particular taxes were not a “tax required to be collected” within the meaning of § 507(a)(8)(C), and that consequently, the taxes were not excepted from discharge under § 523(a)(1)(A). The state entity conceded that the taxes were not withheld from employees, but argued that they still fell within the scope of § 507(a)(8)(C). Finding the statute ambiguous, the BAP looked to legislative history, which showed that a “tax required to be collected” must be collected from a third party, and the unemployment insurance taxes were payable directly by the employer, never collected from another party. To be excepted from discharge, the tax must be a priority tax, as contemplated by §§ 507(a)(3) or 507(a)(8). *In re Hansen*, 470 B.R. 535 (BAP 9th Cir. 2012).

Document filed late by debtors was not “return” for purposes of § 523(a)(1)(B). Examining the definition of “return” that was added by BAPCPA in a hanging paragraph to § 523(a), and as used in IRS Code § 6020(a), the Bankruptcy Appellate Panel found that the precise meaning of the two sentences in the hanging paragraph, when read together, was not clear. The panel reviewed the positions that other courts had taken on § 523(a)(1)(B) and the hanging paragraph. However, the debtors at issue did not file their 2001 return until August 2006, after IRS had engaged in “the burdensome process of determining their tax liability, providing the statutory notice of deficiency, assessing the taxes, and attempting collection.” Consequently, the late return, filed 17 months after assessment, did not meet filing requirements, and the 2001 tax liability was excepted from discharge. *Wogoman v. IRS (In re Wogoman)*, 475 B.R. 110 (BAP 10th Cir. 2012).

Misrepresentations about building permit was nondischargeable. Reversing its Bankruptcy Appellate Panel, at 453 B.R. 452, the First Circuit agreed with the bankruptcy court that the creditor established a § 523(a)(2)(A) exception by the debtor/builder’s misrepresentations about a building permit. Examining causation, the facts established that the creditor would have cancelled the home construction contract and recovered a deposit if the debtor had not lied about having a building permit. As to legal cause, the creditor’s loss resulted from the misrepresentation on which the creditor reasonably relied. *Sharfarz v. Goguen (In re Goguen)*, 691 F.3d 62 (1st Cir. 2012).

Representation of ownership of particular residence is not statement regarding financial condition. The Fifth Circuit observed a split of circuit authority on interpretation of § 523(a)(2)(A), with the Fourth Circuit, in *In re Van Steinburg*, 744 F.2d 1060 (4th Cir. 1984), holding that a debtor’s false representation that property was unencumbered, when it was pledged as collateral, was a statement regarding the debtor’s

financial condition, while the Eighth and Tenth Circuits, in *In re Lauer*, 371 F.3d 406 (8th Cir. 2004) and *In re Joelson*, 427 F.3d 700 (10th Cir. 2005), concluded that the term “financial condition” in § 523(a)(2)(A) referred to overall financial health. The Fifth Circuit agreed with the Eighth and Tenth, holding that the debtors’ representation about ownership of specific property fell short of representation of their net worth or overall financial condition. The statements of ownership were not statements respecting their financial condition for purposes of § 523(a)(2)(A)’s restriction of the exception. The bankruptcy court’s findings that the debtors made false representations upon which the lender justifiably relied were affirmed. *In re Bandi*, 683 F.3d 671 (5th Cir. 2012).

Subjective intent to deceive required for § 523(a)(2)(A). Finding that the bankruptcy court used an objective standard of fraudulent intent in finding reckless disregard for the truth, rather than the required subjective standard, the Bankruptcy Appellate Panel reversed and found no evidence to support an exception from discharge under § 523(a)(2)(A). The allegation was that the debtor obtained a loan, misrepresenting ownership of water rights, but the panel concluded that the “bankruptcy court found that a prudent person exercising reasonable diligence *should have known* that [the debtor] did not own 10.4 acre-feet of the Water Right and [the debtor] failed to exercise such care and diligence. The bankruptcy court found a breach of the duty of care and competence in representing ownership, *i.e.*, negligence, but not a breach of the duty of honesty. . . .The bankruptcy court found negligence, not scienter.” *DSC Nat’l Properties, LLC v. Johnson (In re Johnson)*, 477 B.R. 156 (BAP 10th Cir. 2012).

Real estate broker did not become jointly and severally liable for loan. The Chapter 7 debtor was a real estate broker and owner of a company that facilitated loans for real estate purchasers. He acted as broker for loans made by an individual and the loans were not repaid. By acting as a loan broker the debtor had not become jointly and severally liable for any fraud committed by the borrowers. The borrowers had previously filed bankruptcy, and the broker had sued them, alleging fraud and seeking equitable indemnification in the event the broker was found liable to the lender. The broker was not judicially estopped by seeking equitable indemnification, since the broker had been seeking a conditional or contingent claim for common law indemnity, while denying that he was liable for any fraud committed by the borrowers. *In re Parker*, 471 B.R. 570 (BAP 9th Cir. 2012).

Bank failed to prove false representation. The bank failed to prove that the debtor made false representations about lien waivers to induce advance of construction funds for a duplex, and the bank did not prove that the debtor knew the funds were being used by a limited liability company to build a different duplex. The debt was not excepted from discharge under § 523(a)(2)(A). The bank also did not prove an intentional tort for purposes of § 523(a)(6). *In re Steger*, 472 B.R. 533 (BAP 8th Cir. 2012).

Bankruptcy court had authority to liquidate debt for § 523(a)(2)(A) exception, distinguishing *Stern*. The Chapter 7 debtor had acted as a general building contractor, and a finding that he intentionally misrepresented that he was a licensed general contractor was affirmed. The creditors justifiably relied on that representation in hiring

the debtor. The bankruptcy court had constitutional authority to liquidate the debt for discharge purposes, with the BAP applying a narrow interpretation to *Stern v. Marshall*'s limitation on the bankruptcy court's authority. The opinion discusses other post-*Stern* authority agreeing that a bankruptcy court continues to have the constitutional authority to hear and determine claims that are excepted from discharge. *In re Deitz*, 469 B.R. 11 (BAP 9th Cir. 2012).

Creditors waived emotional distress damages related to fraud. In pre-bankruptcy litigation, the Tenth Circuit's reversal and remand for damages held that the plaintiffs had waived any claim for emotional distress damages, and in subsequent § 523(a)(2) litigation, the creditors were precluded from pursuing those damages. The opinion discusses the "murky" application of preclusion in bankruptcy, including the distinction between claim and issue preclusion, as well as whether the preclusive effect of a prior federal court judgment is guided by federal or state law. Since the Tenth Circuit had dealt with a diversity judgment, the law of the state in which the federal diversity court sat applied, here Oklahoma law (which the panel found to be essentially the same as federal preclusion law). Although the Tenth Circuit had remanded, it had made a final determination that emotional distress damages had been waived, and preclusion attached to that determination. *In re Zwanziger*, 467 B.R. 475 (BAP 10th Cir. 2012).

Correct reasonable reliance standard applied in § 523(a)(2)(B), and debtor consented to final order on state-law counterclaim. When the bank filed its § 523(a)(2)(B) complaint alleging a false financial statement, the Chapter 7 debtor filed a counterclaim alleging violations by the bank of Nebraska laws. The debtor "impliedly consented to the bankruptcy court's entering a final judgment on the state law counterclaims." The debtor did not object to the bankruptcy court's jurisdiction until it ruled against him, and the bankruptcy estate included any potential causes of action asserted by the debtor. The bankruptcy court applied the correct standard in finding that the debtor used a materially false financial statement, with intent to deceive, upon which the bank reasonably relied. *Bank of Nebraska v. Rose (In re Rose)*, ___ B.R. ___, 2012 WL 6621185 (BAP 8th Cir. Dec. 20, 2012).

Assignee had standing for § 523(a)(2) complaint. An individual executed a residential lease with the debtors, signing it personally "for" the titled owner, and when standing was contested, the individual testified that there was an assignment from the owner to him to rent the property. The debtors did not contend that an assignment did not exist, and although the assignment was not introduced into evidence, the prepetition state court had necessarily determined standing when it entered monetary judgment for the same individual filing the § 523(a)(2) complaint. *Sung Ho Cha v. Rappaport (In re Sung Ho Cha)*, ___ B.R. ___, 2012 WL 6044413 (BAP 9th Cir. Dec. 5, 2012).

After remand of § 523(a)(3) complaint, bankruptcy court could not dismiss complaint on new grounds. After the Bankruptcy Appellate Panel had remanded and reversed dismissal of a § 523(a)(3) complaint, with the dismissal having been on grounds of failure to state a claim, the bankruptcy court again dismissed the complaint on the basis that it was untimely filed, but the BAP found this dismissal to be in violation of "the

spirit, if not the letter of the remand, and was contrary to the law of the case.” The dismissal was vacated and remanded for consideration of the merits of the complaint. *Gonsalves v. Belice (In re Belice)*, 480 B.R. 199 (BAP 1st Cir. 2012).

Attorney fees awarded in arbitration were not excepted under § 523(a)(4). The exception from discharge for defalcation while acting in a fiduciary capacity did not apply to attorney fees awarded, as part of arbitration, against the Chapter 7 debtor who was a former corporate officer who falsely claimed to own an interest in the company. The arbitration resolved the disputed ownership interest and the company was awarded \$50,000 attorney fees, which were not related to defalcation. However, whether the fees resulted from a willful and malicious injury required remand for trial. *Shcolnik v. Rapid Settlements Ltd. (In re Shcolnik)*, 670 F.3d 624 (5th Cir. 2012).

Defalcation requires recklessness. Chapter 7 debtor breached his fiduciary duty as trustee of his father’s trust, by self-dealing, and the Eleventh Circuit affirmed the exception from discharge under § 523(a)(4), concluding that defalcation under this section requires a known breach of fiduciary duty by conduct that is objectively reckless. The defalcation requires more than mere negligence. *Bullock v. BankChampaign (In re Bullock)*, 670 F.3d 1160 (11th Cir. 2012).

Common law duties not sufficient for fiduciary exception. Affirming its Bankruptcy Appellate Panel, at 458 B.R. 504, the Eighth Circuit agreed that a Minnesota statute creating a lien relationship between the debtor and creditor did not create a fiduciary obligation. The debtor was owner and manager of a construction company that did not fully pay a subcontractor. The Minnesota statute provided that payments received for improvement of real estate were to be held in trust for benefit of those furnishing labor and materials, but the statute said that no fiduciary liability was created. It is not enough for the statute to create a trust in name; a statutory trust must include a definable res and impose trust-like duties. *Reshetar Systems, Inc. v. Thompson (In re Thompson)*, 686 F.3d 940 (8th Cir. 2012).

ERISA created technical trust for purposes of § 523(a)(4). ERISA sufficiently established a technical trust for the debtor exercising control over funds that were unpaid pension, health and annuity contributions. The panel examined divided judicial authority on whether one acting in a fiduciary capacity under ERISA satisfies § 523(a)(4). *Raso v. Fahey (In re Fahey)*, 482 B.R. 678 (BAP 1st Cir. 2012).

Debtor, as manager of LLC, was in fiduciary relationship in construction contracts. The individual acted as *de facto* manager of an LLC, when he negotiated contacts on behalf of the LLC and decided which suppliers and subcontractors to pay. New Mexico’s Contractors Act created a technical trust in this situation, and the individual was liable for mishandling funds entrusted to the LLC. *Hawks Holdings, LLC v. Kalinowski (In re Kalinowski)*, 482 B.R. 334 (BAP 10th Cir. 2012).

State court judgment not given preclusive effect on conversion and embezzlement. Since the relevant Michigan statute on conversion does not require fraud, the state court

judgment could not have necessarily litigated the fraud requirement for § 523(a)(4). The bankruptcy court's summary judgment based on the preclusive effect of the judgment was reversed and remanded. *Dantone v. Dantone (In re Dantone)*, 477 B.R. 28 (BAP 6th Cir. 2012).

Rooker-Feldman did not apply to state court's § 523(a)(5) decision entered after bankruptcy filing. When the state court ruled after the Chapter 7 filing that it retained jurisdiction to decide that attorney fees were nondischargeable child support, the Rooker-Feldman Doctrine did not prevent the bankruptcy court's jurisdiction, since that Doctrine only applies "when the state court loser files a new lawsuit in federal court *after* the state court adversely rules," distinguishing "properly invoked concurrent jurisdiction . . . if a state court reaches judgment on the same or related question while the case remains *sub judice* in a federal court." However, the lower courts correctly held that the fee awards were domestic support obligations, and the size of the awards (\$100,000) in child custody litigation did not necessarily mean that they were unreasonable under *Sorah v. Sorah*, 163 F.3d 397 (6th Cir. 1998). *Rugiero v. DiNardo (in re Rugiero)*, 2012 WL 4800059 (6th Cir. Oct. 10, 2012), slip copy.

Former spouse's claim for overpayment of support was not covered by § 523(a)(5), but was excepted from discharge under § 523(a)(15). The Bankruptcy Appellate Panel affirmed the conclusion that, although the former husband had overpaid spousal support, the debt was not a domestic support obligation, since repayment to him would not be "support." However, the debt did fall within the broader provision of § 523(a)(15), under which the claim arose "in connection with a separation agreement, divorce decree or other order of a court of record." Section 523(a)(15) does not require that the debt be support in nature, and a former spouse is included in the statute. However, the claimant was not entitled to attorney fees for prosecuting the proceeding. *Taylor v. Taylor (In re Taylor)*, 478 B.R. 419 (BAP 10th Cir. 2012).

Derivative damages included in § 523(a)(6) exception. The Chapter 7 debtor attempted to kill his ex-wife, beating her and leaving her in an unheated storage facility for eighteen hours, resulting in miscarriage and loss of all toes to frostbite. He was convicted and a civil judgment included damages for battery, false imprisonment, and intentional infliction of emotional distress, as well as loss of consortium for the victim's husband and children. The debtor argued that the state jury did not find that he intended to inflict the specific injuries, but the Seventh Circuit held that all of the damages, including loss of consortium, were excepted from discharge. The opinion observes the lack of consistency in the definition of "willful and malicious" across the circuits, noting that the opinions reflected "different legal definitions of the same statutory language that probably don't generate different outcomes. . . . We imagine that all courts would agree that a willful and malicious injury, precluding discharge in bankruptcy of the debt created by the injury, is one that the injurer inflicted knowing he had no legal justification and either desiring to inflict the injury or knowing it was highly likely to result from his act." *Jendusa-Nicolai v. Larsen*, 677 F.3d 320 (7th Cir. 2012).

Willful and malicious injury to property. The debtor, after being sued along with her former spouse and a partnership in a personal injury action, participated in a conveyance of property owned by the partnership, and the conveyance was a willful and malicious injury to the property interest of the plaintiff. The debtor had been found to be a conspirator with the other defendants in the fraudulent transfer of the property to avoid its being subject to the personal injury plaintiff's \$3.9 million judgment. In the § 523(a)(6) action, finding that the debtor intended to prevent the plaintiff from satisfying his judgment, the transfer was willful and with malice, with the debtor having no just cause to make the transfer. *Maxfield v. Jennings (In re Jennings)*, 670 F.3d 1329 (11th Cir. 2012).

Collateral estoppel not given to state court judgment. A pre-bankruptcy California judgment based on negligence, negligent infliction of emotional distress, intentional infliction of emotional distress and fraud was not given collateral estoppel effect in a § 523(a)(6) complaint for summary judgment purposes. The elements of the California tort of intentional infliction of emotional distress were not identical to § 523(a)(6), since the tort included the alternative of "reckless disregard of the probability of causing" the distress. The judgment had not been based unambiguously on the debtor's subjective intent to injure the plaintiff. Summary judgment was vacated. *B.B. v. Bradley (In re Bradley)*, 466 B.R. 582 (BAP 1st Cir. 2012).

Attorney fees for frivolous claims were excepted under § 523(a)(7). A prisoner serving a life sentence sued the state prosecutors for negligence and emotional distress, and state courts dismissed the suit and appeal as frivolous, awarding attorney fees and costs. Under Idaho law, the fee award was a penalty, excepted from discharge under § 523(a)(7). The court did not need to reach the issue of whether it was also excepted under § 523(a)(17). *Searcy v. Ada County Prosecuting Attorney's Office (In re Searcy)*, 463 B.R. 888 (BAP 9th Cir. 2012).

Expert testimony unnecessary to support undue hardship discharge. When the bankruptcy court heard the debtor's testimony about her mental health issues that adversely affected her completing education as a chiropractor and obtaining employment, and the defendant put on no proof to the contrary, it was not necessary that the bankruptcy court have expert testimony to support its determination of undue hardship. Also, the facts that the debtor had overspent in the past and made unwise financial decisions did not mean that the debtor's hardship was due to self-imposed limitations. The bankruptcy court had opportunity to judge the debtor's credibility on why she dropped out of chiropractic education. *Shaffer v. U.S. Dept. of Education (In re Shaffer)*, 481 B.R. 15 (BAP 8th Cir. 2012).

Partial discharge upheld under Brunner test. The bankruptcy court did not err in partially discharging student loans, properly applying the *Brunner* test to that portion that was discharged. The first prong of *Brunner* "allows the bankruptcy court to determine the amount of student loan debt that prevents the debtor from maintaining a minimum standard of living and discharge only that amount." *Educational Credit Management Corp. v. Jorgensen (In re Jorgensen)*, 479 B.R. 79 (BAP 9th Cir. 2012).

Debtor eligible for Income Contingency Program was not entitled to undue hardship discharge. Applying a totality-of-circumstances test under § 523(a)(8), the Bankruptcy Appellate Panel found no error in the bankruptcy court’s finding that the debtors failed to show an inability to continue to earn stable income and that the debtors were able to maintain a basic standard of living. Under *Educ. Credit Mgmt. Corp. v. Jespersen*, 571 F.3d 775 (8th Cir. 2009), a factor to be considered is availability of the Income Contingent Repayment Program for student loans, and the debtor qualified for the Program, under which projected monthly payments would be zero. “The mere possibility of tax consequences at the expiration of the 25-year repayment period is not dispositive of the issue of whether the ICRP represents a viable avenue for repayment of student loan debt.” The debtors failed to prove undue hardship. *Nielsen v. ACS, Inc. (In re Nielsen)*, 473 B.R. 755 (BAP 8th Cir. 2012).

Reliance on advice of counsel does not protect against § 727(a)(2) objection. When it was clear that the debtor had transferred and concealed property with the intent to hinder, delay or defraud creditors, it was not a defense that the debtor used transferred funds to pay legitimate business or personal debt, or that engaging in the transfers or concealment was on alleged advice of counsel. Reversing the trial court’s ruling for the debtor, the Bankruptcy Appellate Panel found, from totality of the record, that “it is implausible that [the debtor] lacked the intent to hinder, delay or defraud his creditors when he transferred significant assets less than a year before filing a petition for chapter 7 relief.” *Cox v. Villani (In re Villani)*, 478 B.R. 51 (BAP 1st Cir. 2012).

U.S. trustee’s complaint did not contain sufficient facts to support judgment on pleadings for §§ 727(a)(3) and (5). The complaint alleged that the debtor had failed to maintain adequate financial records and to explain a loss of assets, but the pleadings did not support the bankruptcy court’s judgment on the pleadings. “Under § 727(a)(3), a debtor’s burden to show that his record keeping was reasonable under the circumstances is triggered only after the party seeking to deny his discharge establishes that inadequate records exist. That burden was never triggered here.” As to § 727(a)(5), the burden of explaining loss of assets never shifted to the debtor. The debtor’s answer to the complaint had denied allegations, and a prebankruptcy state-court judgment did not have preclusive effect. Even though that judgment contained findings of no records of investments with the state-court plaintiff, the debtor was not precluded from defending the § 727 complaint by denying lack of insufficient records. *McDermott v. Swanson (In re Swanson)*, 476 B.R. 236 (BAP 8th Cir. 2012).

Debtor’s omissions were material for purposes of § 727(a)(4). The Chapter 7 debtor’s omissions from schedules of income and undervaluation of assets constituted a false oath, and the “threshold to materiality is fairly low,” with an omission or misrepresentation of relatively modest assets being sufficient. “By undervaluing his interests, the Debtor sent a message to the Trustee that there was no need to inquire further.” Section 727(a)(4)(A) requires full and complete disclosure. *Kaler v. Charles (In re Charles)*, 474 B.R. 680 (BAP 8th Cir. 2012).

Discharge denied for false oaths. Just because bankruptcy court commented that the debtor had “played fast and loose” did not mean that court applied wrong standard in § 727(a)(4)(A) denial of discharge. The bankruptcy court found that the debtor acted with actual fraudulent intent in omitting from schedules a \$50,000 payment for the debtor’s interest in commercial lease. *In re Phillips*, 2012 WL 1071270 (11th Cir. 2012), slip copy.

Lien Stripping

Chapter 7 debtor could not strip wholly unsecured junior lien. The district court held that lien stripping in Chapter 13 cases is based on § 1322(b)(2), rather than on § 506(a), which was rejected by *Dewsnup* as a means for stripping in Chapter 7. Also, a Chapter 7 debtor may not use § 506(d) to strip such a lien, based on *Dewsnup*. *Wachovia Mortgage v. Smoot*, 478 B.R. 555 (E.D. N.Y. 2012).

Discharge Injunction

Gambling debt action did not violate discharge injunction. The state prosecutor and Hard Rock Casino did not violate the discharge injunction related to the Chapter 7 debtor’s gambling debt that was discharged. Gambling had been the debtor’s primary occupation. The debtor did not produce proof that the casino had engaged in post-discharge collection activity, and the bankruptcy court properly applied *In re Gruntz*, 202 F.3d 1074 (9th Cir. 2000), in denying sanctions against the prosecutor. The debtor’s discharge did not prevent the state from pursuing prosecution when the casino’s marker was returned by the debtor’s bank for insufficient funds. *Nash v. Clark County District Attorney’s Office (In re Nash)*, 464 B.R. 874 (BAP 9th Cir. 2012).

No abuse of discretion in refusing to reopen case for discharge injunction complaint. The Chapter 7 debtor had not listed student loan debts in her schedules until an amended Schedule F was filed, but the debtor did not file a § 523(a)(8) complaint, and no determination of undue hardship was made before the general discharge order was entered. Five years later, the debtor moved to reopen the case, not to seek discharge of student loans, but to pursue sanctions for violation of the discharge injunction, and the bankruptcy court denied reopening. The bankruptcy court had broad discretion on reopening, and the student loan debt was automatically excepted from discharge, since no undue hardship determination had been made. *In re Smyth*, 470 B.R. 459 (BAP 6th Cir. 2012).

Discharge Revocation

Revocation complaint was time-barred. Equitable concepts do not overcome § 727(e)’s time requirements for filing complaints to revoke discharge, and Rule 60 relief is not available for these complaints, under Fed. R. Bankr. P. 9024. Section 727(e)’s timing is not a mere statute of limitations; it is jurisdictional. *The Cadle Co. v. Andersen (In re Andersen)*, 476 B.R. 668 (BAP 1st Cir. 2012).

Reaffirmation

Postpetition renewal of obligation was unenforceable reaffirmation. In a case converted from Chapter 13 to 7, the debtor entered into an agreement postpetition with an unsecured creditor to pay an \$81,000 personal loan in weekly installments. The creditor claimed to have extended additional credit based on the debtor's assurance that the prepetition debt would not be included in the bankruptcy. An agreement to renew a prepetition debt is a reaffirmation, unenforceable in the absence of bankruptcy court approval in compliance with § 524. The bankruptcy court had properly sanctioned the creditor and his attorney, ordering dismissal of a state court suit and awarding \$1,500 attorney fees to be paid by attorney to the debtor. *Williams v. King (In re King)*, 480 B.R. 321 (BAP 8th Cir. 2012).

Ride through eliminated only as to personalty. Sections 362(h), 521(a)(2), 521(a)(6) and 521(d), as amended by BAPCPA, effectively eliminated the ride-through option, but only as to personalty. "To the extent the subject property is real property and the debtor is current on her obligations to the creditor, retention of the property does not require the debtor to specify redemption or reaffirmation on her statement of intentions." The home mortgage creditor's motion to require the debtor to complete reaffirmation, redemption or surrender was denied. *In re Covel*, 474 B.R. 702 (Bankr. W.D. Ark. 2012).

Lease assumption process separate from reaffirmation. The Chapter 7 debtors filed motions to approve reaffirmation agreements, but the underlying obligations were personal property leases, and the court found that personal property lease assumption in Chapter 7, under § 365(p)(2), was a "handshake" process, not one involving the court. Attempting to assume such leases through the reaffirmation process unnecessarily involved the court. The opinion discusses the split of case authority, disapproving attempted reaffirmations, with the order having no effect of validity on any § 365(p)(2) lease assumption agreements. *In re Perlman*, 468 B.R. 437 (Bankr. S.D. Fla. 2012).

Discharge not set aside to enter into reaffirmation. Finding that setting aside the prior Chapter 7 discharge, on motion of the debtors, would undermine § 524's requirement that reaffirmation agreements be entered into before discharge, the debtors cited no authority for their motion. The debtors' "discomfort" at not having a reaffirmation in place on their home was not enough reason to ignore § 524. *In re Smith*, 467 B.R. 122 (Bankr. W.D. Mich. 2012).

Redemption

On conversion from Chapter 13 to 7, redemption value is not the same as in the plan. Reminding the bar of BAPCPA's amendment of § 348(f)(1)(B), Chapter 13 valuations are only applicable in cases converted to Chapter 11 or 12, but when the case is converted to Chapter 7, the court is not bound by valuation of a vehicle in the Chapter 13 plan. For redemption purposes, the court adopted a commercially reasonable disposition approach, "considering the property itself, and the property's existing physical condition and age." While the creditor relied solely on N.A.D.A. for value, the

debtor produced proof of higher mileage than the N.A.D.A. guide and appraisals based on the actual mileage. The court commented that “the consumer bankruptcy bar should not slavishly rely upon the N.A.D.A. Appraisal Guide.” *In re Airhart*, 2012 WL 1965609 (Bankr. S.D. Tex. May 31, 2012), slip copy.

Conversion

Funds held by trustee at conversion to Chapter 7 must be returned to debtor. The Third Circuit, with a dissent, held that plan payments not yet distributed to creditors and held by the trustee at the time of conversion to Chapter 7 must be returned to the debtor, in the absence of bad faith. Funds had accumulated in the trustee’s hands after stay relief had been granted to allow foreclosure, but the debtor had not modified the confirmed plan to reduce plan payments. The Circuit concluded that § 348(f) did not completely resolve the legal issue of what the trustee should do with such funds when the case was converted, but on conversion to Chapter 7, “the order converting the case is effectively backdated to the time of the order for relief under Chapter 13,” suggesting that property of the Chapter 13 estate acquired postpetition is excluded from property of the Chapter 7 estate. Since confirmation vests property in the debtor, under § 1327(b), “the implication is that property held by the Chapter 13 trustee after plan confirmation is ‘under the control of the debtor as of the date of [a later] conversion’ for purposes of § 348(f)(1).” Returning undistributed funds to the debtor better aligns with termination of the Chapter 13 trustee’s duties, except for accounting for funds by filing a final report under Rule 1019; the trustee is not authorized to distribute funds under a plan that is no longer operative. A textual reading of § 348(f), along with its legislative history, led the panel “to conclude that undistributed plan payments held by a Chapter 13 trustee at the time of conversion must be returned to the debtor absent bad faith.” *In re Michael*, 699 F.3d 305 (3d Cir. 2012).

In case converted to Chapter 7, § 523(a)(16) applied. In a case converted from Chapter 11 to 7, the debtor moved to extend the automatic stay, arguing that condominium association fees would be discharged, but the association’s fees became due and payable after the Chapter 11 petition was filed and before conversion to Chapter 7. Although §§ 348(b) and 727(b) together treat debts that arose after the Chapter 11 filing and before conversion to Chapter 7 as prepetition debts, § 727(b) includes the § 523 exceptions, and homeowner association fees that become due and payable “after the [Chapter 11] order for relief” are excepted from a Chapter 7 discharge under § 523(a)(16). The court found a distinction in § 523(a)(16)’s reference to “order for relief” rather than to § 348’s “order for relief under the chapter” to which the case was converted; therefore, since the association’s fees arose after the Chapter 11 filing, they were excepted from discharge. *In re Hijjawi*, 471 B.R. 917 (Bankr. N.D. Ill. 2012).

Reopening Case

Chapter 7 case reopened and discharged trustee had standing to be heard on conversion. The Chapter 7 debtors moved to reopen their case and to convert to Chapter 11, disclosing for the first time that they had a prepetition cause of action for personal

injury. The BAP, in a first impression decision, held that the Chapter 7 trustee, although discharged on closing of the case, had standing to be heard on the motion, since the underlying issue was control of the litigation that had not been disclosed previously. Section 350(b) does not define “party in interest,” but to deny the trustee standing would be contrary to common sense. The debtors did not own the undisclosed prepetition cause of action, since it was not abandoned. The BAP’s opinion cites other case authority for recognizing the discharged trustee’s standing and for the trustee falling within § 350(b)’s “party in interest.” The bankruptcy court did not abuse its discretion in granting the reopening, but denying conversion. *In re Levesque*, 473 B.R. 331 (BAP 9th Cir. 2012).

Chapter 13 Issues

United States lacked standing to seek injunctive and mandamus relief. The Sixth Circuit held that the United States lacked standing in its effort to block the procedure in the Eastern District of Michigan, under which the confirmation orders required IRS to pay future tax refunds the trustees. The defendants were the standing Chapter 13 trustees and the district court had entered the injunctive and mandamus relief, with the latter directing the bankruptcy judges not to include the tax refund requirement in confirmation orders. The government claimed that the tax refund orders violated sovereign immunity, but the government simply should have appealed any of the confirmation orders; it lacked standing to seek the relief sought. *United States v. Carroll*, 667 F.3d 742 (6th Cir. 2012).

Eligibility

Attorney-fee only plan not per se bad faith. See summary of *Sikes v. Crager* (*In re Crager*), 691 F.3d 671 (5th Cir. 2012), below under **Attorney Fees**.

Dismissal after stay relief motion was granted made debtor ineligible. When the debtor dismissed the case after a grant of stay relief and refilled a new case on the same day, § 109(g)(2) was triggered, along with § 362(b)(21)(A), with no stay going into effect in the second case. *Leafy v. Aussie Sonoran Capital, LLC* (*In re Leafy*), 479 B.R. 545 (BAP 9th Cir. 2012).

Whether debtor violated § 109(g)(1) and is ineligible requires evidentiary hearing. In a dispute over whether the automatic stay applied in the debtor’s third case to stop foreclosure, with the creditor arguing for dismissal because the second case had been dismissed for failure to comply with an order to file required schedules and documents, the court held that a finding of willfulness under § 109(g)(1) could not be inferred, but was rather a question of fact requiring evidence. *Anjos v. Bank of American, N.A.* (*In re Anjos*), 482 B.R. 697 (Bankr. D. Mass. 2012).

Debtor not ineligible under § 109(g)(2). Discussing the conflicting views of § 109(g)(2), the meaning of “following” in the statute must be determined by the statute’s context, concluding that the most reasonable meaning is “as a result of,” a causation relationship. “In this context, causation is the focus of the relationship, not simply chronology. Here, the debtor did not seek voluntary dismissal as a result of the motion

for stay relief, because the motion had been granted and the moving creditor's collateral returned years before the dismissal." Section 109(g)(2) did not make this debtor ineligible. *In re Payton*, 481 B.R. 460 (Bankr. N.D. Ill. 2012).

No per se rule against simultaneous Chapter 20 cases. Reversing dismissal of a Chapter 13 case filed while a prior Chapter 7 was still pending, the district court concluded that there was no per se rule against such a filing; rather, on remand, the bankruptcy court must determine if the Chapter 13 was filed in good faith, or if other grounds existed for dismissal. *Sood v. Business Lenders, LLC*, 2012 WL 2847613 (D. Md. July 10, 2012), slip copy.

Joint petition by mother and son constituted two petitions. Although the joint petition filed by a mother and her son was improper, not entitled to joint administration, and the petition of the mother was then dismissed, the filing constituted the commencement of a case by each party, triggering the automatic stay for each. Each party owed a filing fee. The son's petition was still active when a foreclosure took place, in violation of the stay. *Stancil v. Bradley Investments, LLC (In re Stancil)*, 473 B.R. 478 (Bankr. D. Dist. Col. 2012).

Eligibility calculation includes in rem debt left after Chapter 7 discharge. Agreeing with the majority view, although the debtor's in personam liability had been previously discharged, the in rem claim must be included in the § 109(g) calculation, and the debtor was ineligible. The opinion discusses, and disagrees with, the contrary authority. *In re Branam*, 476 B.R. 333 (Bankr. S.D. Fla. 2012). See also *In re Rios*, 476 B.R. 685 (Bankr. D. Mass. 2012), which looked to the undersecured mortgage creditor's proof of claim, not simply to the debtor's schedules, holding that the unsecured portion of the undersecured claim must be counted for eligibility.

Confirmation Issues

Local Plan Forms

Plan language deviating from local plan disapproved. The district court rejected debtors' plan language warning secured creditors that if they did not object to the plan's proposed treatment of liens or arrearage amounts, the plan would bind them as to the lien and claim amount, with the court finding that this language, which deviated from the local plan form, was in conflict with Bankruptcy Code and Rule claims procedures. The bankruptcy courts in the District of Colorado had disagreed whether debtors could include such language in plans, and the district court adopted the position taken in *In re Butcher*, 459 B.R. 115 (Bankr. D. Colo. 2011). The issue involved plan confirmation occurring prior to expiration of the claims deadline, and "under the debtors' approach, a claim filed by a secured creditor after confirmation of a Chapter 13 plan cannot alter the plan, even if the claim demonstrates that the plan is not in compliance with the requirements of the Code and the Rules." The standard local plan in the district provided that after confirmation the debtor shall file a modified plan providing for allowed priority and secured claims that were filed timely but after confirmation. The local bankruptcy

rules also required a modified plan filing. The non-standard language proposed by some debtors would permit the plan, without the required modification, to define the claim amount and treatment of secured claims and liens, but the district court held that bankruptcy courts have an obligation to direct that a debtor conform the plan to the Code's requirements. Section 1329 does not prevent the bankruptcy court from requiring post-confirmation modification, and the local standard language requiring modification is part of the res judicata effect of confirmation—the required modification provision had binding effect. *In re Gordon*, 2012 WL 1020643 (D. Colo. Mar. 27, 2012), slip copy.

See also *In re Walters*, 2012 WL 1536964 (Bankr. E.D. Okla. Apr. 30, 2012), slip copy, in which the court, while agreeing that the district's current seventeen page plan form needed revision, denied confirmation of a non-standard, shorter plan. "The Court believes that a standard plan form is essential for this Court to meet its responsibility to review all Chapter 13 plans, . . .to provide proper notice to interested parties, and to promote efficiency in the review of those plans." The opinion notes that it is unlikely that a national plan form will be adopted in the near future, and that the bankruptcy bar and trustees were encouraged to "work toward an acceptable revision of the current standard form that will comply with the Bankruptcy Code and be in a form that most debtors and creditors can comprehend."

See also *In re Vu*, 2012 WL 1521635 (BAP 9th Cir. May 1, 2012), slip copy, where the BAP rejected the mortgage creditor's argument that compliance with a local addendum to a plan was unduly burdensome and expensive. A similar argument had been rejected in *In re Herrera*, 422 B.R. 698 (BAP 9th Cir. 2010), *aff'd* 650 F.3d 1300 (9th Cir. 2011).

Local plan requirements upheld. The district court held that the trustee's requirement that payments be made only by certified funds, automatic wage deduction or electronic transfer was reasonable and that it was "simply a way to ensure the efficient and reliable transfer of the required currency payments." A required model form confirmation order was also approved; it did not make the confirmation process burdensome for debtors or their attorneys. A requirement that debtors review all proofs of claim and resolve discrepancies in claims and the plan before submitting a plan for confirmation was upheld, as not impermissibly shifting the burden on claim objections. A requirement that the confirmation order contain a provision that it did not constitute an informal proof of claim for any creditor was valid and did not violate any Ninth Circuit precedent. A provision that a modified plan did not supersede any trustee request for documentation or information was upheld. A remand was required as to one objection concerning the bankruptcy court's rejection of a plan's provision that payments on secured claims shall be applied first to principal and then to interest, with further factual proof needed on how the proposed plan would affect adequate protection for secured claims. *Reyes v. Brown* (*In re Reyes*), 482 B.R. 603 (D. Ariz. 2012).

Debtor did not treat secured claim, as required in local form plan. Finding the local form plan for the Eastern District of California to conform to Code and Rule requirements for claims, that plan required that a proof of claim determined the amount and classification of a claim, and the plan should treat the claim accordingly, unless a valuation or lien avoidance motion had been granted, or a claim objection had been

sustained, requiring different treatment. The fact that the debtors' claim objection and adversary proceeding contesting a mortgage claim were pending, but not resolved, did not excuse the debtors from complying with the local form plan requirement. Failing to treat the mortgage claim violated § 1322(b)(2) and justified denial of confirmation. Failure to timely propose and confirm a plan also justified conversion to Chapter 7. *de la Salle v. U.S. Bank, N.A. (In re de la Salle)*, 461 B.R. 593 (BAP 9th Cir. 2011).

Classification

Confirmation should not be denied solely because plan separately classified and preferred debt guaranteed by debtor's mother. The plan separately classified an unsecured consumer debt, on which the debtor's mother was guarantor, and proposed to pay that debt in full, with interest, while paying very little to other unsecured creditors. The trustee objected. Discussing the divergent views on the "however" clause in § 1322(b)(1), the BAP found that "courts have been unable to derive from the text of the statute a plain and unambiguous meaning for the 'however clause.'" Looking to legislative history, principally the committee reports related to 1981 and 1983 acts leading up to the Bankruptcy Amendments and Federal Judgeship Act of 1984, the BAP held "that Congress sought to permit a chapter 13 debtor to separately classify *and* to prefer a codebtor consumer claim when the facts are similar to those presented in [*In re Utter*, 3 B.R. 369 (Bankr. W.D. N.Y. 1980), and *In re Montano*, 4 B.R. 535 (Bankr. D. D.C. 1980)]—both cases cited in the legislative history]. . . . Whatever else the 'however clause' may or may not do, a court may not deny confirmation of a plan under § 1322(b)(1) solely because the plan prefers a codebtor consumer claim over all other unsecured claims." *In re Renteria*, 470 B.R. 838 (BAP 9th Cir. 2012).

Classification and preferred treatment of unsecured, non-priority tax claims was unfair discrimination. The bankruptcy court did not err in confirming a plan over the debtors' objection, when the debtors' original plan had proposed to pay unsecured, non-priority state tax claims ahead of other unsecured claims, which would have been unfair discrimination. The fact that the taxes would be nondischargeable did not, standing alone, justify the discrimination. The debtors were essentially asking other unsecured creditors "to pay for the Debtors' failure to file timely tax returns." *Copeland v. Fink (In re Copeland)*, 483 B.R. 534 (BAP 8th Cir. 2012).

Separate classification of student loan debt was unfair discrimination. The plan proposed to separately classify student loan debt, treating it as long-term debt, to be paid with interest, resulting in that debt receiving 47% dividend, while other unsecured creditors would receive 1% distribution. Section 1322(b)(1) placed a fairness limitation on § 1322(b)(5) treatment of long-term unsecured debt, and the court found the plan to unfairly discriminate against other unsecured creditors. Also, § 1322(b)(10), added by BAPCPA, prevents payment of interest on unsecured nondischargeable debt, such as student loan, unless disposable income is sufficient to pay allowed claims in full. The court noted that this provision essentially mooted the fairness inquiry in this case. *In re Kubiczko*, 2012 WL 2685115 (Bankr. D. Colo. July 6, 2012), slip copy. See also *Gorman v. Birts (In re Birts)*, 2012 WL 3150384 (E.D. Va. Aug. 1, 2012) (Plan paying

student loan as long-term debt, with interest, unfairly discriminated against other unsecured creditors receiving 7% distribution.).

Priority Claims

Straddling tax is prepetition, priority claim. The Michigan Department of Treasury objected to the debtor filing a proof of claim on its behalf for a 2008 income tax when the debtor filed Chapter 13 in January 2009, arguing that it was a postpetition tax for which the debtor had no authority to file a claim. The Sixth Circuit found that the 2008 tax was entitled to priority under § 507(a)(8)(i), concluding that the statute’s phrase “after three years before the date of filing the petition” includes all dates that occur after the three years, including dates occurring after the petition was filed, agreeing with *In re Dixon*, 218 B.R. 150, 153 (BAP 10th Cir. 1998). If § 507(a)(8)(i) only applied to prepetition time periods, it would make § 502(i) unnecessary. Section 502(i) treats a claim arising after the petition filing that is entitled to § 507(a)(8) priority as if it had arisen before the petition filing; “a postpetition claim for a tax qualifying under § 502(i) is treated as if it was a prepetition claim.” Also, the 2008 tax was entitled to priority under § 507(a)(8)(iii), because the tax became assessable after commencement of the case. Since the tax is subject to § 502(i), the debtor was permitted to file a claim on behalf of the Department under § 502(c), even if not authorized to do so under § 1305. This conclusion was consistent with the requirement of § 1322(a)(2) that the priority tax must be paid in full in a plan, even though it could be paid in deferred cash payments. Section 1305(a) was not a nullity, since there would be some taxes for a tax year ending after the petition filing that would not be entitled to § 507(a)(8) priority, for which the debtor could not file a proof of claim under § 502(i) and § 502(c). Bottom line, the debtor could file a “protective claim” on behalf of the Department for the 2008 tax. *In re Hight*, 670 F.3d 699 (6th Cir. 2012). *Accord In re Wilson*, 2012 WL 441177 (E.D. Mich. Feb. 10, 2012), reaching the same conclusion as *Hight*, but also concluding that an income tax for 2009 was payable on January 1, 2010, and when the petition was filed February 26, 2010, that tax was a prepetition claim for which the debtors could file a proof of claim on behalf of the state. Acknowledging a split of authority on the debtor’s ability to file a claim for the creditor on a “straddling tax” under § 1305(a), the *Wilson* Court disagreed with the conclusion of the district court in *In re Senczyszyn*, 444 B.R. 750 (E.D. Mich. 2011), holding that “although § 1305(a) does not authorize a debtor to file a proof of claim on behalf of a creditor for taxes that become payable while the bankruptcy case is pending, neither does it prohibit such action.”

Former spouse’s attorney fee was domestic support obligation and priority claim. Taking the majority position, although the former spouse’s attorney is not a named party to whom a domestic support obligation is owed in § 101(14A), “there is no support in the legislative history of BAPCPA that Congress intended to reduce protection for non-debtor former spouses.” The claim filed by the attorney was for a fee related to child custody dispute, and it was a DSO, given priority treatment under § 507(a)(1)(A). *In re Tepera*, 2012 WL 439257 (Bankr. S.D. Tex. Feb. 9, 2012), slip copy.

Disposable Income

Household size may be determined by use of fractional economic unit. In a direct appeal, the Fourth Circuit affirmed the bankruptcy court's method of determining the debtor's household size for purposes of § 1325(b)'s disposable income, when the bankruptcy court found the number of individuals with income and expenses, intermingled with the debtor's, and used a "fractional economic unit" approach to calculate how much the part-time residents were members of the debtor's household. The debtor had custody of two minor children from a first marriage 204 days of the year, and her current husband had custody of three children from a prior marriage 180 days of the year, resulting in fluctuating expenses for the care of those seven persons, five of whom resided in the home part-time. The bankruptcy court had identified three methods of finding what constitutes a "household," a term not defined in the Code: (1) "heads-on-bed" approach, using the Census Bureau's definition; (2) "income tax dependent" approach; and (3) economic unit approach, and the Circuit Court approved use of the latter, even though it meant dividing the minor children into fractions. The "§ 707(b) means test calculation will be affected by the threshold determination of how many people are part of [the debtor's] 'household,' as determined for purposes of § 1325(b)." Household size is relevant to the calculation of the "amounts reasonably necessary to be expended," under § 1325(b)(3). Use of the "heads-on-bed" approach is an overly broad definitional basis for "household, . . . too removed from the purposes of § 1325(b)," with the Circuit Court agreeing with the majority of bankruptcy courts that this approach was "inconsistent with the purpose and objectives of the Code." In contrast, the "economic unit" approach was consistent with § 1325(b) and the Code as a whole. "The approach is flexible because it recognizes that a debtor's 'household' may include non-family members and individuals who could not be claimed as dependents on the debtor's federal income tax return, but who nonetheless directly impact the debtor's financial situation. . . . In other words, those whose income and expenses are interdependent with the debtor's are part of his or her 'household' for purposes of § 1325(b)." *Johnson v. Zimmer*, 686 F.3d 224 (4th Cir. 2012).

After payment of 401(k) loan, funds are projected disposable income. Affirming its BAP on slightly different grounds, the Sixth Circuit held that after the debtor completes required repayment of a 401(k) loan, the funds used for the repayment become projected disposable income that must be dedicated to unsecured creditors under § 1325(b)(1)(B); the debtor may not use that money to fund future 401(k) contributions. Section 541(a), in conjunction with §§ 541(b)(7) and 1306, fixes the amount of exclusion from property of the estate as the amount the debtor was voluntarily contributing on the date of filing Chapter 13. *Seafort v. Burden*, 699 F.3d 662 (6th Cir. 2012).

Projected disposable income must reflect vehicle being surrendered. The debtor's schedules indicated intention to surrender two all-terrain vehicles and that her ex-boyfriend was making payments on a truck that was in his possession, but Form B22C reflected the secured payments on all three items, and the trustee objected to confirmation. The reasoning of *Hamilton v. Lanning*, 130 S.Ct. 2464 (2010), while addressing changes in income, applied to expenses. The Fourth Circuit agreed with the

Sixth and Seventh Circuits that the debtor's projected disposable income must take into account the fact that the debtor would not be making secured payments on the surrendered ATVs and the truck. *In re Quigley*, 673 F.3d 269 (4th Cir. 2012).

Social Security benefits excluded from projected disposable income. The Fifth Circuit adopted the position of the Sixth and Eighth Circuits, holding that Social Security benefits were excluded from projected disposable income. Congress had specifically excluded those benefits from current monthly income, which is the starting point for a projected disposable income analysis. *Beaulieu v. Ragos (In re Ragos)*, 700 F.3d 220 (5th Cir. 2012). *Accord Anderson v. Cranmer (In re Cranmer)*, 697 F.3d 1314 (10th Cir. 2012), in which the Tenth Circuit agreed that Social Security benefits need not be included in projected disposable income, holding that the debtor's failure to dedicate benefits could not be the basis for determination that the plan was not proposed in good faith.

Railroad Retirement annuity is included in projected disposable income. In contrast to Social Security benefits, an annuity under the Railroad Retirement Act (RRA) is included in the calculation of projected disposable income. It is not excluded from current monthly income, nor does the RRA protect it. The court relied on *Hisquierdo v. Hisquierdo*, 439 U.S. 572 (1979), where the Supreme Court construed the word "anticipated" in the RRA as referring to a premature receipt of payment. "Taking RRA annuity income into account when calculating a debtor's projected disposable income does not 'anticipate' that income in the trust law sense of the term, [as construed by the *Hisquierdo* Court.] Doing so merely allows the bankruptcy court to calculate the amount of future income a debtor will in fact have available to repay creditors. . . . There is no sense in which RRA annuity payments are 'anticipated' as that term is used in 45 U.S.C. § 231m(a)." *Meyer v. United States Trustee (In re Scholz)*, 699 F.3d. 1167 (9th Cir. 2012).

Secured payments could be deducted regardless of need for collateral and exclusion of Social Security income was in good faith. The Ninth Circuit BAP affirmed confirmation of a plan in which the debtors retained six vehicles, continuing to make payments on them. The trustee had objected on the basis that some of the vehicles were not necessary and that the debtors' failure to take into account Social Security income was in bad faith. Two of the vehicles were ATVs and one vehicle was used by the debtors' daughter, a medical resident who was unable to make the payments. One of the ATVs was used to plow the driveway in the winter. As to disposable income for these above-median income debtors, the BAP concluded that § 707(b)(2)(A) allows deduction from current monthly income of payments on secured debt, averaged over 60 months, regardless of whether the collateral is necessary. This is distinguished from payments on collateral being surrendered. As to Social Security income, the BAP discussed the split of authority on whether debtors' exclusion of that income was indicative of lack of good faith, "the fact that a debtor excludes income from the disposable income calculation that Congress specifically allows the debtor to exclude is not, by itself, probative of a lack of good faith." There may be circumstances where the exclusion of that income, coupled with other factors, might indicate bad faith, but that was not the case here, where the

trustee relied solely on the exclusion of income. There was a dissent as to good faith. *Drummond v. Welsh (In re Welsh)*, 465 B.R. 843 (BAP 9th Cir. 2012).

Objection to exemption mixed with plan objection. The trustee had not objected to confirmation or raised failure to devote projected disposable income, when the trustee objected to claim of exemption in tax refunds. Although an exemption objection may be a “placeholder” for a plan objection under § 1325(b), here the exemption objection was sustained on the basis that failure to devote the tax refund to plan payments would violate § 1325(b)(1), but by that time the debtor had amended the plan, dedicating non-exempt tax refunds to fund the plan. An objection based on projected disposable income was not ripe when the order denying the exemption was entered, since the trustee had not raised a plan objection at that point. *Matos v. Rivera (In re Matos)*, 478 B.R. 506 (BAP 1st Cir. 2012). *Accord Santiago v. Rivera (In re Santiago)*, 478 B.R. 516 (BAP 1st Cir. 2012).

Disposable income issue not preserved for appeal. When the bankruptcy court confirmed a plan, and there was no reservation of the disputed issue raised by the trustee over a personal injury claim being disposable income or exempt, there was no jurisdiction for appeal of the exemption claim. *Boyajian v. Vargas (In re Vargas)*, 2012 WL 2450170 (BAP 1st Cir. June 8, 2012), slip copy.

Voluntary postpetition contributions to retirement account are not excluded from disposable income. Pointing out the split of authority and agreeing with *In re Seafort*, 669 F.3d 662 (6th Cir. 2012), and *In re Prigge*, 441 B.R. 667 (Bankr. D. Mont. 2010), the Bankruptcy Appellate Panel held that although § 541(a)(7)(A) excludes from property of the estate withholding by an employer for contributions to specified retirement accounts, § 1306(a) brings into the Chapter 13 estate the debtor’s postpetition earnings. Section 541(a)(7)(A) provides protection for amounts held by employers at the time of case commencement, and is limited to prepetition contributions. The “except that” clause hanging to § 541(a)(7) excludes those prepetition withholdings from property of the estate and disposable income, with postpetition, voluntary contributions by the debtor not protected from inclusion in disposable income. *Parks v. Drummond (In re Parks)*, 475 B.R. 703 (BAP 9th Cir. 2012).

Social Security always excluded from projected disposable income, and amount required for home mortgage arrearage is presumptively reasonable. The trustee objected to confirmation, for failure to dedicate all projected disposable income, but the court agreed with *Baud v. Carroll*, 634 F.3d 327 (6th Cir. 2011), that Social Security income was always excluded from the projected disposable income calculation, as supported by Form 22C’s deduction of the Social Security income from current monthly income. Although Schedule I includes the income, that Schedule does not determine projected disposable income. As to the trustee’s objection to arrearage, the court noted that curing home mortgage default was one of the primary reasons to file Chapter 13, and the amount necessary to cure the prepetition arrearage was presumptively reasonably necessary and deductible in arriving at projected disposable income. Also, it does not violate confirmation requirement that the debtor will have negative projected disposable income in the first months of the plan, because of mortgage arrearage payments, since the

debtor voluntarily “can dip into his Social Security income” to make the proposed plan payments, and after the arrearage is cured, the debtor would have positive monthly disposable income. *In re Wise*, 476 B.R. 653 (Bankr. D. Dist. Col. 2012).

Housing expenses were excessive and not reasonably necessary. The applicable IRS Local Standard for housing for a household size of one was \$1,125, and that was the starting point for determination of whether housing expenses were reasonably necessary. The debtor occupied the residence alone, and it had 6,100 square feet, with five bedrooms, and other luxuries, such as a 300-plus bottle wine cellar, second kitchen and heated pool. His utilities were double the Local Standard. The debtor had not attempted to demonstrate special circumstances, and the home value was less than the mortgage debt. The mortgage payment of \$5,857.13 was unreasonable. Moreover, the plan was not proposed in good faith. *In re Konowicz*, 470 B.R. 725 (Bankr. D. N.J. 2012).

Hybrid plan prohibited. Absent the secured creditor’s consent, a plan may not treat bifurcated mortgage on rental property, paying the prepetition mortgage arrearage over a sixty-month period in reduction of the bifurcated secured portion, while paying the remaining secured portion as long-term debt. Section 1322(d) imposes a maximum five-year limit on paying the bifurcated secured claim. Discussing conflicting authority, the court concluded that a debtor may not combine §§ 1322(b)(2) and (b)(5) for treatment of the same claim. *In re Fortin*, 482 B.R. 35 (Bankr. D. Mass. 2012).

Applicable Commitment Period

Debtor with no projected disposable income may confirm less than 60-month plan. The Ninth Circuit held that its precedent in *In re Kagenveama*, 541 F.3d 868 (9th Cir. 2008), survived *Hamilton v. Lanning*, 130 S.Ct. 2464 (2010), with *Kagenveama*’s construction of the applicable commitment period still valid. The debtors proposed a 36-month plan, with 1% distribution to unsecured creditors, and the trustee objected, on the basis that *Lanning* required a full 60-month plan. After an initial appeal to the BAP, the bankruptcy court certified the plan duration issue for direct appeal. The facts were not in dispute, with the debtors’ current monthly income above the median income in their location, but their monthly disposable income was negative. Although the Code defines “applicable commitment period,” the panel observed that “its role in defining the duration of the Debtor plan of reorganization is not [defined].” The panel discussed the pre-*Lanning* interpretations of § 1325(b), with *Lanning* adopting the forward-looking approach to projected disposable income. The panel then discussed the divergent views on applicable commitment period, concluding that *Lanning* did not address that issue and that the applicable commitment portion of *Kagenveama* was not “clearly irreconcilable” with *Lanning*. The majority of the panel ended its opinion with the observation that it was not deciding the applicable commitment period issue as a matter of first impression; rather, it was bound by *Kagenveama*. “Only the Supreme Court or an en banc panel of this court may revisit *Kagenveama*’s holding regarding the applicable commitment period.” *Danielson v. Flores (In re Flores)*, 692 F.3d 1021 (9th Cir. 2012), *en banc* review granted, 2012 WL 6618328 (Dec. 19, 2012).

Five-year maximum length not tolled in gap between dismissal and reinstatement.

In addition to holding that the automatic stay is not reinstated retroactively during a gap period between case dismissal and reinstatement, the court held that the five-year cap for a plan length was not tolled during that period. The bankruptcy court had dismissed the case, and with some delay, the district court reinstated, but the debtors were unable to complete plan obligations within the maximum five-year term. Confirmation was properly denied. *In re Scarborough*, 2012 WL 70638 (3d Cir. 2012), slip copy.

Inheritance—Property of Estate

Inheritance received more than 180 days after commencement was included in estate.

Citing dicta from the Eleventh Circuit, *Waldron v. Brown (In re Waldron)*, 536 F.3d 1239 (11th Cir. 2008), the bankruptcy court held that an inheritance received by the debtor more than 180 days after the petition filing became property of the estate under § 1306(a). The *Waldron* court had cited *In re Noe*, 269 B.R. 250 (Bankr. M.D. Fla. 2000), in which the inheritance was received about two years postpetition, as “an example of a post-petition inheritance that was properly included in a chapter 13 estate.” The bankruptcy court concluded that “not applying the 180-day limitation under § 541(a)(5), when determining what is included within a chapter 13 estate under § 1306(a), is consistent with a major distinction between chapters 13 and 7.” *In re Tinney*, 2012 WL 2742457 (Bankr. N.D. Ala. July 9, 2012), slip copy.

Lien Modification and Stripping

Section 506(d) not available to void unsecured lien.

The Tenth Circuit has rejected the debtor’s reliance on § 506(d)’s voiding language as a means to strip a wholly unsecured junior mortgage. Noting that the debtors may have had a valid lien stripping method under § 1322(b)(2), joined with § 506(a), the debtors “repudiated the only possible winning argument they may have had,” by specifically declining the panel’s invitation to use that approach. In supplemental briefing requested by the panel, the debtors “announced ‘[t]here is no Code provision other than 11 U.S.C. § 506(d) that declares void a wholly unsecured lien.’” The panel, therefore, held that it was bound by *Dewsnup v. Timm*, 502 U.S. 410 (1992), although a Chapter 7 case, because the *Dewsnup* Court held that § 506(d)’s term “allowed secured claim” includes a lien that is valid under applicable state law, without regard to whether there is value to support the lien. The mortgage at issue before the Tenth Circuit was valid under Utah law and was an allowed claim. Section 506(d) applies in Chapter 13, as well as Chapter 7, and, although the Circuit panel acknowledged that it was difficult to justify the Supreme Court’s reasoning, it was bound by *Dewsnup*. It seems clear that the panel would have followed other appellate authority in recognizing that a wholly unsecured lien may be stripped by use of §§ 506(a) and 1322(b)(2), commenting “that *Dewsnup* has lost every away game it has played: its definition of ‘secured claim’ has been rejected time after time elsewhere in the code and seems to hold sway only in § 506(d).” *Woolsey v. Citibank, N.A. (In re Woolsey)*, 696 F.3d 1266 (10th Cir. 2012).

Stripping lien by debtor ineligible for discharge was not final order for appeal.

Although the Bankruptcy Appellate Panel held that a Chapter 13 debtor who was not eligible for discharge could strip off a wholly unsecured junior lien, *In re Fisette*, 455 B.R. 177 (BAP 8th Cir. 2011), that was not a final order subject to appeal, since the BAP had remanded for consideration of other confirmation issues. *Fisette v. Keller (In re Fisette)*, 695 F.3d 803 (8th Cir. 2012).

Plan stripping junior mortgage was in good faith. The trustee objected to confirmation, based on lack of good faith, when the plan proposed to pay directly a first mortgage, while stripping off the wholly unsecured second mortgage and paying \$150 a month for 36 months, which would provide 17.25% dividend to unsecured creditors, including the stripped mortgage creditor. The unsecured debt, except for the mortgage, was only \$549. The debtor amended the plan to increase monthly payments to \$275, which increased the dividend slightly. The trustee posited that the debtor's sole purpose was to strip the mortgage, since the debtor's income was sufficient to pay monthly expenses and debt. Under *In re Goeb*, 675 F.2d 1386 (9th Cir. 1982), the good faith determination cannot be based exclusively on one factor; rather, a totality of circumstances must be considered. The BAP held that looking only to the factor that the debtor was stripping the mortgage was not proper. This debtor had not previously filed Chapter 7, so this was not a Chapter 20 case; the opinion distinguishes the facts in Chapter 20 cases in which courts had discussed the need for a debtor's good faith in lien stripping. The BAP also rejected analogy to the attorney-fee only cases, as urged by the trustee. The court noted that the second mortgage creditor would receive a substantial unsecured distribution. The bankruptcy court did not err in finding the debtor's plan in good faith. *In re Lepe*, 470 B.R. 851 (BAP 9th Cir. 2012).

Petition date is time for determination of § 1322(b)(2) protection. Discussing the split of authority, the BAP held that for purposes of determination of the debtor's principal residence and protection of a loan from modification, the appropriate date was the petition date, rather than the time of execution of the mortgage. The bankruptcy court had applied the time of the transaction, applying the contract language to permit modification, but the BAP applied its prior rule in a Chapter 11 case, *BAC Home Loans Servs., L.P. v. Abdelgadir (In re Abdelgadir)*, 455 B.R. 896 (BAP 9th Cir. 2011), which held that under § 1123(b)(5), the petition date was appropriate. Language of § 1123(b)(5) and § 1322(b)(2) is identical, and the BAP found the majority of case law under § 1322(b)(2) to support using the petition date. *Benafel v. One West Bank, FSB (In re Benafel)*, 461 B.R. 581 (BAP 9th Cir. 2011).

See also TD Bank v. Landry, 479 B.R. 1 (D. Mass. 2012). When the purpose of valuation is to determine if the claim is protected by § 1322(b)(2), or whether the creditor is entitled to stay relief, the time for valuation is the petition date, with the district court citing *In re Benafel*, 461 B.R. 581 (BAP 9th Cir. 2011). *Accord BAC Home Loans Servicing v. Nieto (In re Nieto)*, 2012 WL 6097983 (BAP 9th Cir. Nov. 28, 2012), slip copy, applying *Benafel*. Contrast *In re Williams*, 480 B.R. 813 (Bankr. E.D. Tenn. 2012), holding that for purpose of deciding lien stripping of a junior mortgage and its valuation, the time for valuation was plan confirmation, rather than the petition date. The court cited in support the *Landry* bankruptcy court's opinion, which was subsequently

reversed above, but the *Williams* court specifically found that valuation was in the context of confirmation, with two competing appraisals having been conducted postpetition. For valuation purposes, the *Williams* court also concluded that the proper standard for lien stripping purposes was price at which comparable properties had sold in arm's length sales transactions, with an appraisal using only foreclosure transactions more appropriate for surrendered property than for a residence that the debtor proposed to retain.

Mandamus not appropriate to compel bankruptcy judge to follow district court decision. The district court rejected debtors' petition for writ of mandamus, in which they sought to compel a bankruptcy judge to follow another district judge's decision on stripping of wholly unsecured liens, in *Carroll v. Key Bank*, 2011 WL 6338912 (D. Utah 2011). The debtors did not show that they had no alternative means to obtain relief, with the district court pointing out that they must appeal any adverse ruling. Also, the court discussed the "mandate" rule, concluding that it applied to bankruptcy courts, but that there was no "law of the district," since each district judge is not required to follow as precedent a decision of another district judge. The "mandate rule" simply requires a bankruptcy judge to follow an appellate court's ruling on a specific issue in the same case. *Hall, et al. v. Thurman (In re Walk)*, 2012 WL 3292934 (D. Utah Aug. 10, 2012), slip copy.

Antimodification and cure-maintain provisions mutually exclusive. Sustaining the mortgage creditor's objection to a "hybrid" plan that proposed to modify the claim, by stripping down the secured portion and paying it beyond the plan life, the bankruptcy court held that when the mortgage is subject to modification, the secured portion must be paid within the life of the plan. The mortgage at issue was subject to modification, but the plan's proposal to pay the stripped down secured portion, while continuing payments under terms of the original note, was in conflict with § 1322(d)'s requirement that payments be no longer than five years, and it violated § 1325(a)(5)(B)(ii)'s "present value" requirement. Acknowledging that the genesis of this "hybrid" plan was *In re McGregor*, 172 B.R. 718 (Bankr. D. Mass. 1994), the court found the proposal in conflict with *Nobelman v. American Savs. Bank*, 508 U.S. 324 (1993). The court concluded that "§§ 1322(b)(2) and (5) are mutually exclusive and that a plan that proposes to both modify the rights of the secured claim holder and thereafter cure and maintain payments on the secured portion of the claim for period that exceeds the term of the plan cannot be confirmed over the creditor's objection." *In re Bullard*, 475 B.R. 304 (Bankr. D. Mass. 2012). See also *In re Hinkle*, 474 B.R. 460 (Bankr. M.D. Pa. 2012) (reaching same conclusion, with a modified loan subject to § 1322(d)'s time limitation).

Plan by debtors ineligible for discharge, attempting to strip lien, was not in good faith. The debtors received Chapter 7 discharges in 2009, then filed the Chapter 13 in which they filed a proof of claim on behalf of a second mortgage holder and an adversary proceeding seeking to declare the mortgage wholly unsecured. The debtors then attempted to withdraw the proof of claim they had filed, and the trustee objected to confirmation of grounds of lack of good faith. The court first held that the debtors could not withdraw the proof of claim, agreeing with other courts that Rule 3006 only permits

the creditor to withdraw a claim. Although a default judgment was entered in the adversary proceeding, it only declared the lien wholly unsecured and did not disallow the creditor's unsecured *in rem* claim. The plan, therefore, must treat the creditor as unsecured, and the debtors had sufficient disposable income, an actual monthly surplus, precluding them from paying nothing to the unsecured mortgagee. In fact, their disposable income was sufficient to pay unsecured claims in full. The plan was not proposed in good faith, and it violated § 1325(b)(1)(B). *In re Renz*, 476 B.R. 382 (Bankr. E.D. N.Y. 2012).

Time for valuing residence for lien stripping purposes. When the debtor's adversary proceeding seeking to strip off a wholly unsecured junior mortgage was not a part of the confirmation process, the time to determine value of the residence was not at confirmation, with the district court holding that § 1325(a)(5)(B)(ii)'s "as of the effective date of the plan" referred to the value of property to be distributed under the plan, not to the allowed amount of the secured claim. The proceeding was remanded for determination of the appropriate date for fixing the residence value, which might be the time of judgment in the adversary proceeding. *Marsh v. United States Dep't of Housing & Urban Dev. (In re Marsh)*, 475 B.R. 892 (N.D. Ill. 2012).

Condominium lien is statutory. Discussing the split of authority on whether a lien held by a condominium association is a statutory lien or a security interest, the district court held that under § 101(53) and Pennsylvania law, the lien was statutory, because the lien automatically and solely arose under the state's statute when the association's assessment became due. Even though the state statute permitted the association to enforce its lien by foreclosure, it was not converted to a security interest. *Young v. 1200 Buena Vista Condominiums*, 2012 WL 3705004 (W.D. Pa. Aug. 27, 2012), slip copy.

Debtor not allowed to strip lien for non-filing spouse. Disagreeing with *Strausbough v. Co-op Services Credit Union (In re Strausbough)*, 426 B.R. 243 (Bankr. E.D. Mich. Mar. 25, 2010), and agreeing with *Hunter v. Citifinancial, Inc. (In re Hunter)*, 284 B.R. 806 (Bankr. E.D. Va. Sept. 30, 2002), debtor may not avoid second mortgage lien on tenancy by entirety property as to nondebtor spouse. "[A]s to property owned by tenants by the entireties, the debtor and the nondebtor spouse each have a bundle of rights. Each has, for example, a survivorship interest and ownership rights in the event the tenancy is severed. If [debtor were] correct, in a tenants by the entireties context, not only would the debtor Husband end up with an ownership interest in a property no longer subject to the second lienholder's security interest, but the nondebtor spouse would also." *Alvarez v. HSBC Bank, USA*, 2011 WL 6941670 (D. Md. Dec. 28, 2011).

Debtors bound by plan's treatment of junior lien as secured. More than a year after confirmation provided for treatment of a junior lien as secured, the debtors filed an adversary proceeding to value and strip the lien as wholly unsecured, and the court held that the debtors must start the lien modification process in the plan, and if the confirmed plan provided for modification, the debtors may then pursue an adversary proceeding to determine the validity, extent and priority of the lien. Here, the debtors were bound by their confirmed plan, and barring successful modification of their plan, *res judicata*

prevented the relief sought in the complaint. *In re Pierce*, 2012 WL 1903263 (Bankr. E.D. Va. May 24, 2012), slip copy.

Surrender

Partial surrender doesn't satisfy § 1325(a)(5)(C). Adopting the majority position, the debtors' proposal to surrender part of the collateral under § 1325(a)(5)(C), while paying the balance of the secured claim under subsection (B), was not confirmable. The debtors must choose one of the alternatives. Subsection (C) requires surrender of all of the collateral. *In re Snyder*, 2012 WL 1110119 (Bankr. N.D. N.Y. 2012), slip copy.

Effect of Confirmation

Former wife bound by confirmed plan. The confirmed plan provided for payment of a \$78,000 domestic support obligation, less than an asserted \$139,199.06 claim, but the ex-wife participated in the confirmation process and was bound by the confirmed plan. However, only \$78,000 of the prepetition domestic support obligation would be discharged upon plan completion, with the remaining balance excepted from discharge under § 1328(a) and § 523(a)(5). Despite § 362(b)(2)'s exceptions from the stay, the ex-wife was bound by confirmation and must await plan completion and discharge before resuming attempts to collect the nondischargeable portion. Collection of any postpetition domestic support obligation was not stayed. *In re Hutchens*, 480 B.R. 374 (Bankr. M.D. Fla. 2012). See also for discussion of DSO claims, *In re Angelo*, 480 B.R. 70 (Bankr. D. Mass. 2012); *In re Ashworth*, 2012 WL 4596217 (Bankr. C.D. Cal. Oct. 1, 2012), slip copy; *In re Conte*, 2012 WL 4739339 (Bankr. E.D. N.Y. Oct. 3, 2012), slip copy;

Post-confirmation Modification

No threshold requirement for change in circumstances, and debtors not in good faith in proposing modification to shorten plan term. The BAP first held that there was no threshold requirement of changed circumstances for a post-confirmation modification. Section 1329 contains no "express requirement [of] a substantial and unanticipated change in the debtor's financial circumstances. . .to overcome the res judicata effect of a confirmed plan under § 1327(a)." However, some courts had incorporated such a test, including *In re Murphy*, 474 F.3d 143 (4th Cir. 2007). The Ninth Circuit had not directly ruled on the issue, and the BAP was not bound by dicta in *In re Anderson*, 21 F.3d 355 (9th Cir. 1994), which suggested "that the substantial and unanticipated change test applies." Although not adopting the test as a required one, the bankruptcy court may consider change in circumstances in exercising its discretion, and "it may make little practical difference whether the bankruptcy court applies the substantial and unanticipated change test as a threshold requirement or uses it as a discretionary tool." In this case, to the extent the bankruptcy court used the test, it was harmless error. The above-median debtors moved to modify their confirmed plan, increasing payments but reducing the plan term from 60 to 36 months, and the bankruptcy court approved the payment increase but denied the term reduction. The bankruptcy court's holding and facts of the case fit within a good faith analysis, and

“allowing them to shorten their plan would be an inequitable result,” since their income had increased significantly. The BAP emphasized “that the continued absence from § 1329(b)(1) of any reference to § 1325(b) is conclusive as to whether a debtor may modify his or her plan to reduce the term below the applicable commitment period required for an original plan.” *In re Mattson*, 468 B.R. 361 (BAP 9th Cir. 2012).

Modification based on recalculation of disposable income denied. The trustee moved to modify the confirmed plan, based on debtors having more disposable income than at time of confirmation, but the court concluded that § 1325(b)’s disposable income test does not apply to postconfirmation modifications. Disposable income is determined based on “current monthly income,” and the trustee’s modification depended on recalculating the disposable income. While modification may be based on changes in circumstances related to income and expenses, the trustee’s motion depended on recalculation of disposable income, with no proof offered of change in circumstances or that the debtors were able to pay more than currently paying. *In re Coay*, 2012 WL 2319100 (Bankr. C.D. Ill. June 19, 2012), slip copy.

Debtors may modify to pay lump sum before end of applicable commitment period. Overruling the trustee’s objection, the debtors were permitted to modify their confirmed plan, paying the remaining plan payments in lump sum, funded by relatives, before expiration of the applicable commitment period. The court concluded that “§ 1329 does not incorporate § 1325(b), and thus a chapter 13 plan may be modified so that it has a term shorter than the applicable commitment period, so long as the plan as modified satisfies the other requirements of § 1329 including the specifically incorporated provisions of §§ 1322(a), 1322(b), and 1323(c) and the requirements of § 1325(a).” In the original plan, because the debtors were above the median income, the applicable commitment period was five years, and the plan proposed to pay unsecured creditors 6.8% over that term. The cash gift from a relative was conditioned on using it to pay off the plan four years early in lump sum. Noting the split of authority on allowing modification to pay off the plan in a shortened term, the court concluded that § 1325(b) is a prerequisite to confirmation, but the “Code does not require that a modified plan have a particular minimum term. Section 1329 recognizes that modification may require an extension or reduction in the time for payments.” No one suggested that the modification was lacking good faith. The court distinguished *Whaley v. Tennyson (In re Tennyson)*, 611 F.3d 873 (11th Cir. 2010), which dealt with confirmation, not modification. *In re Tibbs*, 478 B.R. 458 (Bankr. S.D. Fla. 2012).

Discharge

Borrower’s failure to comply with mortgage assignment did not create fiduciary relationship. The residential mortgage contained an assignment of proceeds, including those from damage to the property, and the debtor had settled with builders of her home but did not pay the proceeds to the mortgagee. While a state statute may create the necessary fiduciary relationship for purposes of § 523(a)(4), a statute can’t transform ordinary individuals or transactions into fiduciaries by simply using the terms “trust” or “fiduciary.” The relevant Arkansas statute, Ark.Code § 4-58-105(b)(2), did not create a

fiduciary relationship between the mortgagor and mortgagee in a strict sense, as required for § 523(a)(4). Moreover, the debtor did not embezzle, since one can't embezzle her own property. *In re Nail*, 680 F.3d 1036 (8th Cir. 2012).

***Brunner* doesn't necessarily require debtor to "indenture" herself to Ford Program for purposes of § 523(a)(8).** Discussing the precedent of *In re Brunner*, 831 F.2d 395 (2d Cir. 1987), in the context of whether a debtor is required to participate in the current William D. Ford program for student loan repayment, the bankruptcy court concluded that the *Brunner* test remained binding, but that it must be interpreted in light of changes since 1987. The *Brunner* test does not require that the 64-year old debtor indenture herself to another 25 years of debt repayment, under the Ford Program's adjusted payments. The totality of circumstances was applied to a debtor who passed the *Brunner* test, finding that the debtor had no hope of improved job or income; that the debt was 24-years old, increasing from \$16,931 borrowed to \$56,000 at time of bankruptcy; that the debtor had paid all she could on the student loan debt; and that the debtor was close to complete reliance on Social Security income. Agreeing with *Collier on Bankruptcy*, the Ford Program should not be "viewed as an implied repeal of 11 U.S.C. § 523(a)(8)," and the debtor had established that repayment would be an undue hardship. *Bene v. Educational Credit Management Corp. (In re Bene)*, 474 B.R. 56 (Bankr. W.D. N.Y. 2012).

Rule 1019 is silent as to new period for complaints when Chapter 13 is converted to Chapter 11. In a case filed under Chapter 13 and then voluntarily converted to Chapter 11, the time for filing § 523(a)(2) complaints did not begin to run anew. The time had expired in the Chapter 13 case, without a motion to extend, and Rule 1019 does not address the renewal of time when the case is converted to Chapter 11. Section 523(a)(2) debts are excepted from discharge in both Chapters 13 and 11, and the creditor had the same incentive to file a timely complaint in the Chapter 13 phase of the case. Under § 348, conversion did not create a new case. The complaint was untimely and dismissed. *Bank of Commerce v. Schupbach (In re Schupbach)*, 473 B.R. 423 (Bankr. D. Kan. 2012).

Discharge Injunction

Student loan creditor violated discharge injunction. Education Credit Management Corp. (ECMC) filed a proof of claim for \$55,000, to which the debtor objected, with the objection served on ECMC, which did not respond nor attend the objection hearing. The debtor's objection stated that the student loan debts had not been adequately documented and that one had been satisfied fully before bankruptcy. At the evidentiary hearing, the debtor testified and subsequently filed an affidavit, with an order entered sustaining the objection and allowing the claim in the amount of -0-. After the debtor received a discharge, ECMC contacted the debtor, stating that the debts were not discharged and that collection would be pursued. After the debtor reopened the case and filed a complaint, a declaratory judgment was entered, with \$9,134.72 remedial sanction for the debtor's costs, related to ECMC's violation of the discharge injunction. The Bankruptcy Appellate Panel affirmed, holding that the issue involved the disallowance of ECMC's

proof of claim under § 502(b), rather than whether an allowed student loan debt was dischargeable. The debtor invoked the claims allowance procedure, and the resulting disallowance order determined both the validity and amount of the claim. Since there was no liability on the claim, there could be no collection post-discharge by ECMC. ECMC's attempt on appeal to couch the issue in terms of dischargeability ignored the res judicata effect of the order disallowing its claim. ECMC's collection attempts violated the discharge injunction, for which sanction in the amount of the debtor's attorney fees was appropriate. *Hahn v. Educational Credit Management Corp. (In re Hahn)*, 476 B.R. 344 (BAP 1st Cir. 2012).

Conversion and Dismissal

Funds held by trustee at conversion to Chapter 7 must be returned to debtor. The Third Circuit, with a dissent, held that plan payments not yet distributed to creditors and held by the trustee at the time of conversion to Chapter 7 must be returned to the debtor, in the absence of bad faith. Funds had accumulated in the trustee's hands after stay relief had been granted to allow foreclosure, but the debtor had not modified the confirmed plan to reduce plan payments. The Circuit concluded that § 348(f) did not completely resolve the legal issue of what the trustee should do with such funds when the case was converted, but on conversion to Chapter 7, "the order converting the case is effectively backdated to the time of the order for relief under Chapter 13," suggesting that property of the Chapter 13 estate acquired postpetition is excluded from property of the Chapter 7 estate. Since confirmation vests property in the debtor, under § 1327(b), "the implication is that property held by the Chapter 13 trustee after plan confirmation is 'under the control of the debtor as of the date of [a later] conversion' for purposes of § 348(f)(1)." Returning undistributed funds to the debtor better aligns with termination of the Chapter 13 trustee's duties, except for accounting for funds by filing a final report under Rule 1019; the trustee is not authorized to distribute funds under a plan that is no longer operative. A textual reading of § 348(f), along with its legislative history, led the panel "to conclude that undistributed plan payments held by a Chapter 13 trustee at the time of conversion must be returned to the debtor absent bad faith." *In re Michael*, 699 F.3d 305 (3d Cir. 2012).

Bad faith justified conversion and denial of debtor's motion to dismiss. Applying *Jacobsen v. Moser (In re Jacobsen)*, 609 F.3d 580 (5th Cir. 2010), the debtor's bad faith, including misrepresentations in schedules, provided cause for the bankruptcy court's conversion of the case to Chapter 7 and denial of the debtor's motion to voluntarily dismiss. *Elliott v. Sutton (In re Elliott)*, 2013 WL 69285 (5th Cir. Jan. 7, 2013), slip copy.

Fees to Chapter 7 trustee and sanction for appealing consent orders affirmed. In appeals of fees awarded to Chapter 7 trustee after conversion, the debtors also appealed from some consent orders. Most of the appeals were properly dismissed by the district court as untimely or for lack of standing of the debtors, but the district court properly sanctioned the appeal of the consent orders under Rule 11. Appeal of consent orders is permitted only under limited exceptions: (1) the party did not actually consent; (2) the

court did not have subject matter jurisdiction to enter an order approving the consent; or (3) the consent order “explicitly reserves the right to appeal.” *In re Mondelli*, 2012 WL 6685476 (3d Cir. Dec. 26, 2012), slip copy.

Case dismissal for failure to attend § 341 meeting affirmed. The pro se debtor had filed a second Chapter 13 case after foreclosure of her home, and there were deficiencies in the petition and schedules, with the debtor failing to attend the § 341 meeting, despite requesting and obtaining two resettings of that meeting. There was no abuse of discretion in the dismissal. *Oliver v. United States Trustee (In re Oliver)*, 2012 WL 5232201 (9th Cir. Oct. 23, 2012), slip copy. *Accord, Zapata v. United States Trustee (In re Zapata)*, 2012 WL 4466283 (9th Cir. Sept. 28, 2012), slip copy.

Dismissal for unreasonable delay affirmed. When the debtor had not obtained confirmation, after filing five proposed plans, the bankruptcy court did not err in finding that the debtor had delayed unreasonably, that the plans did not provide for secured claims, that the plans lacked detail as to proposed liquidation of assets, from which proposed payments would be made, and that disposable income was “mythical.” The debtor’s motion for new trial or amendment of the dismissal judgment was also properly denied, when the debtor merely addressed the same issues already litigated. *Paulson v. Wein (In re Paulson)*, 477 B.R. 740 (BAP 8th Cir. 2012).

Dismissal of case and adversary proceeding proper. In dismissing the Chapter 13 case of deceased debtor, the bankruptcy judge properly assessed the value of a pending avoidance proceeding brought by the trustee and former Chapter 7 trustee (the case had been converted from 7 to 13), finding no value in the proceeding and that it was time barred. Dismissal of the case left the trustees with no standing to pursue a cause of action on behalf of a former estate; the attorneys for the trustees were attempting to recover fees but there was no source of payment of those fees. *Dockery v. Busuego (In re Christensen)*, 2012 WL 603708 (BAP 9th Cir. Feb. 2, 2012), slip copy.

Right to convert was absolute. Adopting *In re DeFrantz*, 454 B.R. 108 (BAP 9th Cir. 2011), the district court held that a Chapter 13 debtor had an absolute right to convert to Chapter 7. Although BAP decisions were not binding, the court found the *DeFrantz* reasoning and its distinction of conversions from Chapter 7 and 13 to be persuasive. “*Marrama*’s reasoning does not directly translate to conversions under § 1307(a) because there is no cause for concern that a debtor may use that provision to ‘escape the consequences of bad faith conduct or for abuse of process.’” *In re Taylor*, 472 B.R. 570 (C.D. Cal. 2012).

Dismissal with two-year bar as sanction for contempt was appropriate. In a fourth bankruptcy case, the debtor failed to appear at scheduled deposition, related to the U.S. Trustee’s discovery requests concerning a mortgage, and the debtor then had notice of a show cause hearing on why she did not appear, along with notice of the U.S. Trustee’s request for sanctions and case dismissal. As a sanction for disobeying the discovery order requiring appearance at her deposition, the bankruptcy court did not abuse its

discretion in dismissing the case with a two-year refilling bar. *In re Cline*, 474 B.R. 785 (BAP 6th Cir. 2012).

Debtor did not have absolute right to dismiss. Reviewing the split of case authority subsequent to *Marrama v. Citizens Bank of Massachusetts*, 549 U.S. 365 (2007), the district court held that a Chapter 13 debtor's right to voluntarily dismiss the case is dependent on good faith, finding that the reasoning of *Marrama* should apply. There was cause for conversion of the case to Chapter 7 "in light of [the debtor's] exceptional bad faith conduct." The court found that the debtor had no intention to pay creditors, using the Chapter 13 to litigate claims while having substantial inaccuracies in the schedules. His plan proposed \$10 a month, but there were \$65,000 in priority claims. *In re Mitrano*, 472 B.R. 706 (E.D. Va. 2012).

Debtor had absolute right to dismiss case, but trustee could distribute settlement proceeds. After confirmation, the debtor and GMAC settled, with GMAC withdrawing its proof of claim, releasing the debtor's mortgage and paying \$20,000, with a state court suit against GMAC dismissed. The Chapter 13 trustee moved for turnover of the \$20,000 and the debtor moved to voluntarily dismiss the case. A dismissal would not give the debtor a right to the \$20,000, since those proceeds were property of the estate, subject to disbursement under the confirmed plan. Under § 349(b)(3), the court has authority to "order otherwise" than allowing vesting of the settlement proceeds in the debtor. The confirmed plan promised unsecured creditors a pro rata share of litigation proceeds, and cause existed to authorize the trustee to disburse the settlement proceeds to unsecured creditors. The trustee was holding additional funds in excess of the 20% distribution provided for in the plan; therefore, the trustee would distribute the \$20,000, plus any accrued interest on that amount, then on dismissal, remit the balance on hand to the debtor. *In re Darden*, 474 B.R. 1 (Bankr. D. Mass. 2012).

Dishonesty and bad faith justified dismissal with prejudice and sanction. After discharge had been denied in a prior Chapter 7, the debtors' third case, a Chapter 7 that was converted to Chapter 13, was dismissed with prejudice to refilling for two years, and the debtors were sanctioned attorney fees and expenses of an objecting creditor that prosecuted a motion to dismiss. There was no purpose in filing the present case under Chapter 7, since the debts were the same as those for which discharge had been denied in a prior case; therefore, the filing was for the purpose of hindering and delaying creditors. Although converted to Chapter 13, the debtors lied under oath about their income on Schedule I, and they did not timely amend after the conversion. Cause existed to dismiss under § 1307(c)(1), because of prejudicial delay to creditors, and the court had inherent authority, as well as under § 105(a), to sanction the debtors' misconduct, and to bar them from refilling for two years under § 105(a) and § 349(a). *In re Mehlhose*, 469 B.R. 694 (Bankr. E.D. Mich. 2012).

Attorney Fees

No per se bad faith in attorney-fee-only plan. The Fifth Circuit reversed the district court, affirming the bankruptcy court's confirmation of a plan that essentially paid only the debtor's attorney fees, concluding that there is no per se violation of the good faith

requirement in such a plan. Under the totality of circumstances, the bankruptcy court did not err in finding the plan in good faith, when there was credible evidence that the debtor had good reasons to file under Chapter 13 rather than 7. The debtor had only Social Security and modest food stamp income, and her only debts were a home mortgage and credit card debt. She was current on the mortgage and credit cards at filing, but it would take 20 years of minimum payments to pay the \$7,855 credit card debt. The bankruptcy court had found that it would “border on malpractice” for her attorney to advise filing Chapter 7. In addition, the attorney’s \$2,800 no-look fee was reasonable, with the Circuit panel noting that the trustee’s plan objection turned a simple case into a complicated one for the attorney. *Sikes v. Crager (In re Crager)*, 691 F.3d 671 (5th Cir. 2012).

Fee-only plan not per se bad faith. The First Circuit held in March that a fee-only Chapter 13 plan was not per se proposed in bad faith. “While fee-only plans should not be used as a matter of course, there may be special circumstances, albeit relatively rare, in which this type of odd arrangement is justified. Given this possibility, prudence dictates that we hew to the overarching principle that the presence or absence of good faith should be ascertained case by case. . . .The dangers of such plans are manifest, and a debtor who submits such a plan carries a heavy burden of demonstrating special circumstances that justify its submission.” *In re Puffer*, 674 F.3d 78 (1st Cir. 2012).

Reduction of fees in uncomplicated case was affirmed. The First Circuit, with Justice Souter sitting, affirmed the bankruptcy court’s denial of \$8,000 additional fees to the Chapter 13 debtors’ attorney, holding that the bankruptcy court properly applied § 330. That section and the lodestar method do not bind the bankruptcy court to a single way of calculating the number of hours that are reasonable, and the bankruptcy court properly determined that the case was relatively uncomplicated. The attorney’s argument that “convoluted” calculations under the means test for an above-median debtor required much time didn’t get far, and the bankruptcy court was not required to explain its fee award by a line-by-line examination of the application. “There is no requirement that a bankruptcy court, in explaining a fee award, be precise to the point of pedantry.” *Berliner v. Pappalardo (In re Sullivan)*, 674 F.3d 65 (1st Cir. 2012).

Fee reduction affirmed. Although the debtors’ attorney was attempting to contest that the district’s fee formula was “parsimonious,” the Bankruptcy Appellate Panel could only consider the facts in the present case, and the bankruptcy court did not err in reducing the requesting \$9,000 fee to \$3,500 in what was a “mill-run chapter 13 case,” in which the attorney had spent excessive, unnecessary time. *In re Little*, ___ B.R. ___, 2013 WL 69186 (BAP 1st Cir. Jan. 4, 2013). *See also Bada v. Curry (In re Santana)*, 2012 WL 6605993 (BAP 9th Cir. Dec. 19, 2012), slip copy, in which the attorney’s appeal of a disgorgement order was dismissed as untimely, when the attorney did not appeal the first, final order.

On remand, no special circumstances to justify fee-only plan. After the Second Circuit, at 674 F.3d (2d Cir. 2012), held that attorney fee-only plans were not per se filed in bad faith and remanded for determination of whether special circumstances existed to justify the plan in this case, the bankruptcy court found that there were no such

circumstances and that the attorney's services were worthless to the debtor. The debtor was 32 years old, employed, in good health, and living with his parents. After paying the attorney a \$500 retainer, he waited ten months to file the case, with a plan that would pay the balance of the attorney fees and little else. The attorney was only allowed reimbursement of the filing fee and ordered to disgorge the balance of the retainer. *In re Puffer*, 478 B.R. 101 (Bankr. D. Mass. 2012).

Law firms' advances of filing fees were loans and prepetition claims. Law firm that provided clients with "no money down" bankruptcy filing and that advanced required filing fees had made loans to the clients, distinguishing those advances from normal expenses. As a result, the advanced filing fees were not reimbursable expenses under § 330(a)(4)(B), with the court also construing "compensation" narrowly. The advances were not "actual and necessary" expenses under that Code section, since the expense "did not arise from a transaction with the bankruptcy estate." The treatment in plans of those advanced fees as administrative expenses was unfair discrimination, favoring one class of prepetition unsecured claims over others. *In re Marotta*, 479 B.R. 681 (Bankr. M.D. N.C. 2012).

Fee disclosure should include overhead charge. Although the law firm should have disclosed a \$50 to \$150 fee charged to clients as recurring overhead costs, under § 329 and Rule 2016, the firm had self-reported the disclosure violations and disgorgement of all fees would be overly harsh. However, the firm was sanctioned and ordered to pay \$8,750 to the United States Trustee, \$8,000 to a pro bono organization, and \$42,675 disgorgement to the Chapter 13 trustee in pending cases. *In Matter of the Dellutri Law Group*, 482 B.R. 642 (Bankr. M.D. Fla. 2012).

Debtors' attorney sanctioned and no fees. In show cause hearing, attorney appeared fifteen minutes late, and then did not know what the hearing concerned, despite having received a show cause order. The debtor expressed dissatisfaction with the attorney's work in the case. Finding, among other things, that the attorney violated Rule 9011(b)(2), by signing and submitting a motion that was not warranted and without conducting an investigation, the pleading was frivolous, since the court had already denied an identical motion. The debtors were not eligible for Chapter 13 relief, and the value of the attorney's services was zero, with all fees disgorged. Further, the attorney was publicly reprimanded, and referral was made to the state bar. *In re Spickelmier*, 469 B.R. 903 (Bankr. D. Nev. 2012).

Illegal fee sharing examined. An agreed order had been entered in the Chapter 13 case, providing that if the debtors became sixty days delinquent, the stay would be lifted, and a \$600 fee for the moving creditor had been allowed, with the order approved by debtors' counsel and the Chapter 13 trustee. The bankruptcy court addressed the issue of whether outsourcing of paralegal and administrative support services by a law firm to third party vendors was an illegal fee sharing, in violation of § 504(a) or Rule 2016. The law firm had sold non-legal assets to a third party vendor, and the law firm's former non-lawyer employees were now employees of the vendor. The \$600 fee allowed was being paid by the debtors through their confirmed plan, with that payment directed to be paid to Chase

Home Finance, not to the law firm or the third party vendor; the disputed fees that were billed by the law firm or third party vendor to Chase were not being paid from the bankruptcy estate, and Rule 2016(a) did not come into play. The court did not find monthly fees paid by the law firm to its third party vendor to be illegal fee sharing. “It is actually no different from a law firm paying other outside vendors or its own employees and paralegals on a periodic basis from earnings that it manages to collect.” The outsourced paralegal working for the vendor was supervised by a law firm attorney, and the paralegal used template forms prepared by the law firm; therefore, since there was supervision by a licensed attorney, “to construe that this procedure is the unauthorized practice of law would place form over substance.” The court also found the outsourcing procedure to be in compliance with applicable Mississippi Rules of Professional Conduct. *In re Thorne*, 471 B.R. 496 (Bankr. N.D. Miss. 2012).

Claims

Judicial estoppel did not apply to mortgage creditor’s proof of claim. Reversing, the Fifth Circuit held that lower courts interpreted § 1305 overly broadly, by applying judicial estoppel to the mortgage creditor’s failure to include all of its arrearages in proofs of claim filed in the first Chapter 13 case. Under prior precedent, judicial estoppel does not apply when “a party’s change of position is merely implied rather than clear and express.” There is no Code or Rule requirement that Wells Fargo include all of its postpetition arrearages in the proofs of claim it filed in the first case; therefore, the amount claimed in the second case is not inconsistent as a matter of law. Also, the fact that the first case was dismissed without grant of discharge indicates that the bankruptcy court’s acceptance of the plan, even if based on the claims filed, “was negated and the parties were no longer bound by its terms.” *Wells Fargo Bank, N.A. v. Oparaji (In re Oparaji)*, 698 F.3d 231 (5th Cir. 2012).

Mortgage creditor’s failure to file proof of claim did not result in loss of lien. The mortgage creditor had elected not to file a proof of claim, but the attorney for Chapter 13 debtors filed two claims on the creditor’s behalf, to which the trustee objected. With no response from the creditors, the claims were disallowed. The debtors then began an action to void the mortgage lien under 506(d), arguing that the claims filed by the debtors were disallowed. Subsequent to the claims disallowance, the debtors admitted that Bank of America held a valid lien; therefore, the claims disallowance had nothing to do with the actual substance of the lien or claim. Pointing out that a debtor’s use of § 501(c) to file a claim on behalf of the creditor and then use of § 506(d) to attempt lien voiding may run afoul of *Dewsnup*, issue was avoided by reconsideration of the claims disallowance under § 502(j), with the disallowance set aside. *Oudomsouk v. Bank of American, N.A. (In re Oudomsouk)*, 483 B.R. 502 (Bankr. M.D. Tenn. 2012). See also *Shelton v. CitiMortgage, Inc. (In re Shelton)*, 477 B.R. 749 (BAP 8th Cir. 2012), in which the BAP held that a secured creditor’s lien is not avoided under § 506(d) solely because the creditor’s claim was disallowed for untimeliness. “Liens pass through bankruptcy unless avoided on their merits.”

Debtors could not file proof of claim for postpetition taxes. Distinguishing *In re Hight*, 670 F.3d 699 (6th Cir. 2012), in which the debtors could file a proof of claim for the tax creditor for a taxable year ending before the petition date, here the petition was filed before the taxable year ended and the debtors could not force the tax creditor into the case for a postpetition claim. *In re White*, 482 B.R. 905 (Bankr. W.D. Ark. 2012).

Claim for overpayment of child support was domestic support obligation. Discussing the conflicting judicial authority on the issue, the Chapter 7 debtor's former husband had overpaid child support, in an amount fixed by a prebankruptcy state court, at the same time he was paying at least half of the child's support while in his custody, and the court concluded that the overpayment claim was a domestic support obligation entitled to § 507(a)(1)(A) priority. *Kerr v. Meadors (in re Knott)*, 482 B.R. 852 (Bankr. N.D. Ga. 2012).

Amended claim was new claim, untimely filed. Reviewing the standard for when an amended claim is permitted, amendments are freely allowed "where the purpose is to cure a defect in the claim as originally filed, to describe the claim with greater particularity or to plead a new theory of recovery on the facts set forth in the original claim," but here the amended claim would reclassify a portion of the original claim as unsecured, having a significant impact in the case, detrimental to other unsecured creditors. "If a secured creditor wishes to preserve its unsecured deficiency claim for treatment in a chapter 13 case, it must formally file an unsecured claim in a timely manner." Moreover, the effect of confirmation barred the attempted new claim. *In re Jackson*, 482 B.R. 659 (Bankr. S.D. Fla. 2012).

Scheduling but then objecting to every claim was violation of Rule 9011. Affirming, the district court upheld \$500 sanction against debtors' counsel, who objected to every credit card claim scheduled on grounds of insufficient documentation. There was no evidence that debts were not owed or that substantive defenses existed. *In re Armstrong*, 2012 WL 4355464 (E.D. Tex. Sept. 21, 2012), slip copy.

Debtor bound by judicial estoppel effect of scheduling claims in same amounts as proofs of claim. When the Chapter 13 debtor scheduled all of the credit card claims in the same amount as the proofs of claim filed, even though checking them as "disputed," the debtor was prevented from objecting to those claims on lack of documentation grounds. Also, the court held that failure to attach documentation was not grounds for disallowance under § 502(b) or revised Rule 3001(c). "The across-the-board disputing of a debtor's schedules of debts which the debtor knows or should know she owes, as a part of a strategy to minimize the amount she will have to pay under a chapter 13 plan, is an abuse of the bankruptcy process." *In re Rehman*, 479 B.R. 238 (Bankr. D. Mass. 2012). See also *In re Muller*, 479 B.R. 508 (Bankr. W.D. Ark. 2012), in which debtors scheduled credit card debt in almost same amount as proof of claim, and judicial estoppel prevented debtors from disputing owing at least amount they scheduled. The court also reviewed rules governing documentation of proofs of claim.

Objection to standing is substantive claim objection under § 502(b)(1). The debtor's challenge to a creditor's standing to file a proof of claim is a substantive objection, triggering 502(b)(1) as basis to disallow the claim that is unenforceable under applicable law; "if a claimant has not proven it is the owner of a claim with a right to payment (i.e. the party with standing), the claim is unenforceable against the debtor under state law." *In re Richter*, 2012 WL 3763657 (Bankr. D. Colo. Aug. 29, 2012), slip copy.

Local rule not grounds for claim disallowance, but local rule remained valid. A mortgage creditor challenged whether the district's Local Rule 3001-1 was preempted by new Federal Bankruptcy Rule 3001, with Local Rule 3001-1 requiring the mortgage creditor to include with a proof of claim a detailed loan history in a specific format. Finding that the two rules were not incompatible, while compliance with Federal Rule 3001 gave the proof of claim prima facie validity, and non-compliance with Local Rule 3001-1 was not a basis for objection to the claim, the Local Rule may nevertheless impose a duty on a creditor. The Local Rule requires additional information that is not duplicative of the Federal Rule, with both rules serving "the salutary purpose of providing information with respect to the basis of a home mortgage proof of claim." The mortgage creditor was required to comply with the Local Rule, but "noncompliance does not alter the prima facie validity of [its] proof of claim." *In re Armistead*, 2012 WL 3202964 (Bankr. S.D. Tex. Aug. 3, 2012), slip copy.

Bankruptcy court had authority to submit proposed findings and conclusions in core proceeding, involving proof of claim issue. In a proceeding remanded by the circuit court, 665 F.3d 906, after which the bankruptcy court revised its summary judgment decision into a recommended one, 464 B.R. 807, the district court held that, although the proceeding was core, as found by the circuit court, and 28 U.S.C. § 157(c)(1) does not explicitly authorize proposed findings and conclusions in core proceedings, the bankruptcy court did not exceed its statutory authority in such a recommendation. "When § 157 is read in light of *Stern*, it seems obvious that bankruptcy courts have authority to issue proposed findings of fact and conclusions of law in core proceedings in which they lack authority to enter final judgments." The proceeding involved Aurora Health Care's violation of a state statute when it attached unredacted medical information to its proofs of claim. The district court denied the recommended summary judgment and withdrew the reference. *Ortiz v. Aurora Health Care, Inc.* (*In re Ortiz*), 477 B.R. 714 (E.D. Wis. 2012).

For claim reconsideration, Rule 60(b) standards apply to claims that have been litigated. Although Rule 60(b) standards apply when the court is reconsidering a claim the merits of which have previously been litigated, as to a claim that had not been previously litigated, that Rule does not apply; instead, the court may exercise its discretion and equities of the case to determine whether an allowed claim should be reconsidered. Notwithstanding the creditor's failure to attach sufficient documentation, when the debtors waited sixteen months after a local rule's deadline to object, their objection was denied. The court expressed concern that the particular creditor was not in compliance with the documentation requirements of Rule 3001(c). *In re Ruth*, 2012 WL 1455814 (Bankr. S.D. Tex. Apr. 26, 2012), slip copy.

Documentation for assigned credit card claims, another analysis. Examining the issues of what documentation is required for an assigned credit card claim, to which the debtor had objected, and what evidence is required by the objecting debtor to rebut the presumption of prima facie validity, the bankruptcy court held that evidence of an assignment did not require specific account numbers of the original credit card, but when the debtors' affidavits swore that they had no dealings with eCast and did not owe eCast, with lack of documentary evidence of specific assigned debts, the debtors rebutted the presumption. Under New York law, there was insufficient documentation of specific credit card accounts or assignment, failing to prove eCast's right to payment. "Rule 3001(e) does not relieve an assignee creditor from the obligation to provide competent proof of the assignment and the underlying debt, but simply limits who may file the claim of the assignee who has acquired the claim." *In re Taranto*, 2012 WL 1066300 (Bankr. E.D. N.Y. Mar. 27, 2012), slip copy.

See also *In re Reynolds*, 2012 WL 1190296 (Bankr. D. Colo. Apr. 9, 2012), slip copy, in which the court analyzed Bankruptcy Rule 3001(c)(2)(D), as revised, effective December 1, 2011, and whether that revised Rule controlled whether a claim may be disallowed because of the creditor's failure to attach the documentation required by Rule 3001(c). There is a conflict between the revised Rule 3001 and the Tenth Circuit's opinion issued before the Rule's revision, *In re Kirkland*, 572 F.3d 838 (10th Cir. 2009), with *Kirkland* "establishing a rule that adds a creditor's failure to attach documents to its proof of claim as an independent ground for denial of the claim as a matter of law. But intervening changes to the Bankruptcy Rules require the Court to question whether that aspect of *Kirkland's* holding continues to control the issue currently before the Court." Rule 3001(c)(2)(D)'s remedies do not include disallowance of a claim, although 3001(c)(2)(D)(ii) refers to "other appropriate relief." The Rules Advisory Committee Note to 3001(c)(2)(D) says that "[f]ailure to provide the required information does not itself constitute a ground for disallowance of a claim." From this Committee Note, "the revised Rule 3001 makes it clear that a creditor who fails to fully comply with the documentation requirements of Rule 3001(c), primarily faces the *evidentiary* sanction of being precluded from introducing its documents at a subsequent hearing on a substantive objection to its proof of claim under § 502(b). Conversely, Rule 3001(c) does not provide authority for this Court to deny a creditor's claim based solely on its failure to attach documentation to its proof of claim under Rule 3001(c). Because claim disallowance falls outside of the remedies enumerated under Rule 3001(c)(2)(D), the rule precludes such a remedy." Since the debtors' objections to claims did not state any grounds under § 502(b), the court could not disallow the claims. Also, the debtors' scheduling of each of the claims triggered judicial estoppel, which prevented the debtors from now denying liability on the scheduled claims.

Mortgage Issues

RESPA violation did not cause foreclosure, but damages may have resulted. The Sixth Circuit affirmed a finding that the home mortgage lender's failure to respond to the borrower's qualified written request about a dispute over payments did not cause the foreclosure. The former Chapter 13 debtor had made mortgage payments in her plan, but

had not made payments after receiving a discharge, despite the trustee's instructions for her to resume payments. Also, the borrower did not seek to stay the foreclosure, nor did she seek to redeem the property after foreclosure, under applicable Michigan law. However, the Circuit remanded to the district court for determination of whether the borrower was entitled to monetary damages, if any, that could be traced to the RESPA violation. *Houston v. U.S. Bank Home Mortgage Wisconsin Servicing*, 2012 WL 5869918 (6th Cir. Nov. 20, 2012), slip copy.

Class properly certified for injunctive relief to former debtors curing arrearages. The Fifth Circuit affirmed a class certification by the bankruptcy court for former Chapter 13 debtors who had cured home mortgage arrearages and received discharges, in a complaint alleging that Countrywide misapplied plan mortgage payments to pay unauthorized fees. The bankruptcy court had held that Rule 2016 applied to mortgage lenders as to fees assessed during the bankruptcy cases but not collected until after discharges. The bankruptcy court complied with *Wilborn v. Wells Fargo Bank, N.A.*, 609 F.3d 748 (5th Cir. 2010), in certifying a narrowly defined class for injunctive relief and denying class certification on damages, which would require a case-by-case analysis for each debtor. (*In re Rodriguez*), 695 F.3d 360 (5th Cir. 2012).

Debtors bound by judicial estoppel effect of prior case's confirmation and consent orders. In their prior case, the debtors obtained confirmation of a plan that included the secured mortgage claim and they had entered into two consent orders related to the mortgagee's stay relief, without reserving any right to contest standing of the creditor. In the second case, the debtors again scheduled SunTrust Mortgage as a secured mortgage. Judicial estoppel was triggered by the prior positions. Moreover, under Missouri law, the note was a negotiable instrument, and the note and deed of trust were enforceable by SunTrust. *Knigge v. SunTrust Mortgage, Inc. (In re Knigge)*, 479 B.R. 500 (BAP 8th Cir. 2012).

Waiver of rescission right enforced. In an interpretation of the Truth in Lending Act and Massachusetts Consumer Credit Cost Disclosure Act (MCCCDCA), the borrower knowingly and voluntarily waived his right to rescission in a loan modification, and the debtor failed to state claims for relief under those acts. *DiVittorio v. HSBC Bank USA (In re DiVittorio)*, 670 F.3d 273 (1st Cir. 2012).

Fair Debt Collection Practices claim against attorney for foreclosing party. The Sixth Circuit reversed the district court's dismissal of a claim that Washington Mutual's attorneys violated the Fair Debt Collection Practices Act and Ohio's Consumer Sales Practices Act by filing for foreclosure on behalf of Washington Mutual when it had not yet received or recorded an assignment. The foreclosure action had been filed in state court more than a month before Washington Mutual received a transfer of the mortgage from Wells Fargo, and the Circuit panel held that the borrower's complaint sufficiently stated a claim under FDCPA of a material misrepresentation that would confuse or mislead an unsophisticated consumer. The plaintiff's complaint referred to a statement in the foreclosure complaint that Washington Mutual was the holder of the mortgage, and the complaint sufficiently stated a cause of action to overcome a Rule 12(b)(6) motion.

Remand was ordered. *Wallace v. Washington Mutual Bank, F.A., et al.*, 683 F.3d 323 (6th Cir. 2012).

MERS had authority under deed of trust. Affirming the bankruptcy court's dismissal of the debtor's complaint alleging wrongful foreclosure, the debtor failed to allege that the foreclosure violated California law, and the deed of trust, which designated MERS as nominal beneficiary for the lender and lender's successor's and assigns, expressly gave MERS authority to exercise all of the lender's rights, including the right to foreclose. *In re Cedano*, 2012 WL 1191860 (BAP 9th Cir. 2012), slip copy.

Massachusetts court construes who is entitled to conduct foreclosure. Addressing the propriety of a foreclosure by power of sale undertaken by a mortgage holder that did not hold the underlying mortgage note, the Massachusetts Supreme Judicial Court concluded that a foreclosure sale conducted under a power of sale in a mortgage must comply with statutory requirements. The court construed "mortgagee" as used in the relevant statute as referring to the person or entity then holding the mortgage, and also either holding the mortgage note or acting on behalf of the note holder. Prior to this decision, the term "mortgagee" was not free of ambiguity, and the court gave prospective effect to its holding, applying it only to foreclosures under a power of sale where statutory notice is provided after the date of the decision. The court did not conclude that a foreclosing mortgagee must have actual physical possession of the mortgage note, but if the mortgagee lacks possession of the note, it must act as the authorized agent of the note holder. As background, the court reviewed Massachusetts status as a "title theory" state. Under Massachusetts common law, a real estate mortgage is a transfer of legal title to the mortgaged property and serves as security for an underlying note, with the title transfer being defeasible when the debt is paid. When a mortgage and note are separated, the holder of the mortgage holds it in trust for a purchaser of the note, who has an equitable right to obtain assignment of the mortgage. At common law, a mortgagee possessing only the mortgage was without authority to foreclose on his own behalf the mortgagee's equity of redemption or disturb the possessory interest. *Eaton v. Federal Nat'l Mortgage Assoc., et al.*, 462 Mass. 569, 969 N.E.2d 1118 (Mass. Supreme Judicial Court 2012). See also *In re Bailey*, 468 B.R. 464 (Bankr. D. Mass. 2012), finding that Massachusetts law requirement for mailing notice of foreclosure sale to the owner was satisfied, but that the debtor/mortgagor had standing to raise that the entity assigning the mortgage to foreclosing party did not hold the mortgage at time of alleged assignment. Issue of fact prevented summary judgment. The court distinguished this debtor's attack on the assignment from those cases in which the debtor had no right of action under HAMP.

Notwithstanding no private right of action under HAMP, debtor could proceed under state law. Without deciding whether there was a private right of action under HAMP, the borrower was not precluded by HAMP from pursuing a cause of action under Massachusetts law for breaches of implied covenants of good faith and fair dealing. The cause of action related to the conducting of a foreclosure sale, with the plaintiff alleging lack of authority by the foreclosing party. *Blackwood v. Wells Fargo Bank, N.A.*, 2011 WL 1561024 (D. Mass. 2011).

Lost note affidavit sufficient for standing. The Chapter 13 debtors objected to the mortgage claim, asserting lack of standing, but the bankruptcy court correctly found standing, including that the claimant was entitled to enforce the note. The applicable Washington statute provided for a person no longer in possession of a note to still enforce it by an appropriate lost note affidavit that gives adequate proof of the existence and terms of the note. The affidavit included an endorsement in blank of the original note. Under Washington law, the deed of trust follows the note. *In re Allen*, 2012 WL 2086563 (BAP 9th Cir. June 8, 2012), slip copy.

Judicial estoppel prevented attack on mortgagor's standing to enforce note and mortgage. The debtors had scheduled SunTrust Mortgage, Inc. as having undisputed secured claims in two bankruptcy cases, proposing to cure and maintain the mortgage, and in the current case, the debtors agreed to settlement of SunTrust's objection to confirmation. Judicial estoppel prevented the debtors from changing position to assert SunTrust's lack of standing to enforce the note and mortgage. Moreover, on the merits, SunTrust was in possession of the note, with standing to enforce it. *In re Knigge*, 2012 WL 1536343 (Bankr. W.D. Mo. Apr. 30, 2012), slip copy.

\$3 million punitive against Wells Fargo. In a case with history, including remand from the Fifth Circuit, *Wells Fargo Bank, N.A. v. Jones (In re Jones)*, 439 Fed.Appx. 350 (5th Cir. 2011), to reconsider monetary sanctions, the bankruptcy court found that it had jurisdiction for civil contempt and assessed \$3,171,154 punitive damages "to deter Wells Fargo from similar conduct in the future," in addition to \$24,441.65 compensatory damages and \$292,673.84 attorney fees and costs of litigation. The court had previously imposed remedial measures on Wells Fargo in lieu of monetary sanctions, but the Fifth Circuit remanded for consideration in light of *In re Stewart*, 647 F.3d 553 (5th Cir. 2011). Reviewing why Wells Fargo's treatment of the debtor's payments were inappropriate, and finding nothing in the record to support that Wells Fargo had corrected its past errors or to assure compliance in the future, in this case, Wells Fargo had overcharged the debtor \$24,000 and caused the debtor to incur hundreds of thousands in legal fees over five years of litigation. The court found that the punitive damage award was warranted. *Jones v. Wells Fargo (In re Jones)*, Case No. 03-16518, A.P. No. 06-1093, Docket No. 470 (Bankr. E.D. La. Apr. 5, 2012). See also *Wells Fargo v. Rodriguez*, 2012 WL 393319 (W.D. La. Feb. 6, 2012), slip copy, in which the bankruptcy court properly sanctioned in the amount of \$5,535 fees to the trustee's attorney for Wells Fargo's delay in responding to the trustee for accounting of how plan payments were allocated between pre-petition arrearage and on-going payments.

Attorney fees under mortgage penalty clause were properly reduced. Applying Puerto Rico law, as required by § 1322(e), the bankruptcy court did not abuse its discretion when it reduced the mortgagee's attorney fees from \$7,600 to \$2,000. The contractual penalty clause was subject to "moderation" under Puerto Rico law, and the requested penalty was larger than the \$6,400 arrearage. *RNPM, LLC v. Alvarez (In re Alvarez)*, 473 B.R. 853 (BAP 1st Cir. 2012).

Alleged defects in pooling and servicing agreement not grounds for claim objection.

The Chapter 13 debtor objected to the proof of claim on grounds that the claimant had not complied with the pooling and servicing agreement underlying the securitized mortgage, and the court held that the note was a negotiable instrument under Pennsylvania's UCC Article 3, with the claimant having the right to enforce the note. The debtor lacked standing to object to the claim on the basis that the assignment of the note was defective under the pooling and servicing agreement. The debtor, as maker, could satisfy the note at any time by paying it. *In re Walker*, 466 B.R. 271 (Bankr. E.D. Pa. 2012).

Fair Debt Collections Practices Act

Creditor's attorney liable under Fair Debt Collection Practices Act. The Eleventh Circuit held that the debtor stated a cause of action under the Fair Debt Collection Practices Act when the collection attorney sent a letter incorrectly identifying BAC Home Loan Servicing, L.P. as the creditor and BAC had not yet received the loan assignment transfer. Any false representation in connection with debt collection is forbidden under the FDCPA. The district court had held that BAC was within the ordinary use of the term "creditor," and that any error was harmless, but the circuit court vacated the dismissal of the complaint and reversed. *Bourff v. Rubin Lublin, LLC*, No. 10-14618 (11th Cir. Mar. 15, 2012), per curiam.

IRS agent not debt collector under Fair Debt Collection Practices Act. The IRS agent was collecting in the performance of official duties, and the FDCPA excludes from "debt collector" any officer or employee of the United States or any state who is collecting within that scope. However, the former Chapter 7 debtor had stated a claim for violation of the discharge injunction, surviving a motion to dismiss. *Pomerenke v. IRS*, 2012 WL 5416536 (8th Cir. 2012), per curiam.

Employment of special counsel

Chapter 13 debtor, rather than trustee, has responsibility to move for employment of special counsel. Analyzing § 327(c) in Chapter 13 cases, where special counsel is needed to prosecute a cause of action belonging to the estate (here a prepetition workers compensation claim), the court held that for purposes of § 327(c) the debtor was a debtor in possession, included within that statute's term "trustee," and that the debtor had authority and duty to file an application for employment of special counsel. The debtor controlled that litigation, and the duty to file the application was not on the Chapter 13 trustee. *In re Goines*, 465 B.R. 704 (Bankr. N.D. Ga. 2012).

CONSUMER LAW UPDATE

**Cases reported from January 1, 2013 through
March 31, 2013**

Prepared for Federal Judicial Center

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Automatic Stay

State law discovery citation established lien and justified stay relief. Under Illinois law, when the judgment creditor had served a citation to discover assets, a lien was created on the value of the debtor's bank account. Applying a state decision on point, the bankruptcy court's granting of stay relief to allow collection from that account was affirmed. The bankruptcy court properly decided that the value of a bank account was "personal property" for purposes of the citation's lien. *In re Porayko*, 705 F.3d 703 (7th Cir. 2013).

Mistake in overbidding did not justify stay relief. When the bank made unilateral mistake in bidding the entire amount of its debt on foreclosure of first parcel, it was not entitled to stay relief to foreclose on another parcel. Under applicable state law, there was no debt remaining to justify foreclosure. *State Bank of Florence v. Miller (In re Miller)*, 2013 WL 425342 (6th Cir. Feb. 5, 2013), slip copy.

Petition filing did not stay appeal of tax court decision. After IRS issued its notice of deficiency, the taxpayer filed a petition in the tax court, which found the taxpayer liable for tax deficiencies, and the taxpayer filed an appeal to the Tenth Circuit, which held that § 362(a)(1) did not stay appeal. Discussing the split between the Fifth and Ninth Circuits on the issue, the Circuit Court held that a tax court petition filed by the debtor is "an independent judicial proceeding initiated by the debtor, not the continuation of an administrative proceeding against the debtor;" therefore, § 362(a)(1) did not apply. *Schoppe v. Commissioner of Internal Revenue*, ___ F.3d ___, 2013 WL 1239935 (10th Cir. Mar. 28, 2013).

Stay relief properly granted based on consensual adequate protection order. Following prepetition default and a stay relief motion by the mortgagee, the debtors entered into an adequate protection order to resolve that motion, but they fell into default of the agreed order. Stay relief was affirmed. *Russell v. Aurora Bank FSB (In re Russell)*, 2013 WL 831165 (BAP 9th Cir. Feb. 28, 2013), slip copy.

Considering cause for retroactive stay relief. In considering motion for retroactive relief from the stay, the bankruptcy court could limit its analysis to stay relief factors in *Grady v. A.H. Robbins Co, Inc.*, 839 F.2d 198 (4th Cir. 1998): "(1) whether the case involves only state law so that the expertise of the bankruptcy court is unnecessary; (2) whether modifying the stay will promote judicial economy and whether there would be greater interference with the bankruptcy case if the stay were not lifted because matters would have to be litigated in the bankruptcy court; and (3) whether the estate can be protected properly by a requirement that creditors seek enforcement of any judgment through the bankruptcy court." There was no Fourth Circuit authority requiring consideration of other factors, such as extreme circumstances. *Kadlecek v. Schwank USA, Inc.*, 486 B.R. 336 (M.D. N.C. 2013). See also *In re Grason*, 486 B.R. 448 (Bankr. C.D. Ill. 2013), finding that foreclosure sale purchaser lacked standing to seek retroactive stay relief, when the real party in interest was the foreclosing creditor. The purchaser chose to make improvements to the property when the purchase was

clouded by a pending bankruptcy and an appeal of a state court order, and the purchaser could not assert rights of the third-party mortgagee. The purchaser also lacked standing to question whether the debtor had complied with prebankruptcy credit counseling requirement.

Debtor failed to rebut presumptive lack of good faith for § 362(c)(3)(B). Although the debtor, who had previously filed an unsuccessful Chapter 11, was found to have filed the Chapter 13 in good faith for purposes of § 1325(a)(7), the plan was not filed in good faith under § 1325(a)(3), and the debtor did not overcome the presumption of lack of good faith for purposes of § 362(c)(3)(B), which requires clear and convincing evidence. The focus of §§ 1325(a)(7) and 362(c)(3) is different. The opinion points out that although the stay was not extended, the objecting ex-wife could be bound by a confirmed plan; however, confirmation of the first plan was denied because it would discharge debt resulting from the debtor's misappropriation of retirement benefits in which the ex-wife had been granted an interest in a divorce. *In re Rodriguez*, 487 B.R. 275 (Bankr. D. N.M. 2013).

Property of Estate

Judicial estoppel applied. Without deciding whether the Chapter 13 debtor had standing to file a postpetition employment termination suit, the debtor had a continuing duty to disclose that cause of action, and her failure to disclose justified application of judicial estoppel to bar the suit. *Kimberlin v. Dollar General Corp.*, 2013 WL 1136563 (6th Cir. Mar. 20, 2013), slip copy.

Tax refund erroneously sent to debtor was not property of estate. IRS erroneously sent \$86,512.32 prepetition refund check to the debtor postpetition, which the debtor had returned to IRS, and the debtor never had a legal or equitable interest sufficient to make the check property of the Chapter 7 estate. Since the debtor was not entitled to the refund, the trustee was not entitled to turnover. *Winters v. IRS (In re Winters)*, 485 B.R. 375 (Bankr. M.D. Tenn. 2013).

Exemptions and Lien Avoidance

More time to amend exemptions properly disallowed. The bankruptcy court did not abuse its discretion in denying debtor's motion for more time to amend exemptions, when the debtor had two years already to amend to claim exemption in a large settlement. *In re Hecker*, 703 F.3d 11121 (8th Cir. 2013).

Realtor could avoid lien on vehicle, if established as tool of trade. Under California's exemptions, a motor vehicle could be claimed as exempt under the wildcard's "any property and the Ninth Circuit affirmed the district court's remand to factually determine if the Chapter 7 realtor's vehicle was a tool of the trade. *Orange County's Credit Union v. Garcia (In re Garcia)*, 709 F.3d 861 (9th Cir. 2013).

Under Massachusetts law, holder of remainder interest was not entitled to homestead. A remainder interest holder is not an “owner” of a home, for purposes of the Massachusetts homestead. *Gordon v. Pappalolado (In re Gordon)*, ___ B.R. ___, 2013 WL 987768 (BAP 1st Cir. Mar. 13, 2013).

Kansas bankruptcy-only exemption constitutional. Affirming the bankruptcy court and incorporating that court’s legal reasoning and conclusions, Kansas state-law exemption in earned income tax credit, which was available only to debtors in bankruptcy, is constitutional. *Williamson v. Westby (In re Westby)*, 486 B.R. 509 (BAP 10th Cir. 2013).

Failure to maintain continuous interest prevented judicial lien avoidance. In a matter of first impression in the circuit, the Bankruptcy Appellate Panel held that § 522(f) required that the debtor maintain a continuous interest in the homestead in order to avoid a judicial lien. When the debtor conveyed the homestead after a judgment lien was recorded and then reacquired the property, the debtor had acquired a new interest, failing to have a continuous interest in the property. The lien attached before the debtor acquired the new interest, preventing lien avoidance. *McCoy v. Kuiken (In re Kuiken)*, 484 B.R. 766 (BAP 9th Cir. 2013).

Debtors entitled to homestead in residence previously rented. Applying Tennessee law, debtors were entitled to homestead in the residence that they had previously rented, after the tenant had moved out, since the law does not require actual residence, only the right to present occupancy. This was the only property to which the Chapter 7 debtors had such a present right of occupancy. *In re Patterson*, 487 B.R. 485 (Bankr. W.D. Tenn. 2013).

Debtors must specify monetary value of exempt assets. Under North Carolina’s exemptions, the asset itself is not exempt, only a specific dollar maximum amount and Chapter 7 debtors must identify the monetary value of the assets being claimed as exempt. The debtors’ language on Schedule C that they were claiming “100% of Debtors’ interest and 100% fair market value in each and every item listed, irrespective of the actual value claimed as exempt” was disapproved, and counsel was warned that continued use of that language could result in sanctions. *In re Gregory*, 487 B.R. 444 (Bankr. E.D. N.C. 2013).

Dollar amount increases April 1, 2013. Along with other dollar amounts subject to automatic adjustment every three years, the various exemption amounts under § 522 increased on April 1, 2013.

AMERICAN BANKRUPTCY INSTITUTE

Code Section Number	Former Dollar Amount (2010)	Adjusted Dollar Amount (2013)
11 U.S.C.A. § 522(d)(1) homestead exemption	\$21,625	\$22,975
11 U.S.C.A. § 522(d)(2) vehicle exemption	\$3,450	\$3,675
11 U.S.C.A. § 522(d)(3) personal property exemption	\$550 \$11,525	\$575 \$12,250
11 U.S.C.A. § 522(d)(4) jewelry exemption	\$1,450	\$1,550
11 U.S.C.A. § 522(d)(5) wildcard exemption	\$1,150 \$10,825	\$1,225 \$11,500
11 U.S.C.A. § 522(d)(6) tools of trade exemption	\$2,175	\$2,300
11 U.S.C.A. § 522(d)(8) life insurance exemption	\$11,525	\$12,250
11 U.S.C.A. § 522(d)(11)(D) personal injury exemption	\$21,625	\$22,975
11 U.S.C.A. § 522(f)(3)(B) lien avoidance cap	\$5,850	\$6,225
11 U.S.C.A. § 522(f)(4)(B) household goods cap	\$600 (each time it appears)	\$650 (each time it appears)
11 U.S.C.A. § 522(n) IRA cap	\$1,171,650	\$1,245.475
11 U.S.C.A. § 522(p)(1) homestead exemption cap	\$146,450	\$155,675
11 U.S.C.A. § 522(q)(1) homestead exemption cap	\$146,450	\$155,675

Chapter 7 Issues

Discharge Exceptions and Objections

Issue preclusion not applied when debtor did not substantially participate in state action. Applying Arizona's issue preclusion law, when the debtor had not answered, filed responsive pleadings or participated in discovery in state court action, the debtor did not participate to any substantial degree, and preclusive effect should not be given to the Arizona judgment. *Child v. Foxboro Ranch Estates, LLC (In re Child)*, 486 B.R. 168 (BAP 9th Cir. 2013).

Bank reasonably relied on false financial statement. Under prior circuit authority, "[r]easonable reliance connotes the use of the standard of ordinary and average person," and evidence supported that bank reasonably relied on Chapter 7 debtor's materially false financial statement. Bank asked questions about the statement and actually relied on it, as was its customary banking practice. *Davenport v. Frontier Bank (In re Davenport)*, 2013 WL 530842 (11th Cir. Feb. 13, 2013), slip copy.

Casino failed to prove § 523(a)(2)(A), but bankruptcy court did not abuse discretion in denying debtor's attorney fees. Evidence supported bankruptcy court's finding that debtor had intention to repay casino's markers for \$550,000, but although debt was dischargeable, there was no abuse in denying the debtor's fees. Under § 523(d), the trial court's decision on whether the creditor was substantially justified in filing the complaint is reviewed under the abuse of discretion standard. *Adamar of New Jersey v. Innerbichler (In re Innerbichler)*, 2013 WL 659078 (BAP 10th Cir. Feb. 25, 2013).

Only part of state judgment given collateral estoppel effect. When applying collateral estoppel, the bankruptcy court properly looked to the entire state court record, not just to the judgment, and Colorado judgment for \$513,000 was only partially based on fraud (\$171,000), with balance based on breach of contract and negligent misrepresentation. Only fraud portion was exception from discharge under § 523(a)(2). *Hogan v. George (In re George)*, 2013 WL 135274 (BAP 6th Cir. Jan. 11, 2013), unpublished.

Unscheduled creditor had actual knowledge of bankruptcy. When evidence established that the unscheduled creditor had actual knowledge of the Chapter 7 filing in time to file a timely complaint, the § 523(a)(2), (3), (4) and (6) complaint was untimely and properly dismissed. *Burgraf v. Munion (In re Munion)*, 2013 WL 135294 (BAP 6th Cir. Jan. 11, 2013), slip copy.

Willfulness satisfied by state standard. Willfulness requires subjective motive to inflict injury or subjective belief of injury substantially certain to occur, and applying Nevada preclusion law, abuse of process claim required willfulness, essentially the same as required under § 523(a)(6). Also, state judgment based on nuisance in Nevada was "an *intentional* interference with the use and enjoyment of land," satisfying the willfulness requirement. *Black v. Bonnie Springs Family Ltd. Partnership*, 487 B.R. 202 (BAP 9th Cir. 2013).

Attorneys settling personal injury claims committed willful and malicious injury to other attorneys. Two attorneys worked with other attorneys in thousands of suits on behalf of medical providers against an insurance company. Without notifying the other attorneys, the two future Chapter 7 debtors settled claims with the insurance company, structured to give them large attorney fees. Their actions were willful and malicious, intentionally designed to increase the debtors' attorney fees, causing injury to other attorneys and acting with "animosity" toward them. *Kane v. Stewart Tilghman Fox & Bianchi, P.A.*, 485 B.R. 460 (S.D. Fla. 2013).

Loans from former spouse were excepted from discharge under § 523(a)(15). A debt entered into between the parties before they married was excepted from discharge under § 523(a)(15), with the state divorce court having found that the debt was "more than a mere contractual obligation unrelated to the marriage." The former spouse had loaned the debtor \$23,675.50 before the marriage and another \$20,000 during the marriage, for his business. *Kincade v. Kincade (In re Kincade)*, 707 F.3d 546 (5th Cir. 2013).

Discharge Revocation

Postpetition bonus was not property of estate and its dissipation not grounds for discharge revocation. Applying Minnesota law, when employer retained discretion to award employee bonus, the Chapter 7 debtor did not have legal or equitable interest in future bonus at time of petition filing, and the postpetition bonus did not become property of the estate. Consequently, discharge should not have been revoked on the basis that the debtor had dissipated the bonus or failed to deliver it to the trustee. *Seaver v. Klein-Swanson (In re Klein-Swanson)*, ___ B.R. ___, 2013 WL 1164430 (BAP 8th Cir. Mar. 22, 2013).

Discharge Injunction

Refusal to foreclose after surrender did not violate discharge injunction. Affirming, the mortgage lender's refusal to foreclose or release its lien after the Chapter 7 debtor surrendered the home did not violate the § 524 discharge injunction. The discharge injunction "does not enjoin a secured creditor from recovering on valid prepetition liens, which, unless modified or avoided, ride through bankruptcy unaffected and are enforceable in accordance with state law." Surrender in the context of § 521(a)(2) means that the debtor makes the collateral available to the secured creditor, but the creditor "has the prerogative to decide whether to accept or reject the surrendered collateral." The creditor may not use its decision to coerce payment of the discharged debt, but the evidence did not suggest such coercion. *Canning v. Beneficial Maine, Inc. (In re Canning)*, 706 F.3d 64 (1st Cir. 2013).

Collection of postpetition incarceration costs did not violate discharge injunction. The State of Missouri did not violate the discharge injunction by automatically deducting from the discharged debtor's account, partially collecting the State's care costs incurred postpetition. The prepetition costs of incarceration had been discharged. *Smith v. State of Missouri (In re Smith)*, ___ B.R. ___, 2013 WL 425452 (BAP 8th Cir. Feb. 5, 2013).

Conversion and Dismissal

Inaccuracies in schedules and bad faith denied conversion to Chapter 13. The debtor failed to disclose a co-owner of property and the payment received from other property shortly before filing Chapter 7, as well as the postpetition purchase of a motorcycle for \$8,000 cash and the fact that he was married. These and other inaccuracies contributed to a bad faith finding and denial of conversion to Chapter 13. *Nordin v. Galaba (In re Nordin)*, 2013 WL 936370 (BAP 10th Cir. Mar. 12, 2013), slip copy.

Case dismissed for presumption of abuse. Although U.S. trustee was obligated by § 704 to file statement of whether case is presumed abusive within ten days of conclusion of meeting of creditors, failure to file timely did not prevent later move to dismiss case for abuse under means test. Nondebtor spouse’s regular payment of private school tuition for debtor’s dependent children was payment of “household expense,” included in income for means test calculation. Fact that most income was earned by nondebtor spouse did not create “special circumstances” rebuttal to presumption of abuse. *In re Persaud*, 486 B.R. 251 (Bankr. E.D. N.Y. 2013).

Chapter 13 Issues

Eligibility

Dollar amounts increased April 1, 2013. Along with other dollar amounts subject to automatic adjustment every three years, the maximum amounts for Chapter 13 eligibility increased on April 1, 2013.

Code Section Number	Former Dollar Amount (2010)	Adjusted Dollar Amount (2013)
11 U.S.C.A. § 109(e) Chapter 13 debt limits	\$360,475 unsecured \$1,081,400 secured (each time they appear)	\$383,175 \$1,149,525 (each time it appears)

Debtor lacked regular income. The debtor’s unemployment compensation had terminated, and his only income was support gratuitously paid by his girlfriend, who could stop paying at any time; therefore, the debtor lacked the required “regular income” to qualify for Chapter 13. Missing here was a commitment by the nondebtor party to continue to contribute the required income to fund the plan. *In re Loomis*, 487 B.R. 296 (Bankr. N.D. Okla. 2013).

Debtor lacked good faith in scheduling deficiency debt as “unknown.” The debtor, who was a mortgage broker, scheduled a deficiency debt on a residential mortgage as “unknown,” but the debtor was aware of the foreclosure sale and that the deficiency was at least \$250,000, which added to other unsecured debt made the

debtor ineligible. Scheduling the debt in that manner was effort to conceal ineligibility, and the case was filed in bad faith. The debtor was given opportunity to convert to Chapter 7 or the case would be dismissed. *In re Kwiatkowski*, 486 B.R. 409 (Bankr. E.D. Mich, 2013).

Good faith filing requirement applied in Chapter 24 petition. After debtor filed and obtained confirmation in Chapter 11 case, subsequent and simultaneous Chapter 13 petition was not filed in good faith. Filing was effort to frustrate secured creditor in confirmed Chapter 11, and debtor had § 1127 modification available if necessary, to resolve dispute with bank. *In re McMahan*, 481 B.R. 901 (Bankr. S.D. Tex. 2012).

Confirmation Issues

Proceeds of personal injury settlement not projected disposable income. Under *Hamilton v. Lanning*, when personal injury suit was pending at filing of Chapter 13, settlement proceeds were not known or virtually certain at that time; therefore, those proceeds were not projected disposable income. *Connor v. Carroll*, 2013 WL 150150 (6th Cir. Jan. 15, 2013), slip copy.

Social Security benefits and payments to secured creditors not part of good faith inquiry. Reviewing the history of good faith under § 1325's confirmation requirements, the Ninth Circuit affirmed its BAP, holding that BAPCPA's means test eliminated consideration of Social Security income in the good faith analysis—"consideration of disposable income—now defined in great detail by Congress—has no role in the good faith analysis." Also, Congress did not "limit or qualify the kinds of secured payments that are subtracted from current monthly income to reach a disposable income figure;" therefore, the bankruptcy court did not need to consider payments to "luxury" secured creditors in its good faith inquiry. *Drummond v. Welsh (In re Welsh)*, ___ F.3d ___, 2013 WL 1192961 (9th Cir. Mar. 25, 2013). See also *In re Scott*, ___ B.R. ___, 2013 WL 765691 (Bankr. M.D. Ga. 2013), holding that neither Social Security income payable to debtor nor to nondebtor spouse was included in projected disposable income. Failure to include that income did not deprive the plan of good faith.

Above-median income debtors with no disposable income have applicable commitment period. The proposed plan would terminate before the applicable commitment period for above-median income debtors, payments decreasing after paying trustee commission and attorney fees, with the court concluding that *Lanning's* forward-looking approach was "totally contradictory to the concept of a plan which includes an early termination provision." The debtors must either amend the plan to pay for the full 60 months or prove "that it is known or virtually certain they are unable to continue payments. . .for sixty (60) months." The trustee's request for certification of the issue for direct appeal to the Fourth Circuit was granted. *In re Pliler*, ___ B.R. ___, 2013 WL 153846 (Bankr. E.D. N.C. Feb. 21, 2013). See also *In re Boyd*, ___ B.R. ___, 2013 WL 145751 (Bankr. E.D. N.C. Jan. 14, 2013).

Marital agreement to hire ex-wife as consultant until eligible for Social Security was domestic support obligation. Confirmation of a plan that did not provide for full payment of a domestic support obligation was denied, when the parties' agreement that

the husband would hire the former wife as a consultant to the family business until she became eligible for Social Security benefits was found to be a domestic support obligation. *In re Ashby*, 485 B.R. 567 (Bankr. W.D. Ky. 2013).

Postpetition voluntary contributions to retirement plan excluded from projected disposable income. Disagreeing with minority view, § 541(b)(7) excludes the debtor's voluntary contributions postpetition to retirement plans and annuities, so long as made in good faith. Even though these debtors were not making such contributions when the petition was filed, there was a history of similar contributions prepetition, which had been temporarily interrupted by circumstances beyond the debtors' control. *In re Drapeau*, 485 B.R. 29 (Bankr. D. Mass. 2013).

Lien Stripping and Modification

Strip of IRS lien not controlled by § 506(d). Agreeing with *In re Woolsey*, 696 F.3d 1266 (10th Cir. 2012), "*Dewsnup* applies in Chapter 13 to the extent a debtor relies solely on § 506(d) to void a lien unsupported by value in the collateral," but the debtor may seek to strip IRS's lien under § 1322(b)(2) through the plan, with the stripping contingent on confirmation, plan completion and discharge. Although the lien will not be avoided before discharge, debtor's complaint was not premature, since Rule 7001(2) and (9) require an adversary proceeding to determine the validity and extent of the lien. *Brinson v. United States of America (In re Brinson)*, 485 B.R. 890 (Bankr. N.D. Ill. 2013). See also *Brisco v. United States of America (In re Brisco)*, 486 B.R. 422 (Bankr. N.D. Ill. 2013). Under § 506(d)(2), a lien may not be avoided simply for failure to file a proof of claim, and when SBA did not file a claim, it did not have an "allowed claim" for purposes of determining secured status under § 506(a). Since § 506(a) was not triggered, modification of SBA's lien was not possible under § 1322(b)(2).

Debtor ineligible for discharge could strip wholly unsecured junior mortgage. Although an unsecured lien is not void under § 506(d), the Chapter 13 debtors could use § 1322(b)(2) to avoid the wholly unsecured junior mortgages, treating them as unsecured in the plan. The fact that the debtors were not eligible for discharge, because of prior Chapter 7 discharges, did not prevent this result, agreeing with those courts holding that § 1325(a)(5) "does not apply to a claim that is unsecured pursuant to Section 506(a)." *Wong v. Green Tree Servicing, LLC (In re Wong)*, ___ B.R. ___, 2013 WL 1088620 (Bankr. E.D. N.Y. Mar. 14, 2013).

Shifting burden of proof for § 506(a) valuation. Discussing the burden of proof in plan confirmation context and use of § 506(a), the court adopted the view of *In re Heritage Highgate*, 679 F.3d 132 (3d Cir. 2012), which placed the initial burden on the party (debtor) challenging a secured claim's value, and if that party establishes with sufficient evidence that the proof of claim overvalues collateral, the creditor then has an ultimate burden of persuasion, by preponderance of evidence, to prove its collateral value. This standard was applied in the Chapter 13 case in which value of the debtor's residence was at issue, and the bank failed, through its appraisal evidence, to carry its ultimate burden. *Rosinski v. ANB Bank (In re Rozinski)*, 487 B.R. 549 (Bankr. D. Colo. 2013).

Mortgage on former rental property could not be modified. Although the debtors' property was rental when petition was filed, because they intended to move into it and reside there, while surrendering more expensive residence, the mortgage was protected from modification by § 1322(b)(2). Examining the split of authority on the controlling point in time, the court found "nothing in either the statute or the legislative history that requires the determination of what property is the debtor's principal residence to be linked solely to the date on which a secured creditor's claim in bankruptcy arises. . . . [T]he more important temporal consideration is not where debtors reside on the one day they file their petition (a date which may be subject to manipulation) but rather where debtors intend to reside during and after their bankruptcy." Factors are discussed for consideration under this "hybrid" approach. *In re Kelly*, 486 B.R. 882 (Bankr. E.D. Mich. 2013).

Reverse mortgage accelerated on mother's death could be paid over plan life. The debtor's mother executed a reverse mortgage, which was accelerated on her death, but the debtor resided in that property and was co-heir to the decedent's estate; therefore, the debtor could utilize §§ 1322(c)(2) and 1325(a)(5) to decelerate the mortgage and pay it over the plan life. The fact that there was co-ownership with another heir did not prevent the treatment, since the debtor resided in the home—"outcomes in bankruptcy frequently have an impact on non-debtors." *Federal Nat'l Mortgage Assoc. v. Griffin (In re Griffin)*, ___ B.R. ___, 2013 WL 1123826 (Bankr. D. Md. Mar. 18, 2013).

Postconfirmation Issues

Review of standards for modification. Reviewing the four-part framework for § 1329 modification, under *Barbosa v. Solomon*, 235 F.3d 3 (1st Cir. 2000), debtors' attempt to modify confirmed plan to retain and exempt proceeds from prepetition personal injury was denied. "New law" argument, based on application of *Hamilton v. Lanning*, was rejected, since it was decided two months before debtors' bankruptcy filing, and debtors did not attempt to exclude prospective proceeds from disposable income, resulting in their being bound by confirmed plan that dedicated proceeds to plan. *In re Murphy*, 487 B.R. 86 (Bankr. D. R.I. 2013).

Trustee could move to modify to obtain tax refunds. In a review of the various views of vesting and postconfirmation property of estate, and adopting the "estate reconciliation" approach, although postconfirmation tax refunds were property of the estate, they were not subject to turnover to the trustee, since debtors remained in possession of property of the estate, but the trustee could move to modify confirmed plans to obtain those refunds. However, "if prior to confirmation a debtor disclosed his expectation of a tax refund but made no provision for the refund in his plan, a court might well determine that there were no changed circumstances that would justify plan modification," citing *In re Meza*, 467 F.3d 874 (5th Cir. 2006). *In re Hymond*, 2012 WL 6692196 (Bankr. N.D. Tex. Dec. 21, 2012), slip copy.

Revocation of Confirmation

Failure to disclose pending criminal case not fraud for purposes of revocation. Discussing the high standard required under *In re Nikoloutsos*, 199 F.3d 233 (5th Cir. 2000), the debtor's failure to disclose a pending criminal case, involving theft, did not rise to the level of fraud necessary to revoke confirmation. The criminal case was not a contingent claim to be scheduled on Schedule F, and the trustee failed to show that knowledge of the criminal case would have changed confirmation outcome. *In re Leverett*, 486 B.R. 391 (Bankr. W.D. Tex. 2013).

Conversion

Conversion to Chapter 7 was in bad faith and reopening allowed. When the Chapter 13 debtor converted to Chapter 7, she did not disclose a medical malpractice claim that arose postpetition, and the debtor's cause of action was dismissed by the state court for lack of capacity to sue, finding that the action belonged to the bankruptcy estate. The debtor had received Chapter 7 discharge and the case had been closed with no distribution. On the debtor's motion to reopen the case to allow the trustee to pursue the cause of action, the court found that conversion was in bad faith and that under § 348(f)(2), the cause of action was property of the estate. The debtor's bad faith in not scheduling the cause of action did not weigh in the decision to reopen, since reopening would benefit the creditors. The cost-benefit analysis favored reopening to allow the trustee to pursue the cause of action, with defendant's objection to reopening rejected. *In re Easley-Brooks*, 487 B.R. 400 (Bankr. S.D. N.Y. 2013). See also *In re James*, 487 B.R. 587 (Bankr. N.D. Ga. 2013), allowing reopening by Chapter 13 debtor to schedule previously undisclosed cause of action and finding, under particular facts, that judicial estoppel did not prevent reopening. See also *Lenz v. Myers (In re Myers)*, 2013 WL 587311 (Bankr. S.D. Miss. Feb. 14, 2013), slip copy, finding that debtors converted from Chapter 13 to 7 in bad faith and that property of the Chapter 7 estate included property held on the date of conversion.

Conversion was based on unfeasible plan, failure to disclose and prejudicial delay. The bankruptcy court did not deny the debtor substantive due process and had cause to convert the case to Chapter 7, when the proposed plan did not address secured claims, was unfeasible, and the debtor had not disclosed all property of the estate, unreasonably delaying to prejudice of creditors. *Onyeabor v. Centennial Pointe Owners Assoc (In re Onyeabor)*, 2013 WL 819726 (BAP 10th Cir. Mar. 6, 2013), slip copy.

Dismissal

Appeal of dismissal not timely. The debtor's failure to timely file notice of appeal of case dismissal prevented the bankruptcy appellate panel's review, but the bankruptcy court properly denied the debtor's motion for Rule 60(b) relief from the dismissal order. *Rivera v. ASUME (In re Rivera)*, 486 B.R. 574 (BAP 1st Cir. 2013).

Termination of stay under § 362(c)(3) did not justify case dismissal and denial of confirmation. Although the automatic stay terminated under § 362(c)(3)(A), the

presence of the stay is not a *per se* Code requirement for confirmation or continuation of the case, and when no one objected to confirmation, the bankruptcy court should not have denied confirmation and dismissed the case solely because the stay had terminated. Also, the bankruptcy court should not have ordered disgorgement of attorney fees on the basis that failure to move for extension of the stay required denial of confirmation and dismissal. *In re Dyer*, 2013 WL 987729 (BAP 6th Cir. Mar. 14, 2013), slip copy.

Discharge

Debtor not eligible for discharge. Construing § 1328(f), in a case filed originally under Chapter 13 and then converted to Chapter 7, in which the debtor received a discharge, the case “can be characterized as ‘filed under’ both chapter 13 and chapter 7,” resulting in application of § 1328(f)(1)’s 4-year look-back for subsequent discharge eligibility. Section 1328(f) must be read in conjunction with § 348(a), which “effectively converts the First Case to ‘filed under’ chapter 7,” making the debtor ineligible for discharge in the subsequent Chapter 13 filed within four years. *Leavitt v. Finney (In re Finney)*, 486 B.R. 177 (BAP 9th Cir. 2013). See also *In re Johnson*, ___ B.R. ___, 2013 WL 951832 (Bankr. D. Mass. Mar. 11, 2013) (Agreeing with Fourth and Sixth Circuits and First Circuit BAP, filing date to filing date standard applied to § 1328(f), and agreeing with *Finney*, case was considered filed under converted Chapter 7, making debtor ineligible for Chapter 13 discharge. “Where a case starts in chapter 7 but converts to chapter 13 and results in a chapter 13 discharge the debtor is ‘rewarded’ with a 2 year disability before being eligible for another chapter 13 discharge. When a case starts as a chapter 13 (even with the best intentions) but is unsuccessful and converts to chapter 7, the debtor must endure a 4-year discharge disability.”

Pension-sharing obligation was not domestic support. The former spouse’s agreement as part of their divorce for the husband to make periodic payments to the wife as a settlement of her interest in his pension was not a domestic support obligation, but rather a property settlement; consequently, the obligation was dischargeable in Chapter 13, in which § 523(a)(15) is not discharge exception. Also, the former wife’s property interest was not sufficiently vested to make the pension settlement her sole and separate property; rather, the pension was property of the debtor’s bankruptcy estate. Also, the former spouse’s constructive trust argument was rejected. *Steele v. Heard*, 487 B.R. 302 (S.D. Ala. 2013).

Although creditor did not file formal proof of claim, bankruptcy court had authority to adjudicate § 523(a)(2) complaint, which constituted informal proof of claim. Affirming judgment of nondischargeability for \$88,500 against Chapter 13 debtor, bankruptcy court had authority to enter final judgment, including monetary judgment, in core proceeding under § 523(a)(2)(A). The adversary proceeding constituted an informal proof of claim. *Carroll v. Farooqi*, 486 B.R. 718 (N.D. Tex. 2013).

Debtor was in fiduciary capacity to spouse, under § 523(a)(4). When debtor unilaterally liquidated and spent community 401K account, for purposes other than

support of community, debtor committed defalcation, and under Washington common law, the debtor was a fiduciary over community account, a status coming into existence at time of marriage. Trust relationship between spouses in Washington satisfied § 523(a)(4)'s fiduciary requirement. *Mele v. Mele (In re Mele)*, ___ B.R. ___, 2013 WL 878634 (Bankr. W.D. Wash. Mar. 8, 2013).

Attorney Fees

Fees properly reduced in “run of the mill” case. Although the attorney's hourly rate was reasonable, request for \$9,000 fee was properly reduced to \$3,500, with many of the hours unnecessary. The attorney's “starting point was not a function of real world concerns for the plan's practicality; rather, it was an unrealistic indulgence of the [debtors'] predispositions toward work and entertainment.” *In re Little*, 484 B.R. 506 (BAP 1st Cir. 2013).

Mortgage Issues

Mortgage creditor bound by Rule 3002.1(g) response. When the lender responded to the trustee's Rule 3002.1(f) notice of final cure payment with its response and attachment itemizing postpetition amounts not paid, the lender was equitably bound by that response; it was not able to proceed in state court foreclosure, asserting different amounts unpaid. *In re Baca*, 2012 WL 6647733 (Bankr. D. N.M. Dec. 20, 2012), slip copy.

Debtors had standing to challenge mortgage validity based on assignee's lack of right to foreclose. Applying Massachusetts law on validity of assignment and foreclosure, the Chapter 13 debtors had standing to challenge validity of the assignment, which provided basis for right to foreclose. *Lopez v. Mortgage Electronic Registration Systems, Inc.*, 486 B.R. 221 (Bankr. D. Mass. 2013).

Trustee Avoidance

Trustee had statutory authority to file avoidance proceeding. Overruling creditor's objection to trustee's avoidance action, Chapter 13 trustee had statutory authority under §§ 103, 323, and 548 to file fraudulent transfer action, and the facts that debtor did not assert avoidance claim in prior litigation with the defendant or schedule the cause of action did not preclude the trustee's action. *In re Cecil*, ___ B.R. ___, 2013 WL 837592 (Bankr. M.D. Fla. Mar. 7, 2013).

Claims

Remand required for pattern of filing meritless claim objections. The bankruptcy court had denied debtors' objection to a proof of claim for lack of documentation, finding that debtors' scheduling of the credit card debt was an evidentiary admission, and the court had sanctioned debtor's attorney \$3,000 for a “persistent pattern of filing meritless claim objections” in this and other cases. The Bankruptcy Appellate Panel remanded for a more detailed explanation of the basis for the sanction, and to explain how Rule 9011's safe harbor requirement had been satisfied by the moving creditor. *Haines &*

Krieger, L.L.C. v. National Capital Management LLC (In re Hernandez), 2013 WL 829106 (BAP 9th Cir. Mar. 4, 2013), slip copy.

Failure to attach documentation not grounds for disallowance. Reviewing prior case law on the effect of a credit card creditor's failure to attach documentation to its proof of claim, the plan provided for payment of the debtors' attorney fees and \$114,243.92 in scheduled credit card debt, with twenty-eight proofs of claim filed, to which the debtor objected to twenty, 94% in amount of the unsecured claims filed, for lack of sufficient documentation. None of the objected claims had been scheduled as disputed, and the claims were in almost the same amounts as scheduled, with the last four digits of social security number the same as on debtor's schedules. The court reviewed the split in judicial view on effect of lack of documentation for claims, suggesting that Bankruptcy Rule 3001(c)'s amendment may resolve the judicial disagreement. The court concluded that a plain reading of § 502(b) established that insufficient documentation was not grounds for claim disallowance. *In re Brunson*, 486 B.R. 759 (Bankr. N.D. Tex. 2013).

Amended claim did not cure defect in original claim. When an original proof of claim was filed by Bank of America after it had transferred its interest in note and mortgage, the transferee (which was not a successor bank) could not cure that defect by amending the claim. The confirmed plan provided for full payment of the note, resulting in the current holder of note and mortgage being a secured creditor. Even without an allowed secured claim, the bank's lien would survive the bankruptcy, under § 506(d). *In re Moehring*, 485 B.R. 571 (Bankr. S.D. Ohio 2013).

Although proof of claim untimely, confirmed plan allowed late claim. When the confirmed plan specifically set time beyond § 502(b)(9) and Rule 3002(c) for creditors to file unsecured deficiency claims, debtor was bound by the provision, preventing use of Code or Rule time bar as basis for disallowance. *In re Shiver*, 484 B.R. 468 (Bankr. N.D. Fla. 2012).

AMERICAN BANKRUPTCY INSTITUTE

CASE LAW UPDATE

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AMELIA ISLAND, FLORIDA
JULY 18-21, 2013**

SOUTHEAST BANKRUPTCY WORKSHOP 2013

CASE LAW UPDATE

ABI SOUTHEAST - AUGUST 2013

TABLE OF CONTENTS

A.	DISMISSAL	1
B.	SECTION 522 EXEMPTIONS	2
C.	SECTION 544-551 AVOIDANCE ACTION	10
	(i) Preferences	10
	(ii) Fraudulent Conveyances	12
	(iii) Other Avoidance Actions	19
D.	SECTION 542 TURNOVER	26
E.	SECTION 546 LIMITATIONS/DEFENSES	29
F.	SECTION 541 PROPERTY OF THE ESTATE	33
G.	CLAIMS	41
H.	CONVERSION	48
I.	SECTION 362 STAY VIOLATION	48
J.	STANDING	50
K.	SECTION 363 SALES	53
L.	SECTION 554 ABANDONMENT	59
M.	JUDICIAL ESTOPPEL	59
N.	TRUSTEE IMMUNITY/LIABILITY	60
O.	SETTLEMENT	63
P.	SECTION 523 AND 727 DISCHARGE	65
Q.	TAX ISSUES	68
R.	ERISA ISSUES	71
S.	COMPENSATION/SURCHARGE	72
T.	IFP WAIVERS (28 U.S.C. § 1930(f))	78
U.	MISCELLANEOUS	78
V.	STERN V. MARSHALL	86
W.	PONZI SCHEME CASES	90

CASE LAW UPDATE

A. DISMISSAL

1. Ability to pay is a proper consideration of the totality of the circumstances of debtor's financial situation

The bankruptcy administrator filed a motion to dismiss or convert to Chapter 13 on the ground that debtors' petition constituted an abuse of the Chapter 7 process. The court found there was no presumption of abuse under § 707(b)(2)'s so-called means test but held that the petition demonstrated abuse under the totality-of-the-circumstances-test of § 707(b)(3)(B). The primary basis for this determination was that debtors had retained certain luxury items – including a camper, a boat, a trailer, and a tractor – and had continued making payments on these items to the relevant secured creditors. The court determined that their ability to pay coupled with their reluctance to modify their lifestyle to enable a distribution to unsecured creditors indicated the case would be an abuse of Chapter 7. The court gave debtors two weeks to convert the case to Chapter 13. Upon their failure to do so, the court dismissed the case. Debtors appealed to the district court, arguing that an ability to pay may not be considered as part of the totality-of-the-circumstances analysis. Debtors argued that there would be no reason for the complex formula created by Congress if a court could take the factors that are incorporated in the means test and utilize those same factors in the totality-of-the-circumstances-test. The district court rejected this contention and affirmed. Debtors then appealed to the Eleventh Circuit, which also affirmed. *In re Witcher*, 702 F.3d 619 (11th Cir. 2012). The Circuit Court concluded that the ability to pay his or her debts was a proper consideration which Congress had not intended to preclude from consideration. The court made clear that it was not deciding whether a debtor's ability to pay a loan could be dispositive under the totality-of-the-circumstances test or the proper weight a bankruptcy court should give to that factor as compared to other factors making up the totality of the circumstances, since debtors did not raise these issues on appeal.

2. Dismissal provision did not apply in case converted to Chapter 7

Debtor originally filed a Chapter 13 petition but it was converted to Chapter 7 after she was unable to fund her Chapter 13 plan. Section 707(b)(1) provides for the dismissal or voluntary conversion of a case filed by an individual debtor "under this chapter" whose debts are primarily consumer debts if the court finds that the granting of relief would be an abuse of the provisions of Chapter 7. A presumption of abuse arises when a Chapter 7 debtor fails the Means Test. Judge Williamson noted a split in authority with the majority position being the so-called "common sense" view that congress intended for the Means Test to be applied in all Chapter 7 cases, whereas a significant minority of courts follow the "plain language" view that the section applied only to cases "filed under" Chapter 7 and not those converted to it. Here, the court determined to follow the "plain language" view and, therefore, denied the motion to dismiss. *In re Layton*, 480 B.R. 392 (Bankr. M.D. Fla. 2012). In adopting the plain language approach, Judge Williamson provides a detailed analysis of the various views and their supporting and detracting arguments. In particular, he noted that to apply the Means Test, there had to be a mechanical computation of the debtor's current monthly income. Because current monthly

income is a defined term requiring the court to consider the debtor's taxable income during the six-month period ending on "the last day of the calendar month immediately preceding the date of the commencement of the case," he noted that a court would have to consider financials that are either months or even years old and not reflective of the debtor's current financial condition. This faulty application would be avoided by applying the plain language approach. In the event that the court determined that the debtor was converting in bad faith and committing an abuse of process, the court retained the powers under § 105(a) as enunciated *Marrama v. Citizens Bank of Mass.*, 549 U.S. 365 (2007), to dismiss the case. *See contra, In re Davis*, 489 B.R. 478 (Bankr. S.D. Ga. 2013)(Barret, J)("The view "that this statute does not apply to cases converted to Chapter 7 from another chapter – removes a whole category of chapter 7 cases from review for possible abuse, contradicts the manifest intent of Congress, and frustrates the purpose of the statute." [Author's Comment: This case is important to trustees attempting to administer asset cases that have been converted from Chapter 13 and whose dismissal is sought by the United States Trustee.]

3. § 707(b) applied to individuals in converted cases

The issue was whether § 707(b)(1) applies to cases converted by individual debtors to Chapter 7 after being first filed as Chapter 13 cases. Here, the Eighth Circuit BAP held that it did apply. *In re Chapman*, 447 B.R. 250 (8th Cir. BAP 2011). The BAP noted that the bankruptcy courts were split on the question of how to interpret this language. The language "filed by an individual debtor under this chapter" contained in § 707(b)(1) had been interpreted by some courts as requiring that a case be filed under Chapter 7, not converted to Chapter 7. The other interpretation was that the word "filed" in § 707(b)(1) identified the type of debtor (i.e. an individual debtor) rather than a limitation on how the case arrived in Chapter 7. Those courts found that to rule otherwise would create a potential loophole for debtors to "abuse" the system by filing and failing first under Chapter 13 in order to avoid the § 707(b) analysis upon conversion. Ultimately, the BAP relied on a 1982 decision from the Eighth Circuit, *Resendez v. Lindquist*, 691 F.2d 397 (8th Cir. 1982) wherein it was stated that upon conversion from Chapter 13 to Chapter 7, the debtors would be deemed to have filed a Chapter 7 case at the time the Chapter 13 case was filed. *See also In re Davis*, 489 B.R. 478 (Bankr. S.D. Ga. 2013)(Barret, J).

B. SECTION 522 EXEMPTIONS

4. Inherited IRA not exempt

Debtor Heidi Clark was the designated beneficiary of her mother's IRA worth approximately \$300,000. Upon her mother's death, Heidi inherited the IRA and claimed it fully exempt in her Chapter 7 bankruptcy case. The trustee timely objected. The bankruptcy court had agreed with the trustee that the inherited IRA was not exempt, concluding that an inherited IRA does not represent "retirement funds" in the hands of the current owner. Judge Martin had noted that while the funds remained sheltered from taxation until the money was withdrawn, many of the other attributes of the IRA had changed. For example, no new contributions could be made and the balance could not be rolled over or merged with any other account, 26 U.S.C. § 408(d)(3)C). Additionally, instead of being dedicated to Heidi's retirement years, the inherited IRA must begin distributing its assets within a year of the original owner's death and payout must be completed in as little as five years. 26 U.S.C. § 402(c)(11)(A) incorporating 26 U.S.C. §

401(a)(9)(B). The debtor appealed. Judge Martin's decision was reversed by the District Court Judge who followed recent appellate decisions such as *In re Nessa*, 426 B.R. 312 (8th Cir. BAP 2010) and *In re Chilton*, 674 F.3d 486 (5th Cir. 2012). Those courts had observed that any "retirement funds" in the decedent's hands had to be treated the same way in the successor's hands because §§ 522(b)(3)(C) and (d)(12) referred to "retirement funds" without providing that they must be the debtor's. It would be enough if they had ever been anyone's retirement funds. The trustee appealed and was joined by NABT in an amicus brief and was opposed by NACBA in an amicus brief before the Seventh Circuit Court of Appeals. The Seventh Circuit reversed and reinstated the holding of the bankruptcy court. *Rameker v. Clark (In re Clark)*, 2013 WL 1729600, 2013 LEXIS U.S. App. 8112 (7th Cir. April 23, 2013).

In an outstanding opinion authored by Judge Easterbrook, the Circuit Court makes it seem very simple and obvious that "an inherited IRA does not have the economic attributes of a retirement vehicle, because the money cannot be held in the account until the current owner's retirement." It finds that the attributes of any inherited IRA do not in any way resemble "retirement funds." Further, the court concludes: "The district judge thought the question close and believed that close questions should be decided in debtor's favor. We do not think the question close; inherited IRAs represent an opportunity for current consumption, not a fund of retirement savings." The court further concludes that the bankruptcy judge "got this right" and disagreed with the 5th Circuit in *Chilton*. The court recognized that it was creating a conflict among the circuits and noted that it had circulated the opinion before release to all judges in active service. "None of the judges requested a hearing *en banc*." [Author's Comments: Trustees have been making these arguments and losing cases all over the country or winning in the bankruptcy court and being reversed on appeal, which is what happened here when Judge Martin was reversed by the district court. With the contrary appellate opinions from the 5th Circuit and the 8th Circuit BAP, this looked like the last good chance to turn the tide and bring a measure of common sense to statutory interpretation. Congratulations to the NABT's Amicus Committee for another outstanding victory.]

5. Debtor did not impermissibly use IRA to extend himself credit by granting a lien therein against potential future debts

Debtor opened an IRA with Merrill Lynch by rolling over \$64,646 from another financial institution. In connection therewith, he signed a Client Relationship Agreement that included a provision whereby all of the securities and other property in the account "shall be subject to a lien for the discharge of any and all indebtedness or any other obligations you may have to Merrill Lynch." The bankruptcy court relied on an advisory opinion by the Department of Labor that the grant of a security interest in an IRA to cover debt in a non-IRA account "would amount to an extension of credit by the IRA to the IRA owner." Therefore, the bankruptcy court found that the IRA was disqualified and lost its tax exempt status and the bankruptcy exemption claimed in it. The district court affirmed. Debtor appealed to the Circuit Court of Appeals, which reversed. *In re Daley*, 2013 U.S. App. LEXIS 12138 (6th Cir. June 17, 2013). The circuit court noted that debtor never opened a margin-trading account or any other account and, thus, never became indebted to Merrill Lynch nor did he withdraw money from his IRA, borrow from it, or use it as collateral for a loan of any sort. Additionally, Merrill Lynch's IRAs had received a favorable determination letter from the IRS creating a presumption that the funds were exempt. Accordingly, even though the Tax Code provided that any direct or indirect lending of money or other extension of credit between the IRA and its owner was a disqualifying event, the circuit

court found that debtor's "naked lien, stripped of any connection to a credit transaction, was not an extension of credit." The lien provision was contingent on an event that never occurred and thus could be exempted in his bankruptcy case.

6. Short sale incentive belongs to estate

On her petition date, debtor's mortgage was far greater than the value of her home. She nevertheless claimed as exempt "any and all proceeds, revenues, or concessions conceded to or granted by the secured mortgage lender on the property" up to \$11,764. Trustee objected, and the court sustained the trustee's objection. *In re BonnieJean Bunn-Rodemann*, 491 B.R. 132 (Bankr. E.D. Cal. 2013). Judge Sargis stated: "Attempting to claim an exemption in this type of asset is a relatively new phenomenon arising from creditors realizing that a short sale of the property securing the debt (by which the creditor agrees to take less than the full amount owed) is better than the creditor completing a non-judicial foreclosure sale and the creditor becoming the owner of the property." The court explained that some "savvy" borrowers were negotiating incentive payments from the lenders that would be less than the cost of foreclosing, owning the property, and selling the property itself. Further, Chapter 7 trustees had determined that they could obtain incentive payments by conducting short sales of homes rather than abandoning them. When they did so, the incentive payment would not be the liquidation of the asset that the debtor owned on the petition date but, rather, compensation paid by the secured creditor to the trustee for services rendered. However, once the Chapter 7 petition was filed, the debtor no longer had the right or power to conduct a short sale or to "sell her own real estate services." "It is the Chapter 7 Trustee's labor and the estate's expense in working to sell property of the estate which is the subject of the incentive payment." The court observed that when the trustee chose to retain and attempt a sale of the underwater home, the debtor had the option of moving out, asking the trustee to abandon the property, or attempting to stay and negotiating with the trustee the terms of continued possession, such as paying the current insurance and maintenance costs to allow the debtor to avoid paying rent for housing and moving expenses during the first months of a Chapter 7 fresh start. The court observed: "In reality, these debtor-trustee issues concerning a short sale are steeped in the highest tradition of bankruptcy – what deal can be made that is in everyone's best interest." [Author's Comment: This court's analysis seems to state the obvious, particularly with its last comment concerning the deal being made "in everyone's best interest." Nevertheless, in certain regions, the U.S. Trustee objects to efforts to do short-sales or carve-outs, despite the win-win-win scenario, if it feels the trustee and his or her professionals receive a disproportionate amount of benefit when compared to the general unsecured creditors. No assessment of the risk borne by the trustee is part of the calculation nor does it seem to matter that every unsecured creditor would prefer a meaningful distribution rather than no distribution.]

7. 100% FMV exemption claims potentially sanctionable

A court in North Carolina consolidated seven Chapter 7 cases where debtors' counsel inserted the following prefatory paragraph in Schedule C-1, "Undersigned debtors are claiming and intend to claim 100% of Debtors' interest in 100% fair market value of each and every item listed, irrespective of the actual value claimed as exempt." The trustee timely objected to the exemptions. Debtors then amended to remove the 100% language and substituted a longer notice that included the language: "If the 'internal net value' of an asset listed below is equal to or less than the amount of the exemption claimed and if that value is less than the maximum amount of

the exemption allowance under applicable law, the debtor exempts the asset from the estate and his entire interest in the asset from the estate." Thus, by inserting this provision, debtors were attempting to exempt their entire interest in every item listed in Schedule C-1 whenever the "net-value" was less than the allowable exemption, irrespective of the item's actual fair market value. Debtors maintained that under *Schwab v. Reilly*, 130 S. Ct. 2652 (2010), they were authorized to claim the full value of an item as exempt, which the notice provision was intended to indicate. The court disagreed and sustained the trustee's objections. *In re Gregory, et al.*, 487 B.R. 444 (Bankr. E.D.N.C. 2013). Judge Leonard analyzed *Schwab* and its progeny and found the extensive body of case law that had developed as almost entirely uniform in rejecting designations such as "100% of the FMV," "100% equity," or comparable language. It found such language also violated the language of the General Statutes of North Carolina and concluded that if counsel persisted in "further use of this language, the court will not hesitate to utilize its *sua sponte* powers under Federal Rule of Bankruptcy Procedure 9011 to require counsel to demonstrate a colorable basis for its inclusion to avoid sanctions."

8. Objection to amended exemptions not limited to the amended items

Debtor's Chapter 11 case was converted to Chapter 7. After filing his original schedules, debtor amended them five times. The omission of several items of value that appeared on subsequent amended schedules was, in part, the basis for conversion to Chapter 7. After the final amendments were filed, a creditor objected on the 30th day thereafter, asserting that the objection was timely under Rule 4003(b). The debtor, however, asserted that the deadline had long passed on items not previously objected to that had not been amended. The court ruled that the creditor's objection was timely. *I*, 2012 Bankr. LEXIS 4435, 2012 WL 4484890 (Bankr. W.D. Tex. 2012). Judge Gargotta noted a split of authority between the "restrictive rule," wherein a party in interest has 30 days to object only to changes made by the amendment and not to claims that are unaffected by an amendment, and the "non-restrictive rule" under which a party in interest may object to any claimed exemption within 30 days of an amendment to the schedules. The court observed that the 7th and 9th Circuit Courts of Appeals and 8th Circuit BAP had all followed the "restrictive rule," but with very limited analysis, grounding their respective holdings on the need for prompt action and finality. These arguments were found by Judge Gargotta to be "not convincing." He determined that the plain reading of Rule 4003, which does not limit the scope of the objection, and the interdependence of exemption schemes supported adoption of the "non-restrictive rule". The court concluded that a trustee or other party-in-interest should be allowed to reassess a debtor's use of an exemption scheme upon the filing of any amendment that changes that use, particularly since it would not be prejudicial to the debtor whose prerogative it is to file accurate schedules or amendments thereto. [*Author's Comment*: The "non-restrictive rule" could also be referred to as the "common sense approach." Every time a piece of a case is changed the trustee reassesses the whole.]

9. Debtor's bad faith and reckless disregard for the truth precludes him from amending his exemption schedules

Flag Star Bank had obtained a judgment against debtor and others for \$1.1 million on October 2, 2009, and had begun collection proceedings, including garnishment of bank accounts. Over a year later, debtor received over \$107,000 of retroactive retirement benefits from the State of Michigan by direct deposit into his checking account. The following day, debtor withdrew

\$100,000 from the account and purchased a cashier's check made payable to himself which he placed into a safe deposit box. Debtor filed his Chapter 7 petition four months later. Neither the cashier's check nor garnished funds were disclosed in the schedules. Trustee discovered the existence of them upon questioning the debtor at the meeting of creditors. Debtor then filed amended schedules, pursuant to which he disclosed and sought to exempt these funds, pursuant to § 522(d)(12). The trustee objected. Following an evidentiary hearing, the bankruptcy court determined that the debtor's failure to list the cashier's check and the garnished funds in his Schedules was intentional or in reckless disregard of his duty of full disclosure and, as a result, sustained the trustee's objection. The bankruptcy court further ruled that even if the debtor had not acted in bad faith, the claims of exemption pursuant to § 522(d)(12) would be denied as the funds were not in an account exempt from taxation. *See In re Rice*, 452 B.R. 623 (Bankr. E.D. Mich. 2011)(Rhodes, J.). Debtor appealed to the district court. After a thorough review and analysis of the bankruptcy court's holding, the district court affirmed, finding the bankruptcy court's factual findings that Rice was either reckless or intentional in omitting the check to not be clearly erroneous. *In re Rice*, 478 B.R. 275 (E.D. Mich. 2012).

10. Exemption barred in unscheduled IRAs

Debtor had failed to schedule his IRAs or disclose them at three meetings of creditors, a Rule 2004 examination, and various pleadings and motions, or in response to a discovery request by the trustee in a separate proceeding regarding the debtor's profit-sharing plan. When the trustee finally discovered the existence of the IRAs, debtor amended his schedules to claim them as fully exempt. The trustee filed an objection thereto. The bankruptcy court found that, even if the IRAs were otherwise exemptible and not subject to administration by the trustee, the debtor had acted with at least reckless indifference to the truth. The bankruptcy court also rejected the debtor's "advice of counsel" defense. After the bankruptcy court disallowed the exemptions, debtor appealed to the district court, which has affirmed. *Daniels v. Agin*, 482 B.R. 1 (D. Mass. 2012). The district court held that the findings of the bankruptcy court were not clearly erroneous, and further observed: "A debtor cannot, merely by playing ostrich and burying his head deeply in the sand, disclaim all responsibility for statements which he has made under oath."

11. Trustee may surcharge exemptions

The First Circuit Court of Appeals has ruled that bankruptcy courts are empowered to surcharge exempt assets when a debtor fraudulently conceals non-exempt assets. Justice David H. Souter, sitting by designation, authored the unanimous opinion in the case, *Malley v. Agin* (*In re Malley*) 693 Fed. 28 (1st Cir. 2012).

In *Malley*, the debtor fraudulently concealed his right to a portion of the proceeds from the sale of his former marital house. When the trustee discovered the deception, he sought an order surcharging the debtor's exemption in his truck to remedy the fraud. The bankruptcy court granted the trustee's request and surcharged the debtor's exemption in the truck.

On appeal, the Court framed the question: "Should Malley's interest in the truck be recognized as 'exempted under this section' when its exemption would consummate a fraud on creditors by giving the debtor a greater exemption in fact than the code entitles him to claim in law?" The Court answered the question in the negative, resting its holding on 11 U.S.C. § 105(a), and determining that surcharge orders are "necessary and appropriate to carry out the

provisions” of the Bankruptcy Code. Surcharge is grounded in the other provisions of the Bankruptcy Code, as it enforces the disclosure requirements of § 521 and prevents the debtor from retaining more property than permitted by § 522. Although the Bankruptcy Code provides specific penalties for fraud, such as denial of discharge or dismissal, the Court determined that surcharge is a necessary remedy to alleviate the effect of the debtor’s misconduct on creditors, who would otherwise “bear the brunt of the fraud.”

The Court also discussed § 105(a)’s authorization for the bankruptcy court sua sponte to take “any action necessary or appropriate... to prevent an abuse of process.” The Court found no reason to limit this grant to sua sponte actions; instead, courts may enter surcharge orders upon request of the trustee where necessary to prevent an abuse of process. The Court stated, “There could not be a clearer example of foiling abuse of process than a surcharge order mitigating the effect of fraud in retaining non-exempt assets.”

The Court found support in *Marrama v. Citizens Bank of Mass.*, 549 U.S. 365 (2007), where the Supreme Court articulated a broad understanding of § 105 in the context of an abuse of process, and in *In re Hannigan*, 409 F.3d 480, where the First Circuit denied a debtor’s amendment of exemptions based on bad faith conduct. *Malley* is in accord with the Ninth Circuit’s conclusion in *Latman v. Burdette*, 366 F.3d 774 (9th Cir. 2004), the first circuit level decision to approve surcharge orders. There is, however, an ongoing circuit split over the surcharge issue: the Tenth Circuit denied surcharge of exempt assets in *In re Scrivner*, 535 F.3d 1258 (10th Cir. 2008).

12. "100% of FMV" exemption claim rejected by 1st Circuit BAP

The Chapter 13 debtors claimed exemptions in both their residence and car as "100% of FMV," pursuant to § 522(d). The Chapter 13 trustee objected on the grounds that it exceeded statutory limits and was an improper attempt to capture post-petition appreciation in both the residence and the car. The debtors countered that the phrase "100% of FMV" was merely a "phrase of art" authorized by the Supreme Court in *Schwab v. Reilly*, 130 S.Ct. 2652 (2010), where the court stated near the end of the opinion that listing the exempt value as "full fair market value (FMV)" or "100% of FMV" would encourage the trustee to promptly object to the exemption if he wished to challenge it and preserve for the estate any value of the asset beyond relevant statutory limits. The bankruptcy court ultimately sustained the objection and ordered the debtors' exemptions limited to specific dollar amounts. It further held that to the extent any appreciation in the exempted assets exceeded the maximum exemption amounts allowed, that appreciation would be property of the estate potentially available for creditors. Debtors also pointed to proposed changes to Official Form C, which would allow a debtor to state the value of the claimed exemption as "the full fair market value of the exempted property." On appeal, the trustee maintained that the claimed exemptions were facially defective and ambiguous and would hinder the administration of the estate. The Bankruptcy Appellate Panel agreed. *In re Massey*, 465 B.R. 720 (1st Cir. BAP 2012).

The BAP observed that the Supreme Court questioned the effectiveness of a "100% FMV" type of exemption, noting that (a) such an exemption would not likely pass title to the asset itself, (b) the majority of lower courts to have construed *Schwab* found such exemptions impermissible, and (c) no court had interpreted the Supreme Court’s holding as "either unfettered authorization for debtors to exempt assets in-kind or as a mandate for courts to allow such exemptions." It cited with approval the opinion one month earlier from a Massachusetts

bankruptcy court, *In re Luckham*, 464 B.R. 67 (Bankr. D. Mass. 2012), that was in line with the majority of courts in finding that the Supreme Court had not outlined a procedure by which an exemption claim could be legitimately converted into an exemption in-kind and that an evidentiary hearing on valuation was unnecessary because the basis of the objection was the manner in which the debtor had claimed it. The BAP further rejected "the argument that proposed changes to Official Form C support in-kind exemptions which exceed the statutory limits," noting that *Schwab* itself precluded such a form-based argument. Finally, the BAP rejected the debtor's policy argument that such a ruling would impair a debtor's "fresh start" referring to the statement in *Schwab* that the approach advocated by the debtors would "convert a fresh start into a free pass." [*Editor's Note*: On behalf of NABT, the author provided extensive testimony on February 10, 2012, making the same points in opposition to the proposed amendment to Official Form C that this Court makes just three weeks later. The testimony is available on the NABT website.]

13. Joint debtors can stack § 522(p) homestead exemptions

Debtor Charles Gentile conveyed his marital home to his spouse for \$1.00 on August 9, 2011. The following month, she conveyed the property to herself and Mr. Gentile as joint tenants by the entirety. A few months later, they filed a joint bankruptcy petition, in which they claimed the homestead exempt to the extent of \$195,667. Creditors objected to the exemption claim on several grounds. The objections were overruled and the exemption allowed. *In re Gentile*, 483 B.R. 50 (Bankr. D. Mass. 2012). Judge Hoffman first noted that Massachusetts homestead exemption laws are available to individuals who own and occupy or intend to occupy real property as their residence up to a maximum of \$500,000. The only potentially valid argument made by the creditors was under § 522(p), which capped the homestead exemption at \$146,450 in cases where the debtor had acquired an interest in the property within 1,215 days of the petition date. Here, the conveyances occurred within a few months of the petition date triggering application of § 522(p), which code section the court found was equally applicable to transfers between spouses. However, the court also found that under § 522(m), § 522(p) applied separately with respect to each debtor in a joint case, thereby allowing the capped exemption amounts to be "stacked" by the debtors. Here, that would have entitled the debtors to a capped exemption of \$292,900, which exceeded the amount claimed. Therefore, the objection was overruled.

14. Debtor entitled to a single personal injury exemption no matter how many accidents

Debtor had more than one personal injury claim pre-petition and sought to exempt for each injury claim the maximum federal statutory cap set forth in § 522(d)(11)(D) of \$21,625. The trustee timely objected. The court sustained the court's objection. *In re Phillips*, 485 B.R. 53 (Bankr. E.D. N.Y. December 27, 2012). Judge Trust noted a split of authority on the issue of stacking the personal injury exemptions for multiple incidents and turned to the legislative history. He found that the legislative history created more confusion than clarity about congressional intent and failed to illuminate an answer to the problem. The court returned to a plain meaning analysis and read the exemption statute in light of § 102(7)(the singular includes the plural) and determined that the debtor could not exceed in the aggregate \$21,625 no matter how many accidents and injuries debtor has suffered.

15. Debtor's exemption planning unwound from § 522(o)

Judge Markell begins his opinion with the following: "All siblings fight. Rich siblings fight interminably." He then sets forth that debtor's sister obtained a state court judgment for \$525,000 for, among other things, fraud and breach of fiduciary duty plus another judgment for approximately \$518,000 representing attorney fees and costs incurred in obtaining the first judgment. The Colorado trial court had found that the debtor "lives in a different reality and has little capacity to perceive the actual reality." Debtor had liquidated over \$400,000 in real estate and other investments within months of the entry of her sister's judgment, and then distributed the proceeds to family creditors and immediate family (other than her sister). This was done in a hurried fashion to put assets beyond the reach of creditors. The court determined to reduce the value of her allowed homestead exemption pursuant to § 522(o). *In re Stanton*, 457 B.R. 80 (Bankr. D. Nev. 2011). Judge Markell traced the history of the code section noting that it utilized the historic language of fraudulent conveyances – first drafted over 400 years ago under the Statute of 13 Elizabeth and that badges of fraud were relied upon to show the intent to hinder, delay, or defraud. He explained that a "badge of fraud" was a fact which made a transaction suspicious, thus calling for an explanation, and then outlined the 11 most commonly relied upon badges of fraud set forth in § 4(a) of the Uniform Fraudulent Transfer Act. He described debtor's actions as "hoary badges of fraud," engaged in by debtors from time immemorial. The court rejected debtor's uncorroborated testimony that she relied on the advice of others in making the transfers or that she was just taking reasonable actions in light of the economic climate of late-2008. Accordingly, her sister's motion was granted and the exemption limited.

16. Homestead proceeds from foreclosure sale during bankruptcy held property of the estate where not reinvested

Creditor lifted the stay in debtor's bankruptcy and sold debtor's homestead in a foreclosure sale with a portion of the proceeds paid to the debtor as required by the California homestead exemption. The California homestead exemption provides that the debtor's portion of the proceeds loses its exempt status if not reinvested within six months. The debtor did not reinvest the proceeds in that window. Trustee filed complaint against debtor and her husband seeking turnover of the proceeds from the sale, a rental property held in the husband's name, and income earned from that property. The bankruptcy court rejected all of the trustee's claims and the Ninth Circuit Bankruptcy Appellate Panel affirmed. The trustee appealed and the Ninth Circuit reversed in part, holding that the proceeds from the homestead sale belonged to the estate, but the rental property held in her husband's name and the income from it did not. *Wolfe v. Jacobson (In re Jacobson)*, 2012 U.S. App. LEXIS 8103 (9th Cir. 2012).

The Ninth Circuit reasoned that under the "snapshot" rule, bankruptcy exemptions are fixed at filing and whether an exemption applies must be determined by the *entire* applicable state law. In this case, the entire applicable law included a reinvestment requirement. Although the debtor had a right to the exempt proceeds, that right was contingent on reinvesting in a new homestead within six months. Because the debtor did not do so, she forfeited the exemption. As to the rental property, the Ninth Circuit agreed that the trustee's claim failed because the title documents showed that debtor's husband was the sole owner and in California, record title is presumptively correct. In addition, there was no presumption of community property where the husband acquired the property in his name alone and it was traceable to his separate inheritance.

Finally, the court rejected the argument that because the bankruptcy court had found that the debtor ran her husband's affairs in a previous case, the debtor was estopped from arguing she had no interest in the property. It was not inconsistent for the husband to own separate property and let the debtor run his affairs.

C. SECTION 544-551 AVOIDANCE ACTION

(i) Preferences

17. Payment to materials supplier not a preference

The debtor subcontractor's pre-petition joint check agreement with the general contractor and materials supplier required the general contractor to make payments for materials payable jointly to the debtor and supplier. The agreement made the general contractor directly liable for the payments if the debtor failed to timely endorse the checks over to the supplier. During the preference period, the general contractor delivered to the debtor two checks that were made jointly payable to the debtor and the supplier. The debtor endorsed both checks and paid them over to the supplier which deposited them into its checking account. The Chapter 7 trustee commenced a preference action against the supplier to avoid and recover the two transfers. The supplier argued that the debtor had no interest in the funds and was a mere conduit for payment. The bankruptcy court agreed and granted summary judgment to the supplier because the trustee failed to establish that the payments were transfers of an interest of the debtor in property. *Novak v. CMC Joist and Deck (In re Steel Fab, Inc.)*, 2013 WL 65548, 2013 Bankr. LEXIS 700 (Bankr. D. Conn. 2013). Judge Dabrowski found that the transfer of an interest of the debtor in property occurred outside the preference period when the parties entered into the joint check agreement. It was at that time that the debtor gave up dominion and control over the receivables and the right to decide when and how to pay the supplier. The debtor no longer had an interest in the two transfers when it turned them over to the supplier. Explaining further, the court determined that under Connecticut's version of the UCC, a "holder" or someone who has the rights of a holder may properly present an instrument for payment. A "holder" is defined as a person in possession of a negotiable instrument that is payable either to bearer or to an identified person that is the person in possession. Possession required an "intent to control" so Debtor could not be a "holder" and had no property interest in the checks when they were delivered to the debtor by the general contractor.

18. Payment to mechanic not preferential

A mechanic did work on a hospital's emergency generator radiator, invoicing the hospital for \$7,262. The invoice was paid 33 days later but within 90 days of the bankruptcy filing of the hospital. The plan custodian of the hospital's confirmed plan sought recovery of the payment as a preference. On cross-motions for summary judgment, the motion of the mechanic was granted and that of the custodian denied. *Johnson Memorial Hospital, Inc. v. New England Radiator Works (In re Johnson Memorial Hospital, Inc., et al.)*, 470 B.R. 119 (Bankr. D. Conn. 2012). The court found that the alleged preferential payment was not avoidable because it did not satisfy § 547(b)(5) in that it would have received the same pro-rata distribution as other unsecured creditors in a hypothetical Chapter 7 liquidation. This was because had the payment not been made, it would have been the holder of an inchoate statutory lien that would not have been

avoidable and it remained eligible to perfect the lien pursuant to relevant state law and such perfection would not otherwise have been avoidable under the Code.

19. No dismissal of preference complaint based on plausibility of new value defense

In the aggregate, the affiliated debtors constituted one of the largest haulers of new cars in North America, picking up new vehicles from original equipment manufacturers and delivering them to railroad yards, dealerships, etc. While the vehicles were in the possession of the debtor for hauling, debtor was responsible for any damage to the vehicles. Trustee's lawsuits sought return of \$258,507.66 paid during the preference period to Ford Motor Company for damage to vehicles. During that same period, Ford ordered over \$16.4 million in new hauling business to be performed by debtor and paid for by Ford. Ford argued that the magnitude of these orders simply had to provide sufficient "new value" in excess of the amount sued to require dismissal of the lawsuit. The trustee argued that Ford was fully compensated for what it paid the debtor during the preference period and should not be allowed a "new value" defense essentially allowing Ford to "double dip" by receiving "full value" for the new orders it placed that were satisfied, plus a "new value" defense as to preferences. The court ruled in favor of the trustee and declined to dismiss the lawsuits. *In re Performance Transp. Services, Inc.*, 475 B.R. 5 (Bankr. W.D. N.Y. 2012). Judge Kaplan noted that courts are in disagreement on whether the "new value" had to "remain unpaid." Nevertheless, the court found that it was inappropriate to dismiss a preference complaint based on a "proffer" in a Rule 12 context that the complaint was adequately pled. Therefore, the motion of the defendant was denied.

20. Regularly conducted, non-collusive foreclosure sale is potentially avoidable as a preference

The bank conducted a real property foreclosure sale within 90 days of the debtor's Chapter 11 petition. The debtor brought an adversary proceeding against the lender to avoid the transfer/sale as a preference and return the subject property to the bankruptcy estate. Debtor argued that the proximate value of the property was \$3.3 million, whereas the bid-in price was \$1.22 million on a claim totaling \$2.855 million. The bank sought dismissal of the complaint based on *BFP v. Resolution Trust Corp.*, 511 U.S. 531 (1994), which held that a non-collusive foreclosure sale conducted in accordance with applicable state law was, as a matter of law, "reasonably equivalent value," and thus held that the foreclosure could not be avoided as a fraudulent transfer. Noting a split of authority but agreeing with the court in *In re Villarreal*, 413 B.R. 633 (Bankr.S.D. Tex. 2009), the court here denied the dismissal motion. *In re Whittle Development, Inc. v. Branch Banking & Trust (In re Whittle Development, Inc.)*, 463 B.R. 796 (Bankr. N.D. Tex. 2011). Judge Hale determined that applying the Supreme Court's reasoning in *BFP* to § 547 was misplaced because preference law did not concern itself with "reasonably equivalent value" and, instead, simply required a determination of whether the creditor received more than it would have had the transfer not occurred pre-petition. The court held that if an otherwise valid foreclosure sale is found to enable a creditor to obtain more than it would in a Chapter 7 liquidation, then the additional amount of benefit conferred to the creditor is simply brought back into the estate with no effect on the purchaser of the real estate (unless the

purchaser was the creditor itself). Policy arguments concerning clouding the title to real estate were found to be largely moot in the context of § 547 avoidance. The purchaser would not be subject to the avoidance action because preference recovery was only with respect to a transfer "to or for the benefit of a creditor." "Given that it is not only possible but probable that a trustee will secure more than the foreclosing creditor will on his own, the policies of the Code are furthered if a secured creditor can be prevented from reclaiming property and earning a windfall at the expense of the estate." Id. at 802.

(ii) Fraudulent Conveyances

21. "Flexibility and Time" sufficient benefits to satisfy reasonably equivalent value

The debtor was an S corporation and therefore its shareholders were responsible for paying the taxes on the debtor's income. The debtor's shareholder agreement also provided that if the debtor's income becomes taxable to the shareholders then the corporation must pay an annual dividend sufficient to allow each shareholder to cover their portion of the corporation's income tax. Pursuant to the terms of the shareholder agreement, the corporation made a dividend to defendant for approximately \$94,000.

The trustee brought a fraudulent transfer action claiming that the debtor received no reasonably equivalent value for the dividend. The Eleventh Circuit disagreed. *In re Northlake Foods, Inc.*, 2013 WL 1603442 (11th Cir. Apr. 16, 2013). The court held that in return for reimbursing defendant for his payment of the taxes, the debtor was able "to shift to S-corporation status whenever it determined it was advantageous to do so" and "enjoyed the added benefit of freeing up cash that otherwise would have been dedicated to paying its tax liability." In other words, the arrangement "provided [the debtor] with two valuable benefits: flexibility and time."

22. Non-compensatory tax penalties and fines not avoidable as fraudulent transfers

The Chapter 11 debtor sought to recover pre-petition tax penalty payments in the amount of \$637,652.07, arguing that the imposition of the penalty payments provided no value to the debtor, the debtor did not receive reasonably equivalent value in exchange for the penalty payments, and debtor was insolvent when the payments were made. The bankruptcy court disagreed and was affirmed by the 6th Circuit Bankruptcy Appellate Panel. Thereafter, the debtor appealed to the Sixth Circuit Court of Appeals, which also affirmed. *In re Southeast Waffles, LLC*, 702 F.3d 850 (6th Cir. 2012). The Circuit Court noted that a dollar-for-dollar reduction in debt typically constituted, as a matter of law, reasonably equivalent value in the application of fraudulent transfer statutes. Indeed, the Circuit Court was unable to find a single case in which legitimate pre-petition tax penalties (or pre-petition payments made in relation thereto) had ever been avoided as fraudulent transfers. The Circuit Court observed that when Congress enacted the Bankruptcy Code, it specifically addressed non-compensatory penalties and carefully differentiated treatment of such penalties in other contexts within the Code, but they were not addressed in § 548, which the Circuit Court found significant. The Court supported its decision with this quote from a prior Supreme Court opinion: "Where Congress includes particular language in one section of a statute but omits it in another section of the same Act, it is generally presumed that Congress acts intentionally and purposely by the disparate inclusion or exclusion."

[Citations omitted.] *Duncan v. Walker*, 533 U.S. 167 (2001). Finally, the court found that tax penalties arise by operation of law rather than through contractual bargaining which made it more unlikely that Congress intended for payment of such penalties to constitute fraudulent transfers. In conclusion, the court held that fraudulent transfer statutes do not provide debtors with either a means to avoid legitimate tax penalties or to recover pre-petition payments made in satisfaction of them.

23. Pre-petition tax sale may constitute a fraudulent transfer

After the debtor failed to pay his real estate taxes, the township conducted a public tax sale. The successful bidder then assigned its lien and tax sale certificate to a third party, who eventually filed a foreclosure action in state court. The debtor failed to redeem the property and the holder of the certificate obtained a judgment which enabled him to obtain title to the property.

After filing bankruptcy, the debtor sought to void the judgment conveying title as either a preference or fraudulent conveyance. The defendant filed for summary judgment, which was denied. *In re Berley Associates, Ltd.*, 2013 WL 2099816 (Bankr. D.N.J. 2013). In doing so, the court held that the price received at a public tax sale does not automatically qualify as reasonably equivalent value for the underlying real property, distinguishing between a tax sale and mortgage foreclosure. The court noted that the public bidding component of the sale occurred only with the sale of the tax certificate and not with the transfer of the property's title. The court also noted that the value of the tax certificate was fixed and consequently the only bidding that actually occurred is in connection with the underlying interest rate, where the lowest bid wins. Consequently, the court found that this type of public sale does not necessarily reflect the true value of the underlying property.

24. TOUSA – Eleventh Circuit reverses district court and holds lenders liable as transferees of fraudulent transfers

Debtors operated a homebuilding enterprise (TOUSA) with subsidiaries which owned most of the assets of the enterprise and generated nearly all its revenue. TOUSA borrowed unsecured debt that was guaranteed by the subsidiaries and also borrowed funds under a revolving line of credit secured by liens on the assets of the companies. After the downturn in the housing market, TOUSA paid a settlement of \$421 million to a new lender who was funding a joint venture in Florida. To fund this settlement, TOUSA and some subsidiaries incurred additional loans, secured by first and second priority liens on the assets of the subsidiaries and TOUSA. Six months later, TOUSA and the subsidiaries filed for bankruptcy. The official committee of unsecured creditors claimed that the subsidiaries' transfer of the liens to these new lenders to fund the settlement was a fraudulent transfer under section 548(a)(1)(B). The committee argued that the subsidiaries were insolvent or made insolvent by the transfer, had unreasonably small capital, or were unable to pay their debts when due, and they did not receive reasonably equivalent value in exchange for their transfer. The committee sought to recover the payment of the \$421 settlement to the Florida lender as the entity for whose benefit the transfer was made. The bankruptcy court avoided the transfer as fraudulent and the district court quashed the ruling. The Eleventh Circuit reversed and remanded the district court order. *Senior*

Transeastern Lenders v. Official Comm. of Unsecured Creditors (In re TOUSA, Inc.), 680 F.3d 1298 (11th Cir. 2012).

The Eleventh Circuit held that the bankruptcy court did not err when it found that the subsidiaries did not receive reasonably equivalent value in exchange for the liens. The court declined to decide whether the possible avoidance of bankruptcy can confer value, because the bankruptcy court found that the benefits of the transaction were not reasonably equivalent in value to what the subsidiaries surrendered, noting this was a question of fact. Further the court found evidence of avoidance or delay of bankruptcy irrelevant because the transaction was still the more harmful option and at most delayed the inevitable. The Eleventh Circuit also held that the bankruptcy court did not err when it ruled that the transferee lender was an entity for whose benefit the liens were transferred. The court noted cases holding that a creditor similarly situated to the transferee lender could be liable as an entity for whose benefit a transfer was made under section 550(a)(1). The court also dismissed concerns that such a reading of section 550(a) would drastically expand which entities could be liable for a transaction, noting that “every creditor must exercise some diligence when receiving payment from a struggling debtor. It is far from a drastic obligation to expect some diligence from a creditor when it is being repaid hundreds of millions of dollars by someone other than its debtor.” The Eleventh Circuit, therefore, reversed and remanded to the district court.

25. Violations of federal law requiring segregation of customer funds insufficient to establish actual intent to delay, hinder or defraud

Debtor investment manager failed to maintain customer assets in segregated accounts as required by law and, instead, pledged hundreds of millions of customer assets to secure a loan at bank. The bank was thus secured, but the debtor’s customers lost millions after it filed for bankruptcy. The liquidation trustee filed an adversary proceeding against bank, arguing that the debtor fraudulently used customer assets to finance the loan and alleging claims of fraudulent and preferential transfer, as well as avoidance of lien and equitable subordination. The district court held a bench trial and found that the trustee failed to prove actual intent to delay hinder or defraud as required for the actual fraudulent transfer count, and also rejected the other counts. On appeal, the Seventh Circuit affirmed. The issue was whether the district court clearly erred in finding the trustee failed to prove actual fraudulent intent and that the bank engaged in inequitable conduct. The trustee argued that the court erred as a matter of law because the transfers violated federal laws requiring segregation of customer funds, contending that this demonstrated actual intent to defraud customers. The court, however, concluded that the failure to segregate was not sufficient to find actual fraud as a matter of law. The transfers were made “to pay off one set of creditors in an attempt to save the enterprise from sinking,” but according to the Seventh Circuit, “that does not mean that actions taken to survive a financial storm require a legal finding that the debtor intended to hinder, delay, or defraud.” The Seventh Circuit also upheld the district court’s decision that a modified Ponzi presumption did not apply, because the trustee failed to prove that the debtor knew at the time of the transfers that the scheme would collapse. Finally, the Seventh Circuit upheld the district court’s determination as to equitable subordination, holding that the district court did not clearly err in concluding that the bank did not engage in sufficiently inequitable conduct. The district court had found that the bank officials “were such artless liars that they couldn’t have been concealing deliberate wrongdoing” and “were simply trying to cover up their own incompetence.” The Seventh Circuit explained

“incompetence alone, however problematic, won’t require the equitable subordination of the bank’s lien.” *In re Sentinel Mgmt. Grp.*, 689 F.3d 855 (7th Cir. 2012).

26. Trust fund liable for fraudulent transfers because it received property as debtor's nominee

The U.S. government brought both actual and fraudulent transfer claims to collect taxes owed by defendant. On remand from the Second Circuit, the district court was directed to reconsider its findings regarding whether certain conveyances by defendant to a trust created by him for the benefit of his sons were actually fraudulent and whether the trust was defendant’s alter ego or held property as his nominee. Around the time of learning that he owed approximately \$700,000 in tax liability due to a series of tax shelters, defendant set up a trust with his sons as the named beneficiaries and transferred \$220,000 and his primary residence to the trust.

While the district court had originally held that the transfers were not actually fraudulent because (1) defendant remained solvent and (2) his primary motives for creation of the trust were to prevent his estranged wife from reaching the assets and to engage in estate planning (and avoid the estate tax), the Second Circuit held that (1) a finding that the transfers did not leave defendant insolvent did not preclude a finding that the transfers constituted actually fraudulent transfers, and (2) for nominee and alter ego findings, the critical issue is not motive, but control. The district court on remand held that defendant’s transfers to the trust were actually fraudulent, finding the following badges of fraud: (1) the transfers made collection efforts much more difficult; (2) his debts likely exceeded his available assets; (3) he was well aware of his mounting liabilities; (4) he engaged in a pattern or series of transactions or course of conduct after incurring the debt that establish his intent to impair the IRS’s collection; and (5) he maintained the benefits of ownership of his primary residence after he transferred it to the trust for no consideration.

The district court on remand also found the real property transferred to the trust to be nominee for defendant based on the following factors: (1) the trust paid no consideration for the property; (2) the trust was created and property transferred in anticipation of defendant’s liabilities; (3) defendant remained in possession and control of the property; (4) defendant had a close relationship with the trustees, having selected close friends and associates to manage the trust; and (5) defendant retained and enjoyed possession and control over the property. *United States v. Evseroff*, No. 00-06029, 2012 WL 1514860 (E.D.N.Y. 2012)

27. Divorce-related transfers avoided

Debtor and her now ex-husband entered into a consensual separation agreement that divided assets and liabilities and was incorporated into a divorce decree. Approximately six months later, debtor filed a Chapter 7 petition, and her trustee subsequently filed an adversary proceeding to avoid transfers made pursuant to the divorce as fraudulent for failure to provide to debtor reasonably equivalent value. Debtor was clearly rendered insolvent by the transfers. Defendant ex-spouse argued that debtor received what she would have received if the parties had gone through a contested divorce rather than an amicable dissolution. Although the court found that the assets were neither equally divided nor equitably divided, it rejected any application of domestic relations law versus bankruptcy law standards, ruling for the trustee to the extent of \$47,635.27. *In re Neal*, 461 B.R. 426 (Bankr. N.D. Ohio 2011). Judge Woods agreed with the

decisions of *In re Fordu*, 201 F.3d 673 (6th Cir. 1999) and *In re Stinson*, 364 B.R. 278 (Bankr. W.D. Ky. 2007) that a domestic relations court in making a division of property is not constrained by a reasonable equivalent standard. Rather, it may take into account a number of equitable factors that conceivably could produce a division of marital property that would satisfy equitable requirements yet not pass muster under the reasonable equivalence test and, therefore, could not be accorded claim-preclusive effect. Instead, the court must look at the actual division of property to determine reasonable equivalence and apply thereto bankruptcy code concepts to consider the value exchanged of the parties. This is a fundamental recognition that divorce proceedings and fraudulent conveyance proceedings encompass different policy objectives and, hence, divergent decisional standards. Because the debtor did not receive reasonably equivalent value in the divorce, the transfers pursuant thereto were avoided

28. Debtor de facto owner of accounts titled in subsidiaries' name – transfers were fraudulent

The trustee brought fraudulent transfer claims against defendant insiders of the debtor. The bank accounts from which the transfers were made were not titled in the debtor's name and, instead in the name of related subsidiaries. The debtor, however, had the ultimate power to transfer the funds. The bankruptcy court found that the transfers were fraudulent and the district court affirmed. The district court determined that the debtor was the de facto owner of the accounts through which the transfers passed. The Fifth Circuit affirmed. *De la Pena Stettner v. Smith (In re IFS Fin. Corp.)*, 669 F.3d 255 (5th Cir. 2012).

The court found that although the debtor did not legally own the accounts, the debtor had an intent to defraud by attempting to avoid a paper trail. Any money in the account was effectively the debtor's. Further, the court looked to Texas law to determine that the legal title holder is not always the owner of an account and that control is a predominate factor, including in the context of the avoidability of preferential transfers. Regardless of legal title, the debtor had the ultimate power to transfer funds and obscured that power in an intentionally complicated corporate structure. The court found that these facts suggested that control was decisive and that legal title was irrelevant. The court did note that this was a fact-based inquiry and control may not always be decisive. Although the subsidiary that owed the account was distinct from the debtor, the debtor dominated the subsidiary to such an extent that the subsidiary acted at the debtor's direction and the directors and stockholders used the corporate entity to perpetrate a fraud.

29. Exceeding threshold does not remove entire charitable donation from exemption

Under § 548(a)(2)(A), charitable contributions are protected from fraudulent actions "in any case in which the amount of that contribution does not exceed 15% of the gross annual income of the debtor for the year in which the transfer of the contribution is made." Here, the trustee pursued as constructively fraudulent transfers under § 548(a)(1)(B) all of the charitable contributions to defendant Word of Life Christian Center during the two years prepetition, asserting that they excepted from the safe harbor because they exceeded the 15% threshold in both years. Therefore, the trustee sought to avoid those transfers in their entirety. The bankruptcy court disagreed and held that only that portion of the aggregated transfers that exceeded the 15% threshold could be avoided. The trustee appealed, but the 10th Circuit Bankruptcy Appellate

Panel affirmed. *Wadsworth v. The Word of Life Christian Center (In re McGough)*, 467 B.R. 220 (10th Cir. BAP 2012). The bankruptcy court declined to follow the only reported decision, *In re Zohdi*, 234 B.R. 371 (Bankr. MD. La. 1999), which supported the trustee's position. The appellate panel noted that the code section was susceptible to different interpretations. Therefore, it found the provision to be ambiguous and turned to legislative history for further analysis. It focused on the House Report that "The safe harbor protects annual aggregate contributions up to 15% of the debtor's annual income." Therefore, it determined that the trustee could only avoid the amount transferred in excess of the 15% safe harbor. [Editor's Note: The safe harbor provision is inapplicable to cases of actual fraud. Also compare to § 547(c)(9) where cases hold the full amount of the transfer and not just the amount in excess of the \$5,475 threshold is recoverable.]

30. Trustee can recover entire transfer despite § 547(c)(9) limit

Under § 547(c)(9) a trustee may not avoid a transfer "if, in a case filed by a debtor whose debts are not primarily consumer debts, the aggregate value of all property that constitutes or is affected by such transfer is less than \$5,475." In this case, trustee had objected to the creditor's secured proof of claim under § 502(d) because the creditor's lien was an avoidable preference. The creditor argued that the trustee was limited to \$370, being the amount that the lien exceeded the \$5,475 limitation. The bankruptcy court disagreed, holding that the entire claim was avoidable if it exceeded \$5,475, and not just the amount by which it exceeded that sum. The Bankruptcy Appellate Panel affirmed. *Western States Glass Corp. of Northern California v. Barris (In re Bay Area Glass, Inc.)*, 454 B.R. 86 (9th Cir. BAP 2011). The BAP stated: "When Congress intends to limit avoidance to only a portion of a particular transfer, it knows how to do so." Here, there was no limiting language. Therefore, the BAP agreed with the bankruptcy court that once the threshold was reached, the entire claim was recoverable as a preference.

31. No cap on avoidance up to the amount of "unpaid creditor claims"

Chapter 11 debtor filed a fraudulent conveyance complaint, alleging that a transfer of assets in a spin-off was an intentional or constructive fraudulent conveyance under sections 548 or 544(b). The defendant transferee argued that section 550(a) capped the debtor's recovery at the amount of "unpaid creditor claims" in the case. The transferee argued that the phrase "for the benefit of the estate" imposes a cap on its liability as a transferee at the aggregate claims of the creditors who would be benefited by the litigation. The bankruptcy court held that the plain words of the statute created no such cap on recovery and the estate is not limited to the interests of creditors. In addition, benefit to the estate is given a very broad construction and includes both indirect and direct benefits. According to the court, once an avoidance action created some benefit for creditors, section 550 was satisfied – section 550 does not say "to the extent of benefit to the estate." Any other limits on recovery had to be found elsewhere in the law. The court therefore denied the transferee's motion for summary judgment. But the court also determined that the debtor was not correct that there were no limits on recovery other than the value of the property. The court could reduce recovery by the value of consideration paid, the value of any improvement to the property, etc. Therefore, the amount of damages would be determined after trial of all issues. *Tronox Inc. v. Anadarko Petroleum Corp. (In re Tronox Inc.)*, 2012 Bankr. LEXIS 120 (Bankr. S.D.N.Y. 2012). [Editor's Note: Compare to *Rahmi v. Trumble*, 464 B.R.

710 (N.D. W. Va. 2012) where creditor unsuccessfully argued it was a breach of fiduciary duty to sell more "property than was necessary to satisfy the creditors."]

32. Trustee's complaint held sufficiently pled to withstand motion to dismiss

The debtor was the holding company of an FDIC-insured bank, and the FDIC was acting as receiver of the bank, which ultimately closed just prior to debtor's Chapter 7 filing. The trustee sued debtor's officers and directors, seeking recovery from allegedly constructive fraudulent transfers, breach of fiduciary duty, and other claims. Defendants moved to dismiss for failure to state a claim, arguing that the trustee pled insufficient factual allegations to state a plausible claim for relief, and specifically with respect to debtor's insolvency at the time of the transfers alleged. The court denied the motion. *In re Haven Trust Bancorp, Inc.*, 461 B.R. 910 (Bankr. N.D. Ga. 2011). The court reviewed the motion in the context of *Ashcroft v. Iqbal*, 556 U.S. 662 (2009) and *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544 (2007), which had held that "threadbare recitals of the elements of a cause of action, supported by mere conclusory statements, do not suffice." The court noted that those cases also did not impose a probability requirement at the pleading stage and held that determining whether the complaint stated a plausible claim for relief would be a context-specific task requiring the reviewing court to draw on its judicial experience and common sense. The court found that based on the facts alleged and the context in which the action arose, the pleading was sufficient. Indeed, the debtor's insolvency at the time of the transfers would remain a fact to be established at trial or at another juncture. Trustee had pled the fact that the debtor had gone into receivership with the FDIC and that its bankruptcy schedules showed over \$90 million in liabilities and zero dollars in assets just a few months after the transfers. That was deemed sufficient. Further, the transfers occurred before the trustee had any involvement with the debtor, but the very defendants named in the action were in a position to know debtor's financial position and, therefore, had sufficient notice based on the allegations in the complaint to know the claims sought against them and the grounds for each claim. The court also rejected defendants' position that the complaint was subject to heightened pleadings standards provided by Rule 9, Fed. R. Civ. P. and instead found that it governed by the less demanding standards of Rules 8 and 12(b)(6).

33. Transferred funds used only for debtor's benefit still recoverable as a fraudulent transfer

In an older case just recently reported, a Georgia bankruptcy court declined to find that debtor's sister was a commercial conduit rather than an initial transferee, even though all of the transferred funds had been used for the debtor's benefit only. *In re Clark*, 435 B.R. 753 (Bankr. N.D. Ga. 2009). Debtor had sold her residence to her nephew and received net proceeds of approximately \$108,000, which she deposited into her own bank account. Three weeks later, debtor withdrew \$35,000 and obtained a cashier's check payable to her older sister to whom she delivered the check. The sister deposited the funds in her savings account which was in her name alone. Debtor had no access to the account and received no accounting of the funds. The sister agreed to hold the funds for safekeeping and withdraw them at debtor's request to supplement debtor's income and for other necessities. All of the funds were expended on behalf of the debtor. Thus, the sister argued that she was a mere conduit and not an initial transferee under § 550. Judge Murphy reviewed the "conduit" test with a focus on whether the sister had sufficient dominion and control over the funds to render her a transferee or was she merely a conduit

through which the funds passed to the real transferee. The court decided the case initially under Eleventh Circuit precedent, *Nordberg v. Sanchez*, 813 F.2d 1177 (11th Cir. 1987) and *Nordberg v. Arab Banking Corp.*, 904 F.2d 588 (11th Cir. 1990) but ultimately found the subject case was most similar to *Taunt v. Hurtado*, 342 F.3d 528 (6th Cir. 2003). In *Hurtado*, the Sixth Circuit noted that the very point of the transfer was to insulate the debtors from the money so that the debtors' creditors had no access to it. Further, in that case, the money had been transferred to the mother who had no legal obligation to follow the debtors' directions. Thus, debtors would have had no legal recourse if their mother had chosen to use the funds for her own benefit. The bankruptcy court concluded likewise that the funds here had been transferred to the sister absolutely, and the debtors had no legally enforceable rights to the funds. The sister had complete dominion and control over the funds. The fact that the sister used the funds only in accordance with the debtor's instructions and for the debtor's benefit was irrelevant, as the *Hurtado* court also had found. Accordingly, the sister was held to be an initial transferee from whom the trustee could recover the value of the funds. [Author's Note: Interestingly, the defendant apparently failed to raise her entitlement to a credit for the funds spent on the debtor's behalf as allowed by other precedent from the Eleventh Circuit, *In re Kingsley*, 518 F.3d 874 (11th Cir. 2008)].

34. Pre-judgment interest rate determined

The trustee obtained partial summary judgment against the fraudulent transfer defendant on three transfers of \$22.7 million, \$1.5 million, and \$3.3 million, respectively. The defendant contended that the trustee was entitled to pre-judgment interest only at the federal judgment rate, pursuant to 28 U.S.C. § 1961 from the date the adversary proceeding was commenced until judgment was entered. That rate was 0.64%. The trustee argued that the applicable rate should be the federal judgment rates that were in effect on the dates of the three transfers, 3.76% on September 7, 2005, 5.24% on June 26, 2006, and 4.9% on September 29, 2006. The court disagreed with both positions and awarded even greater pre-judgment interest to the trustee. *McHale v. Boulder Capital, LLC, et al. (In re The 1031 Tax Group, LLC, et al.)*, 439 B.R. 84 (Bankr. S.D. N.Y. 2010). Judge Glenn first noted that bankruptcy courts have discretion in deciding whether and at what rate to award pre-judgment interest. Here the court found defendant's proposed rate to be inappropriate but also determined that the interest rates suggested by the trustee were insufficient to fully compensate the estate for the loss of the funds. Accordingly, the court held that the trustee was entitled to a market rate of interest determined by the bank prime loan rate on the dates of each of the transfers, 6.5%, 8%, and 8.25%.

(iii) Other Avoidance Actions

35. Trustee avoids mortgages under his strong-arm powers

The security deeds at issue were on single-family homes in Georgia. Under Georgia's recording statutes, a deed could be admitted to record only if it contained the attestation of two witnesses to the grantor/borrower's signature, one of whom was an official witness. Two cases by the same trustee before the same judge have resulted in clarification of the law in Georgia. In both cases, the trustee sought to avoid the security deeds using his strong-arm powers as a bona fide purchaser under § 544(a)(3). In one case, the security deed lacked any witnesses attesting to the validity of the debtor's signature. In the other case, the security deed had one official witness

but no unofficial witness. In both cases, the security deed holders argued that because the security deeds were actually recorded, there could be no bona fide purchaser as constructive notice was provided. The trustee argued that the security deeds could not be “duly” recorded, filed, and indexed as required by state statute if they were not in the proper, legal form. An additional defense in the second case was that a waiver of borrower's rights and other riders to the security deed contained all the proper attestations and were incorporated into the security deed itself. The bankruptcy court ruled in favor of the trustee in both cases and ordered the security deeds avoided. *Gordon v. U.S. Bank, Nat'l Ass'n (In re Hagler)*, 429 B.R. 42 (Bankr. N.D. Ga. 2009) and *Gordon v. Wells Fargo Bank, N.A. (In re Codrington)*, 430 B.R. 287 (Bankr. N.D. Ga. 2009). Each lender appealed to the district court. The district court certified to the Georgia Supreme Court in *Hagler* the question of whether there was constructive notice where the deed was recorded even though it had no attesting witnesses. The Georgia Supreme Court answered unanimously that there was no constructive notice, so the District Court ruled in favor of the trustee. *U.S. Bank Nat'l Ass'n v. Gordon*, 289 Ga. 12 (2011). The district court then ruled in favor of the trustee in *Codrington*. The lender further appealed that case to the Eleventh Circuit Court of Appeals. The Circuit Court then certified to the Georgia Supreme Court two questions: whether the properly executed and attested riders were sufficient to cure the defects and provide constructive notice and, if not, whether inquiry notice was separately provided by the recording of those documents. The Georgia Supreme Court answered unanimously that neither constructive notice nor inquiry notice was provided. *Wells Fargo Bank, N.A. v. Gordon*, No. S12Q2067, 2013 Ga. LEXIS 158 (Feb. 18, 2013). [Author's Note: Efforts by trustees to avoid mortgages with alleged defects receive mixed results. This is in part because the cases turn on applicable state law which varies widely in terms of what constitutes a fatal defect and other issues of state law. Even where there is a potentially fatal defect, state law may provide other defenses that can rescue the lender from its own mistakes.]

36. Trustee loses strong-arm avoidance action against mortgage lenders

The trustee argued that the two mortgages in question violated Section 11 of the Illinois Conveyances Act by failing to state the interest rate and maturity date on the face of the mortgage, thus arguing that the mortgages did not give constructive notice to subsequent bona fide purchasers. The bankruptcy court entered judgment for the trustee, but on appeal, the U.S. District Court reversed and remanded. *The Gifford State Bank v. Jeffrey D. Richardson (In re Crane)*, 487 B.R. 906 (C.D. Ill. 2013). The district court found that Section 11 used the word “may” and did not actually require mortgage documents to include an interest rate or maturity date. Rather, it was providing a safe harbor clause, whereby a mortgagee who deviated from Section 11 risked losing automatic protection from a challenge, but if a mortgage did not include all of the factors set out in Section 11, it did not necessarily fail to provide constructive notice. The court further noted that even if Section 11 did require an interest rate and a maturity date to be stated on the face of the mortgages, these mortgages were sufficient because they incorporated the promissory notes by reference which provided those terms. By having constructive notice, the trustee was not a bona fide purchaser and could not prevail under § 544(a)(3).

37. Mortgage valid despite trustee's "split-note" challenge

The trustee argued that there had been a split between the Note and Mortgage thereby

nullifying the Mortgage and rendering the Note unsecured because on the petition date, Fannie Mae held the Note and MERS held the Mortgage. Like most states, the law in Wyoming provides that a transfer of a note carries with it the mortgage security and operates as an equitable assignment of the mortgage, unless it is agreed otherwise. When the note and mortgage are split, as a practical matter, the note becomes unsecured. The trustee further argued that the Mortgage was ineffective because of the failure to record the assignment to Fannie Mae. The bankruptcy court ruled against the trustee. On appeal, the Bankruptcy Appellate Panel affirmed. (*In re Trierweiler*, 484 B.R. 783 (10th Cir. BAP December 28, 2012). The BAP concluded that the Mortgage naming MERS as Mortgagee on behalf of the lender was valid when granted and properly recorded prior to the petition date. Thus, the trustee had constructive knowledge of the Mortgage and could not avoid it. Moreover, the Court held that at all times the Note and Mortgage were united with no invalidating split when the loan transaction closed or when the Note was later assigned to Fannie Mae. As to the unrecorded assignment, the court relied on an earlier decision from the Eleventh Circuit Court of Appeals, *Kapila v. Atl. Mortgage & Inv. Corp.* (*In re Halabi*), 184 F.3d 1335 (11th Cir. 1999). In *Halabi*, the mortgage had been assigned three times pre-petition and once post-petition with the latter two transfers not being recorded. The Eleventh Circuit held that the trustee could not prevail under § 544 because the mortgage had been properly perfected and its assignment did not involve a "transfer of property of the debtor" that would activate the trustee's strong-arm powers under § 544. This was merely an assignment from one creditor to another. As there was no transfer of an interest in the debtor's property here, the BAP concluded that the trustee could not avoid the mortgage.

38. Mortgages rendered invalid as to omitted parcels despite corrective documents

Judge Utschig begins his opinion: "Whether one is baking a cake, building a house, or recording a mortgage, sometimes even the slightest deviation from the directions can lead to catastrophe." How true! Here, the trustee brought an adversary proceeding to avoid a refinance mortgage pursuant to § 544(a). The mortgage was secured by two principal properties, a "homestead" parcel and "vacant land." However, the mortgage did not contain legal descriptions for either. Subsequently, an "Affidavit of Correction" was executed and recorded setting forth the correct properties and legal descriptions but was not signed by the debtors/grantors or acknowledged by them in any way. The trustee's argued that the bank did not originally have a properly recorded mortgage on the omitted properties, and the affidavit was invalid because it was not signed by the debtors/grantors. The bank argued that the trustee had either constructive or inquiry notice arising from the recorded affidavit or, alternatively, it had an equitable lien superior to the position of the trustee. The court ruled in favor of the trustee. *In re Couillard*, 486 B.R. 466 (Bankr. W.D. Wis. Nov. 9, 2012).

Analyzing Wisconsin law, the Court noted that it specifies that certain information must be included in recordable documents, including the full legal description of the property to which it relates. Even absent such, a document may still be deemed to be "duly recorded" if the instrument is properly indexed in a public index maintained in the office of such register of deeds and records. The court found that the bank had conflated what rendered an interest in property enforceable between the parties with what made it enforceable against third parties, such as the trustee. The court found that the original mortgage was outside the chain of title with respect to the omitted properties. Moreover, because entire parcels were being added by the affidavit, the affidavit had to be signed by the grantor/debtor. Thus, the improperly recorded affidavit which referenced another improperly recorded document could not constitute constructive notice to a

bona fide purchaser such as the trustee or create inquiry notice. Moreover, the rights of the bona fide purchaser were superior under Wisconsin law to any equitable lien to which the bank might otherwise be entitled. *See also In re Couillard*, (Bankr. W.D. Wis. Dec. 6, 2012)(denying motion for reconsideration) and *In re Borges*, 485 B.R. 743 (Bankr. D.N.M. Dec. 31, 2012)(mortgage that inadvertently omitted 220 acres of land not corrected by a unilateral modification of the property description through a corrected mortgage recorded by the lender without the knowledge or consent of the debtor/grantor; the unacknowledged corrected mortgage was therefore ineligible for recording and could not serve as constructive notice to any prospective purchaser). [Author's Comment: Trustees must be familiar with the recordation laws of the states in which they administer cases. To know whether a mortgage is (a) valid, (b) in recordable form (e.g. properly attested), and (c) encumbering all the property intended, and how to correct such deficiencies can be different depending on the different laws of each state even on identical facts.]

39. Trustee stands in the shoes of homeowner as to avoided mortgage

At the time of her bankruptcy filing, debtor's first mortgage with JPMorgan Chase Bank was unrecorded. In her bankruptcy schedules, debtor valued her home at \$223,500 and listed her second mortgage claim of \$29,431.04 and the unperfected Chase mortgage claim of \$185,770.30. Without challenge, she also claimed a Massachusetts homestead exemption of \$500,000. Invoking his strong-arm powers under § 544, the Chapter 7 trustee filed an adversary complaint seeking to avoid the unrecorded Chase mortgage and to preserve the mortgage lien for the benefit of the bankruptcy estate pursuant to § 551. Debtor filed a counterclaim seeking a declaration that, even should the trustee successfully avoid and preserve the Chase mortgage lien, he could not sell her home without first foreclosing the mortgage in accordance with state law, which she contended he could not successfully do because the mortgage was not in default. The trustee was granted summary judgment. On further appeal, the Bankruptcy Appellate Panel affirmed. *In re Traverse*, 485 B.R. 815 (1st Cir. BAP 2013). The Appellate Panel agreed with the trustee's position that he could in proper order sell the property, satisfy the liens encumbering it, and, if the proceeds reached that far, fund the debtor's exemption. The court noted that with a valid homestead exemption, the debtor extricated from the estate such value as might remain after the mortgages are satisfied. Avoiding the Chase mortgage did not render the trustee to be an assignee, subject to mortgage covenants and state foreclosure law. Rather, it left him in the homeowner's shoes, with the added benefits that funds that would otherwise be allocated to pay the Chase mortgage would instead enrich the estate. The court concluded that such was the "meaning of avoidance and preservation."

40. Trustee not entitled to recover post-petition payments after avoiding mortgage

Debtors owned real estate that appeared of record to be unencumbered. However, over two years before their bankruptcy filing, a mortgage had been given on a loan to certain family members. It was not recorded until less than 90 days before the bankruptcy filing. Once the trustee sought to avoid the mortgage, the defendant's strongly opposed it mostly due to a lack of understanding of why the lien was avoidable as a preferential transfer. Ultimately, the defendants argued that at the very least they retained an equitable lien on the property. Trustee, in addition to seeking to avoid the mortgage, also sought to recover all post-petition payments made to the defendants. The court avoided the mortgage but would not allow the trustee to recover the post-

petition payments. *In re Moorhouse*, 487 B.R. 151 (Bankr. W.D. N.Y. 2013). Judge Kaplan explained that "equitable" claims of ownership or lien could not be honored against other creditors when a "legal" claim of ownership or lien was fully available to the claimants but was not sought. The court analogized to a child or spouse of a debtor who was making all the payments on a car loan that was titled in the name of the debtor for convenience (or because of cheaper insurance rates or better credit worthiness of the debtor). When the bankruptcy is filed, the child or spouse claims to be the "equitable" owner of the non-exempt equity in the car rather than the trustee. Judge Kaplan set forth why such assertions of equitable interests are not to be permitted. The court held the mortgage avoided but the post-petition payments made from post-petition income of Chapter 7 debtors were not recoverable by a trustee. Only if there was evidence that the post-petition payments and the mortgage were made with pre-petition assets could the trustee seek recovery of those payments. [*Author's Comment*: For a contrary case holding that the trustee can also recover the post-petition payments made from post-petition income, see *In re Wyatt*, 440 B.R. 204 (Bankr. D. Dist. Col. 2010)(Teel, J)].

41. Extrinsic evidence not admissible against trustee to vary terms of deed

The debtors' parents purchased the subject properties for \$680,000 with title vested in themselves and debtors as joint tenants. Approximately 2.5 years later, debtors transferred their interest in the subject properties back to the parents as joint tenants via quitclaim deed. The transfer was for no present consideration as no conveyance tax was paid. Less than two years later, debtors filed a Chapter 7 petition, and the trustee sought to avoid the transfer and bring the debtors' former interest in the subject properties back into the bankruptcy estate. The trustee filed an adversary proceeding seeking to avoid the transfer under §§ 544(b) and 548(a)(1). The parents opposed the complaint, essentially arguing that they were at all times the 100% equitable owners of the subject properties having essentially paid the entire purchase price and they originally took title with the debtor "solely for estate planning purposes." The bankruptcy court granted summary judgment to the trustee and the parents appealed. The district court affirmed. *In re Henshaw*, 485 B.R. 412 (D. Hawaii 2013). The district court agreed with the bankruptcy court that third parties such as creditors and the bankruptcy trustee should be allowed to rely on the plain terms of a deed. "Indeed, . . . allowing extrinsic evidence would open the door to collusion given that joint tenants' interests will often be aligned to shield assets from the bankruptcy trustee and/or creditors. The parol evidence rule is designed to prevent this type of possible fraud – the rule discourages interested witnesses to a contract from committing fraud, perjury, or unintentional invention by making statements that the contract did not actually represent the agreement of the parties." The court rejected further those cases where the equitable ownership of a joint bank account could be determined by extrinsic evidence distinguishing such an asset from real property ownership created through a recorded deed. Accordingly, the bankruptcy court's summary judgment ruling was affirmed. See also *In re Corse*, 486 B.R. 241 (Bankr. D. R.I. 2013)(ownership of real estate, unlike bank account, cannot be challenged when the recorded deed is unambiguous, so sale of debtor's remainder interest approved over objection that debtor had only bare legal title).

42. MERS not an "initial transferee" from whom trustee should recover

After the court ruled that the trustee could avoid the subject mortgage on debtor's real property, the trustee sought to recover against MERS, as the nominee/assignor, and BNY Mellon

as the assignee, contending that he could recover a single satisfaction against them under § 550. The court first held that the trustee could not recover against MERS which held only bare legal title to the mortgage and could act only at the direction of the note holder, who retained the beneficial interest therein. MERS thus lacked "dominion and control" sufficient to qualify as a transferee. As to an immediate or mediate transferee, such as BNY Mellon, the trustee had to establish that the transferee took for value, "in good faith, and without knowledge of the avoidability of the transfer avoided." It was undisputed that BNY Mellon took for value. However, Judge Hillman concluded that the mortgage was avoidable due to a patent defect in the Acknowledgment which provided BNY Mellon with sufficient facts that should have compelled it to investigate the matter further. As such, the court held that the trustee was entitled to summary judgment against BNY Mellon. *Agin v. Mortg. Elec. Registration Sys. (In re Bower)*, 462 B.R. 347 (Bankr. E.D. Mass. 2012).

43. Transfers of property to a trust instead of a trustee held invalid

Gloster owned real property that his attorney-in-fact conveyed by warranty deeds to "Morison Outreach, a Trust." Gloster then sued the attorney-in-fact to set aside the transfers as invalid. The Georgia Trial Court held that the deeds were invalid because they attempted to convey property to the Trust instead of to a trustee. On appeal, the Georgia Court of Appeals affirmed. *Ford v. Reddick*, 2012 WL 6621686 (Ga. App. Dec. 2012). The Georgia Appellate Court held that under a state statute, O.C.G.A. § 53-12-25(a), the "[t]ransfer of property to a trust shall require a transfer of legal title to the trustee." In other words, to convey property to a trust by deed, the trustee must be designated as the grantee of legal title. Here, the transfer was directly to the trust which was held to be invalid. [*Author's Comment: Although this is a simple principle, it is an important one for trustees nationally. Trustees must be aware of their respective state laws. This particular holding is not unique. The transfer would be invalid under the laws of many states and should be a prime target for trustees.*]

44. § 362(h) held not to deprive a trustee of standing to avoid a lien

Debtors scheduled Source One Financial with a lien on a 2003 Cadillac. A statement of intent only indicated that the Cadillac would be "retained." It did not state there would be a redemption or reaffirmation. After several months of requests by the trustee, debtor finally produced the contract between debtor and Source One. Trustee investigated and determined that Source One was not listed as a lienholder on the title. Trustee engaged in settlement discussions with counsel to Source One. Unbeknownst to the trustee, during those discussions, Source One was proceeding to perfect its lien on the Cadillac. Trustee eventually sought turnover and avoidance of the lien while also seeking sanctions for willful stay violation. Source One moved to dismiss the complaint on the basis that debtor's failure to comply with § 362(h)(1) both terminated the automatic stay with respect to the Cadillac and also removed it from property of the estate. Therefore, it concluded that the trustee had no authority to seek lien avoidance in reliance on *In re Baine*, 393 B.R. 561 (Bankr. S.D. Ohio 2008). The bankruptcy court agreed with Source One that it could not be held liable for a stay violation, but agreed with the trustee that he could avoid the lien. *In re Mollison*, 463 B.R. 169 (Bankr. D. Mass. 2012). The court clarified that because the stay had been dissolved by operation of law under § 362(h), Source One could not have violated the stay in perfecting its lien post-petition. However, the court disagreed with *Baine* that removal from the estate of such property also deprived the trustee of

the ability to avoid the lien. [Editor's Note: The *Baine* case has been a bane for trustees since its issuance in 2008. National car lenders have regularly used *Baine* to dissuade trustees from seeking lien avoidance where no statement of intent was filed or there was a failure to comply with the stated intent. The author wrote an article entitled "*Section 362(h) Does Not Deprive a Trustee of Standing to Avoid a Lien*," 29-10 Am. Bankr. Inst. J. 50 (January 2011), which is cited by the *Mollison* court in its opinion.]

45. Fourth Circuit holds Chapter 7 trustee cannot avoid transfer made via prepetition foreclosure

Trustee filed an adversary complaint pursuant to section 544(a), seeking to avoid a prepetition transfer of real property conducted via a foreclosure sale. The trustee argued that the original deed of trust executed between the debtors and the mortgage lender was void because it was not properly acknowledged as Virginia's recording statutes require. The trustee sought to use his rights as a hypothetical lien creditor to avoid the foreclosure sale. The Fourth Circuit, in a per curiam decision, affirmed the District Court for the Eastern District of Virginia's decision, which affirmed the bankruptcy court's order denying the trustee's request. The district court ruled that the foreclosure sale effectively transferred title to the purchaser because acknowledgement is a prerequisite for recording a deed under Virginia law, but not for conveying title. Additionally, a hypothetical lien creditor's rights are determined as of the petition date and, because the debtors no longer owned title to the property as of the petition date, the trustee could not attach a hypothetical lien to the property. *Tyler v. Ownit Mortg. Loan Trust*, 474 F. App'x 893 (4th Cir. Aug. 2, 2012).

46. Mortgagee not entitled to good faith defense

Shortly before the bankruptcy filing, property was transferred to debtor's brother for no consideration. Post-petition, the brother transferred the property to an LLC owned by a family friend. These two transfers were avoided by the trustee. The LLC was not validly formed at the time of the transfer but was able to obtain a mortgage for \$155,000. The mortgagee had met with the LLC for less than an hour, did not seek to obtain any financial information about the LLC, did not investigate the discrepancies in the name of the LLC in various documents, and did not update the LLC's certificate of good standing or perform a title or records search. The mortgagee never even saw the actual deed of ownership for the property. The mortgagee was not the initial transferee, so it was able to assert the good faith for value defense under § 550(b)(1). The bankruptcy court found that the mortgagee was not entitled to the defense. The district court affirmed. The circuit court likewise affirmed. *In re Nieves*, 648 F.3d 232 (4th Cir. 2011). The Fourth Circuit joined three other circuit courts in adopting the objective standard for the good faith prong of the defense. Thus, the knowledge prong is satisfied if the transferee knew facts that would lead a reasonable person to believe that the property transferred was recoverable. Here, the mortgagee did not have actual knowledge of facts because it had done no investigation whatsoever. But, it cannot have taken the transfer in good faith because it was willfully ignorant of facts which demanded an investigation. The court held that this requirement was consistent with interpretation of two U.C.C. provisions: § 3-302 for determining a holder in due course and § 1-304 relating to the implied duty of good faith in contracts. Thus, good faith was held to contain both the subjective (honesty in fact) and an objective (observance of reasonable

commercial standards) component which the mortgagee did not meet. Accordingly, the trustee's avoidance of the transfer of the property from the LLC to the mortgagee was upheld.

D. SECTION 542 TURNOVER

47. Lien in account funds relinquished upon turnover to the trustee

Debtor was in the business of check clearing and payment processing services. Debtor and North American Banking Co. ("NABC") had entered into a "Remote Deposit Capture Service Agreement" pursuant to which the debtor submitted to NABC electronic deposits of funds captured from checks the debtor received. NABC would process the check transactions on the debtor's behalf and credit the debtor's account. The U.S. Treasury would charge back claims for fraudulent, counterfeit, or forged Treasury checks. When an item was rejected, NABC was entitled to recover the funds from the debtor's accounts at NABC. Under the agreement, the debtor had assigned all of its deposit accounts to secure its obligations to NABC, and NABC was granted rights of setoff and a security interest in the debtor's deposited funds. At the time of its Chapter 11 petition, debtor had over \$933,000 on deposit in its account with NABC. NABC froze the debtor's account. Soon thereafter, the case was converted to Chapter 7, and the trustee demanded turnover of the funds in the account, agreeing to a \$50,000 holdback to cover future reclamation requests. NABC turned over \$883,120 to the trustee without requesting from the court adequate protection of its lien such as by having its lien impressed upon the turned over funds. After Treasury reclamations that greatly exceeded the \$50,000 holdback, NABC demanded that the trustee return the full \$883,120. The trustee refused. NABC filed a complaint seeking a determination that it held a first-priority lien in the funds. The bankruptcy court ruled that NABC lost its possessory lien because it failed to first obtain a court order granting adequate protection. NABC appealed to the Eighth Circuit Bankruptcy Appellate Panel, which affirmed. *North American Banking Co. v. Leonard (In re WEB2B Payment Solutions, Inc.)*, 488 B.R. 387 (8th Cir. BAP 2013). It is undisputed that NABC's possessory lien had survived the bankruptcy filing. NABC argued that by virtue of § 542 and § 362's automatic stay, it was required to turn over the funds to the trustee, but that its lien was preserved pursuant to *U.S. v. Whiting Pools, Inc.*, 462 U.S. 197 (1983). However, the Appellate Panel noted that *Whiting Pools* involved a statutory tax lien, not a possessory lien, so that the creditor's lien in that case remained with the property after it was turned over. Whereas, the situation here was governed by *Citizens Bank of Maryland v. Strumpf*, 516 U.S. 16 (1995), which recognized that a bank's right to setoff is lost when possession of an account is relinquished. The BAP saw no distinction between a setoff right and a possessory security interest. NABC was entitled to withhold turnover until the bankruptcy court made a determination as to whether, and what extent, it was entitled to adequate protection. It failed to seek or obtain this determination and, therefore, lost its perfected security interest in the account funds turned over.

48. Bank loses its security interest in deposit accounts after voluntary turnover to trustee

The bank loaned \$412,000 to the debtor secured by collateral listed in a security agreement. Debtor later filed Chapter 7 with \$19,601 still on deposit with the bank in two accounts. The bank wrote to the trustee seeking direction about whether the funds should be turned over or released from the estate. The letter contained a box for the trustee to check

indicating his election regarding the funds, and the trustee elected turnover. The bank then transferred the funds to the trustee without asserting any interest therein. Some months later, the bank moved for stay relief, seeking permission to pursue its state law remedies as to the collateral listed in the security agreement and made no mention of the account funds previously turned over to the trustee. The court granted the stay relief motion. The bank filed a proof of claim for \$271,147. Trustee informed the bank that \$10,000 of the funds from the accounts turned over to him were the proceeds from the sale of a vehicle that was not part of the bank's collateral. The bank responded that it held a perfected security interest as well as a statutory banker's lien in all of the funds it had turned over to the trustee. The bank filed a motion to compel abandonment of those funds, which the trustee opposed. The court denied the motion. *In re Willis Enterprises, Inc.*, 2012 WL 3988062 (Bankr. D. Idaho 2012). Trustee argued that his strong-arm powers as a judgment lien creditor were superior to the bank's asserted liens. Judge Pappas noted that under Idaho law, the banker's lien was dependent on possession, which the bank had voluntarily relinquished, thereby constituting a waiver of its right to assert a banker's lien because of the unconditional nature of the turnover. Moreover, even if the turnover was involuntary, the bank was required to take prompt action to preserve its possessory-lien rights. Here, there was a five-month delay which the Court determined was not prompt, particularly in view of the unconditional, voluntary nature of the turnover. Further, while the collateral description of the security agreement included "general intangibles," it did not include "deposit accounts" as required under Idaho's version of the UCC. As to the bank's argument that the account funds could have been the proceeds of its accounts receivable collateral, the bank was unable to trace the funds on deposit to accounts receivable and, therefore, could not show that the funds were of inconsequential value to the estate.

49. Value of refunds spent post-petition still subject to turnover

Debtor did not list his 2011 tax return as an asset nor claim any portion of it as exempt. After debtor received a discharge, the trustee sent debtor a letter requesting a copy of his 2011 tax return, which showed a refund of \$5,135. The trustee sent a second letter requesting turnover of the pre-petition portion of the refund. When debtor did not turn over the refund portion demanded, the trustee moved for an order compelling turnover and for sanctions. Debtors objected arguing that the refund was not property of the estate to the extent of the non-debtor spouse's interests and that the motion to compel was untimely because the money had already been spent. The bankruptcy court granted the motion. Thereafter, debtors amended Schedule C to claim most of the demanded portion as exempt and also filed a notice of appeal. The Bankruptcy Appellate Panel affirmed. *In re Newman*, 487 B.R. 193 (9th Cir. BAP 2013). The Appellate Court noted that under Nevada law, the refund was community property allowing for joint control by each spouse. Consequently § 541(a)(2) "dictates that the entire prorated tax refund is property of [d]ebtors' bankruptcy estate." Next, the court rejected the Eighth Circuit's opinion in *Brown v. Pyatt* (*In re Pyatt*), 486 F.3d 423 (8th Cir. 2007), as representing a minority view in conflict with appellate decisions from four circuits which did not require present possession, custody or control when a demand for turnover was made. *In re Shearin*, 2224 F.3d 353 (4th Cir. 2000); *In re USA Diversified Products, Inc.*, 100 F.3d 53, 56 (7th Cir. 1996)(otherwise, upon receiving a demand from a trustee, the possessor of property of the debtor could thwart the demand simply by transferring the property to someone else); *In re Bailey*, 380 B.R. 486, 491-93 (6th Cir. BAP 2008)(already transferred tax refund subject to turnover); *In re Ruiz*, 455 B.R. 745 (10th Cir. BAP 2011)(petition date checking account balance). The Court concluded that §542(a) had no

"present possession" requirement and would apply to any property in the possession, custody or control of a debtor during the case. *See also In re Pilate*, 2013 WL 827730 (Bankr. D. Dist. Col. 2013)(Teel, J)(holding a Chapter 7 trustee is entitled to a monetary judgment against the debtor for that portion of an inheritance that was no longer in her possession when turnover was sought having been used by the debtor without authorization to make payment to taxing authorities. [Author's Comment: The *Pyatt* case has been a thorn in the side of trustees ever since the opinion was issued. The NABT had filed an amicus brief in that case that did not prevail. It is encouraging to see so many other circuits reject the reasoning of *Pyatt*.]

50. Funds spent from debtors' checking account ordered turned over to the trustee

At the time of debtors' Chapter 7 petition, four pre-petition checks were outstanding in the total amount of \$3,764.99. Debtors listed in their schedules their account balance as \$10.02. All of the checks cleared within four days of the petition date. Trustee filed a motion for turnover against the debtors that was denied by the bankruptcy court. The bankruptcy court held the debtors had constructively turned over the property by disclosing to the trustee in their schedules the existence of the checking account and were under no duty to collect on debts owed to the bankruptcy estate. Instead, it was the trustee's obligation to collect on the debts either directly from the bank or the payees on the checks. The trustee appealed to the Bankruptcy Appellate Panel, which reversed. *In re Ruiz*, 455 B.R. 745 (10th Cir. BAP 2011).

The Appellate Panel determined that the debtors most certainly had "possession, custody, or control" of the funds "during the case" such that they could be required to turn over the property, or its value, to the trustee pursuant to § 542(a). The Appellate Panel noted that debtors had the ability to withdraw all funds in their account, to close the account, to stop payment on any outstanding checks, or to transfer the funds from the account into another account at the time the petition was filed. It rejected the cases that have denied the trustee's right to demand turnover from an entity that did not currently have possession of the funds at the time of the demand. The court quoted *In re USA Diversified Prods., Inc.*, 100 F.3d 53, 55 (7th Cir. 1996): "Otherwise, upon receiving a demand from the trustee, the possessor of property of the debtor could thwart the demand simply by transferring the property to someone else. That is not what the statute says . . . and can't be what it means."

The court also rejected the rationale expressed by the Eighth Circuit in *In re Pyatt*, 486 F.3d 423 (8th Cir. 2007), that likewise required present possession to obtain turnover. That *Pyatt* court was concerned that the trustee could otherwise obtain a double recovery by obtaining the funds both from the debtors and from the transferees. However, the Appellate Panel disagreed with the *Pyatt* court's reliance on the omission of § 542(a) from § 550(d), which limits double recoveries, since § 542 is not an avoidance action and would not be covered by § 550. Moreover, it indicated that if the trustee sought a second recovery, the defendant in the second action would be entitled to raise the double recovery argument as an equitable defense. Finally, the court pragmatically noted: "Since panel trustees stand to be paid only \$60 in a no-asset case, the system is not set up to require those same trustees to spend their personal assets to seize a \$10 bank account." Indeed, the Appellate Panel noted that the panel trustee would not have even known about the case or received the full social security number in time to have prevented these checks from clearing, and that it would be "extremely uneconomical when there are numerous checks in relatively small amounts" for the trustee to pursue the transferees. [Editor's Note: The *Pyatt* opinion has been a thorn in the side of trustees for years, and it is good to see an appellate opinion that addresses and rejects every problematic facet of *Pyatt*.]

51. Are uncashed yet delivered checks property of the estate?

Chapter 7 Trustee objected to debtor's claim of exemption in funds in checking accounts and attempted to compel debtors to turn over the funds held in the account at the time the petition was filed. Debtors had written and delivered checks, but the checks had not been cashed. The Trustee argued that because the funds were still in the debtor's bank account on the date of the petition, they were property of the estate under 11 U.S.C. § 542. The District Court agreed with the Bankruptcy Court that the funds represented by the written and delivered, yet uncashed checks were property of the estate, citing § 541(a) for the proposition that upon filing, all legal and equitable interests in property become property of the estate. The District Court then addressed whether the Trustee could compel the debtor to turn over the value of the property, rather than proceeding under avoidance provisions of the Code. The Trustee was vested with the same rights as the debtor such that the Trustee could have attempted to stop payment on the checks. However, the Trustee instead sought a turnover of the value of the funds. The District Court noted that debtors are required to cooperate with the Trustee and turn over non-exempt property, so the Bankruptcy Court properly ordered the turnover of the value of the uncashed checks. *In re Brubaker*, 443 B.R. 176 (M.D. Fla. 2011).

E. SECTION 546 LIMITATIONS/DEFENSES

52. Statute of limitations extensions for interim trustee analyzed

Debtor filed Chapter 11 on May 14, 2009. The case was converted to Chapter 7 on May 13, 2011. The interim Chapter 7 trustee was appointed that same day. The Chapter 7 meeting of creditors was conducted and concluded on June 30, 2011. The trustee brought an adversary proceeding on May 11, 2012. The defendant moved to dismiss on the basis that the statute of limitations for avoidance actions had expired on May 14, 2011, and that the trustee's lawsuit was filed almost one year later. The trustee asserted that an additional year was afforded to him when he was appointed interim trustee one day shy of the two-year anniversary of the petition date. Pursuant to § 546, the statute of limitations for avoidance actions is "the later of 2 years after the entry of the order for relief or 1 year after the appointment or election of the first trustee under section 702...." (Emphasis added.) The problem arises because interim trustees are appointed under § 701, not § 702 as set forth in the statute. For this reason, many courts, led by the 3rd Circuit in *In re American Pad & Paper Co.*, 478 F.3d 546 (3d Cir. 2007), have employed a plain language analysis and determined that the additional one year is not triggered by the appointment of an interim trustee. The interim trustee must become the permanent trustee before the expiration of the two-year anniversary of the petition date for an extra year to be added. Here, the court disagreed with those cases and extended the statute of limitations by a full year and denied the motion to dismiss the lawsuit. *In re Draiman*, 483 B.R. 338 (Bankr. N.D. Ill. 2012). Judge Barnes found the statute to be ambiguous by using the term "appointment" when § 702 made reference only to elections and not appointments. He then reviewed the history of § 546 and observed that it had always contained the concept of appointment but not election. In his view, an interim trustee would never be afforded the benefit of the statute under the 3rd Circuit's approach, which the Court considered an absurd result. The court acknowledged that its ruling could lead to inconsistent results for elected versus appointed trustees and cause creditors to act differently at a meeting of creditors occurring more than two years after the initial order for

relief. In such instances, the additional year would be lost if creditors elected a permanent trustee but not if there was no election of a new trustee, and the interim trustee had been appointed within two years of the order for relief. [*Author's Comment:* While trustees appreciate this interpretation of the statute, it is recognized that the analysis is somewhat tortured and the holding might not survive an appeal. Neither view seems to make a great deal of sense and congressional action is desperately needed.]

Author's Further Comment: The Seventh Circuit Court of Appeals has indeed agreed with the Third Circuit and reversed the lower court here. 2013 WL 1397159, 2013 U.S. App. LEXIS 7045 (7th Cir. 2013). The Seventh Circuit rejected the trustee's argument that when §546(a)(1)(B) refers to the *appointment* or election of a trustee under §702, it must be referring to the appointment under §701. The Seventh Circuit held that such a "reading reads the reference to section 702 right out of section 546(a)(1)(B)." In sum, the court found the statute to be clear—the extension of the statute of limitations period under §546(a)(1)(B) is contingent upon a permanent case trustee being appointed within two years of the petition date.

53. Trustee entitled to additional one-year period to commence transfer avoidance proceeding

Debtor filed its Chapter 11 petition on March 18, 2009. The case was converted to Chapter 7 on May 19, 2010, and the interim trustee was appointed on May 20, 2010. The trustee commenced the meeting of creditors on June 30, 2010, and continued it several times. The final meeting was conducted on September 23, 2010. The last meeting had a notation in the minutes reflecting a continuance "*Sine die*." The court in the meantime granted four requests by the trustee to extend the deadline to file an avoidance action with the last extension expiring on March 20, 2012. On March 2, 2012, trustee filed an adversary proceeding against the Puerto Rico Electric Power Authority ("PREPA"). PREPA filed a motion to dismiss on the basis that the complaint was time barred because the two-year avoidance action period had expired without the appointment or election of a permanent trustee. PREPA argued that the two-year period expired on March 18, 2011, and the trustee's first requested extension of the avoidance action deadline was on May 3, 2011. Therefore, the deadline had already expired and could not be extended. In rebuttal, the trustee argued that she became the permanent trustee on September 23, 2010, which fell within the two-year time frame and therefore added an additional year to the statute of limitations from that date, which was well after the extensions had been granted by the court. The Bankruptcy Court ruled in favor of the trustee. *In re PMC Marketing Corp.*, 482 B.R. 74 (Bankr. D. Puerto Rico 2012). Judge Tester noted that the version of Rule 2003(e) in effect at all pertinent times in this case permitted a simple announcement at the meeting of creditors of the adjourned date and time. The court discussed two approaches to determination of whether the meeting had been continued. Under the "bright-line" approach, a meeting continued "*Sine die*" without a follow-up date would be deemed to have been concluded automatically but for reasons of promptness and finality. The "case-by-case" approach permitted circumstantial evidence to be examined including consideration of the length of the delay, complexity of the estate, cooperativeness of the debtor, and existence of any ambiguity regarding whether the trustee continued the meeting. Here, the court found that under either test, the meeting should be determined to have been concluded and denied the motion to dismiss, finding the complaint to have been timely filed. [*Author's Comment:* Effective December 1, 2011, Rule 2003 was amended to add the requirement that the trustee promptly file a written notice specifying the date and time to which the meeting is adjourned. Additionally, our Trustee Handbook in the October

1, 2012 edition complements that rule change by requiring that meetings be closed or continued with a specific date and time. This is designed to provide certainty of the meeting's conclusion point for purposes of the 30-day deadline for objecting to exemptions under Rule 4003(b) as well as determining in cases such as this when the statute of limitations for avoidance actions expires.]

54. Second Circuit expands on Enron decision

Unsecured creditors committee sought to avoid pre-petition payments totaling approximately \$375 million debtor made to note holders in connection with repurchase and cancellation of privately-paced notes. The Second Circuit held that these transactions fall within the safe harbor provision of §546(e) as transfers made in connection with a securities contract. *In re Quebecor World (USA) Inc.*, 2013 WL 2460726 (2d Cir. June 10, 2013). In doing so, the Second Circuit rejected that argument that the only financial institutions involved in the transaction were conduits and should be disregarded in determining whether §546(e) applies. The Court held that this argument was foreclosed by the plain language of the statute which states that transfers made by, to or for the benefit of a financial institution may be protected. The Second Circuit also believed that its ruling was in line with the relevant statutory intent because “[a] clear safe harbor for transactions made through these financial intermediaries promotes stability in their respective markets and ensures that otherwise avoidable transfers are made out in the open, reducing the risk that they were made to defraud creditors. Interestingly, the Second Circuit did hedge its bets and in *dicta* noted that while §546(e) is broad it is not limitless and that a “mere structuring of a transfer as a ‘securities transaction’ may not be sufficient to preclude avoidance.”

55. Trustee's avoidance action time barred

The Chapter 7 debtor disclosed in her Statement of Financial Affairs certain transfers of real property for no consideration. Twenty-five months after the petition date, the trustee commenced an action under § 548 to avoid the transfer. Defendant moved to dismiss pursuant to § 546. The trustee then amended the complaint, adding two counts as a judgment lien creditor under an Indiana statute that included a four-year reach-back to avoid fraudulent transfers. The court nevertheless granted the defendant's motion to dismiss, holding that while the Indiana statute allowed judgment lien creditors a four-year reach-back period to avoid fraudulent transfers, and § 544 authorized the trustee to act as a judgment lien creditor, the deadline set under § 546 was a strict statute of limitations for trustees bringing actions under either §§ 544 or 548. Judge Metz concluded: "The Chapter 7 trustee at all times remains a creature of statute of the Bankruptcy Code and the Code's statute of limitations applies to the Chapter 7 trustee regardless of whether the trustee's action is subject to other applicable non-bankruptcy laws. *Tucker v. Brickert (In re Rebecca Lee Brickert)*, 2012 WL 5177976 (Bankr. S.D. Ind. 2012).

56. Statute of limitations equitably tolled

Debtors did not disclose ownership of certain real properties nor lien interests therein. After more than two years from the petition date had run, the lender sought equitable reformation through an adversary proceeding against the trustee seeking determination as to extent and validity of its liens. The trustee opposed the action and filed a counterclaim seeking a

determination that, if the court found the plaintiff had an interest in the properties, that such interest was avoidable pursuant to § 544(a) and recoverable for the benefit of the estate under § 550. The plaintiff argued that the trustee's ability to avoid its equitable liens was time barred under § 546. The court ruled that the lender would be able to equitably reform with respect to one property but not another, and that the statute of limitations was equitably tolled with respect to the trustee's counterclaim. *In re Rent-A-Tent, Inc.*, 468 B.R. 442 (Bankr. N.D. Ga. 2012). The lender had argued that as to both properties there were numerous recorded documents that would have created inquiry notice preventing any purchaser from being a bona fide purchaser. However, the court found that many of those recorded documents, and all of them with respect to one of the properties, were from an entity that was not in the chain of title for the property and therefore could not be held to provide constructive notice to a potential purchaser. The lender had also argued for equitable subrogation, but the court noted that that related to a reordering of priorities and did not establish an equitable lien. Because the property interests were not disclosed in the schedules or at the meeting of creditors or otherwise to the trustee, the court found that equitable tolling was appropriate.

57. Trustee's untimely amendment to complaint allowed under equitable tolling

The Chapter 11 case was converted to Chapter 7. The Trustee filed suit against the defendant principal of the debtor to avoid and recover both preferential and fraudulent transfers. The complaint was filed on March 23, 2011. The statute of limitations expired on April 2, 2011. On May 26, 2011, the trustee sought leave to amend the complaint to include transfers which he asserted were newly discovered. The defendant objected. The court ruled in favor of the trustee. *In re Keystone Surplus Metals, Inc.*, 452 B.R. 554 (Bankr. E.D. Va. 2011). Judge Raslavich disagreed with the trustee that the late-filed claim would relate back to the original complaint because the factual predicates were different. In the original, it was alleged that defendant had used debtor's money to pay down personal loans. In the amendment, it was alleged that debtor's principal had sold the debtor's inventory to customers but pocketed the proceeds for himself. However, relying on *Miklavic v. U.S. Air, Inc.*, 21 F.3d 551, 557 (3d Cir. 1994), the court did apply equitable tolling to allow the amendment, finding that the fundamental rule of equity was that a party should not be permitted to profit from its own wrongdoing. As required by the seminal case of *Reeb v. Economic Opportunity Atlanta, Inc.*, 516 F.2d 924 (5th Cir. 1975), the trustee had the burden of demonstrating that he belatedly learned of the new transfers due to concealment on the defendant's part. Here, Question No. 10 of the SOFA disclosed no transfers, nor did defendant disclose any at the meeting of creditors. Moreover, none of the transactions at issue were listed on the debtor's books and records. Accordingly, the court held the trustee had met his burden of proof for the application of equitable tolling, and the motion for leave to amend the complaint was granted.

58. No equitable tolling of § 548 look-back period

The plaintiff filed a number of adversary proceedings alleging fraudulent transfers under § 548. Many of the defendants moved to dismiss for failure to state a claim, which motions were granted by the bankruptcy court because the challenged transfers fell outside of the two-year look-back period. The plaintiff moved for reconsideration, which the court also denied. *Industrial Enterprises of America v. Burtis, et al. (In re Pitt Penn Holding Co.)*, 2012 WL 204095 (Bankr. D. Del. 2012). Judge Shannon concluded that the two-year look-back period in §

548 is not a statute of limitations, and so it could not be equitably tolled. The court noted that statutes of limitations regulate secondary conduct such as the filing of a lawsuit and not primary conduct – the actions that give rise to the suit.

F. SECTION 541 PROPERTY OF THE ESTATE

59. Tenth Circuit rules that fraudulently transferred property does not become part of the bankruptcy estate until it is recovered

The court stated the issue as "whether a bankruptcy estate includes fraudulently transferred property that the trustee has not yet recovered." The 10th Circuit Court of Appeals noted a split on the issue at the circuit level. The Fifth Circuit in *In re MortgageAmerica Corp.*, 714 F.2d 1266 (5th Cir. 1983) held that fraudulently transferred property is property of the estate under § 541(a)(1) and subject to the automatic stay of § 362 even before it is recovered as a legal or equitable interest of the debtor in property. This rationale had been rejected by the Second Circuit in *In re Colonial Realty Co.*, 980 F.2d 125 (2d Cir. 1992). The Second Circuit thought the language was clear that property could only become part of the estate after it was recovered pursuant to § 541(a)(3). The Tenth Circuit agreed here with the Second Circuit and ruled against the trustee. *Rajala v. Gardner*, 709 F.3d 1031 (10th Cir. 2013). The Tenth Circuit noted that there could be no equitable title to property based on a mere allegation. Further, if § 541(a)(1) included fraudulently transferred property, the Tenth Circuit felt it would render § 541(a)(3) meaningless and lead to an absurd result. [*Author's Comment*: Because of the circuit split, petition for cert. to the United States Supreme has been filed and NABT will be adding its voice through an amicus brief.]

60. Contingency fee owed to debtor-attorney constituted property of the estate

The debtor was a practicing attorney. Three months after the commencement of his bankruptcy case, he became entitled to a fee of \$690,000, representing his share of a contingency fee for referring a case pre-petition to a law firm ten years earlier that concluded its settlement negotiations shortly after the petition date. The bankruptcy court ruled that the trustee was entitled to recover the entire fee as property of the bankruptcy estate. *In re Scotchel*, 2013 Bankr. LEXIS 1736, 2013 WL 1788484 (Bankr. N.D. W.Va. 2013). Judge Flatley found that the claim was completely rooted in the pre-bankruptcy past for which reason it was included in its entirety as property of the bankruptcy estate, in reliance on *Segal v. Rochele*, 382 U.S. 375 (1966). The debtor-attorney was obligated to assist the law firm to which the case was referred with the historical facts of the case and to review depositions and other documents and be prepared to testify as a witness, but he provided no such services after the petition was filed. Moreover, settlement negotiations were handled exclusively by the law firm to which the case had been referred.

61. Bankruptcy trustee becomes owner of life insurance policy invalidating change of beneficiary

Debtor James Meyers owned a \$2 million term life insurance policy insuring his own life and naming as the designated beneficiary his grandmother, Maudie Meyers. James Meyers was unmarried at all relevant times. On April 29, 2009, the insurance company canceled the policy

for non-payment of premiums. On June 16, 2009, James Meyers applied for reinstatement of the policy. He filed a Chapter 7 petition a month later. He did not disclose the policy in his bankruptcy schedules, did not claim any exemption in it, and did not disclose it in his testimony at his meeting of creditors on August 17, 2009. The policy had in fact been reinstated on August 7, 2009. A week after the meeting of creditors, Mr. Meyers executed and submitted a change of beneficiary form to name a creditor listed on Schedule F as the newly designated beneficiary under the policy. The insurance company accepted the change of beneficiary. Maudie Meyers later filed her own bankruptcy petition under Chapter 11. When it was later converted to Chapter 7, the same trustee was appointed in her case. One hundred forty-five days after the petition date of Maudie Meyers, James Meyers committed suicide resulting in the maturity of the policy and death benefits of \$2 million payable to the lawful beneficiary. The creditor maintained that he was the lawful beneficiary, whereas the trustee maintained that the change of beneficiary was null and void because he was the owner of the policy at the time of the attempted change. The trustee further contended that Maudie Meyers' bankruptcy estate was entitled to the policy proceeds as property acquired within 180 days of the filing of her petition under § 541(a)(5). The Bankruptcy Court agreed with the trustee. *In re Meyers*, 483 B.R. 89 (Bankr. W.D. N.C. 2012). Judge Whitley first held that under North Carolina law, only the owner of an unexpired life insurance contract could change the beneficiary. Because James Meyers was not the owner of the policy when the purported change of beneficiary occurred, that purported change was a legal nullity and of no force and effect. He then found that the unexpired life insurance contract constituted property of the James Meyers bankruptcy estate under § 541(a) that had not been claimed as exempt. He further held that reinstatement of a life insurance contract that had been canceled is treated under North Carolina law as if no lapse had occurred. Therefore, the court held that the insurance policy proceeds were payable to the trustee of the Maudie Meyers bankruptcy estate as property acquired within 180 days of her petition date.

62. Post-petition appreciation belongs to the estate

Debtor scheduled a one-eighth interest in vacant land that is subject to an oil and gas lease, along with a one-fourth interest in royalties from the lease. No wells had ever been drilled on the land and no royalties were due. Debtor claimed an exemption of \$4,250 in the land interest and \$1.00 in the royalty interest, which were equal to the scheduled values of these assets, utilizing his federal wild card exemption. After no party timely objected to the exemptions, trustee moved to close the case but to except debtor's royalty interest from abandonment in order to preserve the trustee's ability to recover for the benefit of the estate any potential future royalties resulting from a productive well. Debtor agreed to close the case but objected to the trustee's motion to except the royalty interest from abandonment. The bankruptcy court ruled in favor of the trustee, allowing the royalty interest to be excepted from abandonment and holding the trustee was entitled to pursue any future increase in value of the royalty above the amount of the interest listed as exempt. Debtor appealed, and the district court affirmed. Debtor then appealed to the Third Circuit Court of Appeals, which likewise affirmed. *In re Orton*, 687 F.3d 612 (3d Cir. 2012). The Circuit Court agreed with the trustee and lower courts that the wild card exemption preserved only a debtor's interest in an asset rather than the asset itself in that debtor had not unambiguously claimed as exempt a "full" or "100%" fair market value interest in the royalty interest, nor had debtor done anything else to put the trustee on notice of debtor's intent to exempt the entire royalty interest. The Third Circuit further noted that, even if debtor had claimed that the asset was wholly exempt, the Supreme Court in *Schwab v.*

Reilly, 130 S.Ct. 2652 (2010) had suggested that "it is far from obvious that the Code would 'entitle' [a debtor] to clear title in [an asset]." The Third Circuit also agreed that any potential appreciation in value above the exempted dollar amount would accrue to the bankruptcy estate, not the debtor. This was also the holding of the Ninth Circuit in *In re Gebhart*, 621 F.3d 1206 (9th Cir. 2010).

63. Comingled money in law firm bank account not subject to forfeiture

Rothstein perpetuated a Ponzi scheme through his law firm of Rothstein, Rosenfeldt & Adler, P.A. ("RRA"). Rothstein pled guilty and forfeited to the United States "all of his right, title and interest to all assets listed in the Information." Thereafter, the Government attempted to seize the funds RRA held in some of the listed bank accounts. TD Bank rejected the attempt because of the dispute between the Government and the Trustee, as the Trustee was contending that those funds were a part of the RRA bankruptcy estate. The Trustee petitioned the district court to order the Government to return the RRA accounts and properties which the Trustee contended were purchased with funds from those accounts, as constituting assets of the bankruptcy estate. After the district court denied in large part the petition, the Trustee appealed. The Eleventh Circuit vacated and remanded the judgment of the district court. *In re Rothstein, Rosenfeldt & Adler, P.A.*, 2013 U.S. App. Lexis 11793 (11th Cir. June 12, 2013). Writing for the court, Judge Tjoflat explained that property can only be forfeited as proceeds if the Government "establishes the requisite nexus between the property and the offense." Where no such showing can be made, the Government must resort to the substitute asset forfeiture provisions relating to forfeitable property, such as proceeds that have been "comingled with other property which cannot be divided without difficulty." The Government may seek forfeiture under this provision of property "up to the value of" comingled property.

The court noted that this was not a case involving few individual deposits and easily traceable proceeds. Instead, "Rothstein's investors' funds were deposited in RRA bank accounts and comingled with legitimate income RRA received from the billings of its 70 lawyers, \$12 million in the first ten months of 2009 alone." Therefore, the court found that the district court erred in ordering the forfeiture of the funds as proceeds. Consequently, all proceedings the court held subsequent to the imposition of Rothstein's sentence were vacated. On remand, the Government would be required to identify and establish the value of the proceeds that were comingled. The circuit court also found that the district court erred in refusing to consider the Trustee's claim that other properties listed in the Information in the preliminary order of forfeiture should not have been forfeited because they were neither proceeds nor properties derived from proceeds. While agreeing with the Trustee's theory, the court concluded that it was a question of fact as to whether the account funds were used to acquire the other properties. Therefore, the case was remanded so the district court could resolve that fact issue. Although there is a presumption in the Government's favor, the court concluded: "If the Trustee introduces credible evidence that the properties were acquired with funds from RRA's bank accounts, that presumption will vanish and, in order to establish its right to forfeiture, the Government will have to produce credible evidence that the properties were acquired with proceeds of Rothstein's criminal activity."

64. Direct notice to trustee required in criminal forfeiture case

Erpenbeck defrauded homebuyers and banks of \$34 million in a fraudulent scheme. Creditors commenced an involuntary bankruptcy case against him in 2002. In 2003, he entered a guilty plea which included forfeiture of \$33.9 million of fraudulent proceeds. In 2009, the FBI discovered that before Erpenbeck went to prison, he had buried a cooler containing \$250,000 in cash. The FBI located and recovered the cooler, and the United States posted notice of forfeiture of the money at www.forfeiture.gov. Three months later, the bankruptcy trustee contacted an AUSA and told her that the estate had an interest in the cash and asked about the government's plans. The AUSA did not tell the trustee about the ongoing forfeiture proceedings. Because no one filed a petition asserting an interest in the cash, the district court entered a final order of forfeiture vesting the United States in all right, title, and interest therein. The trustee moved to stay the final order of forfeiture, contending that the cash belonged to the estate. The district court denied the motion, holding that the trustee had waived his claim because he did not file a timely petition asserting an interest. The Circuit Court vacated and remanded the case to the District Court with instructions to accept a third-party petition from the trustee and hold an ancillary proceeding to adjudicate the legitimacy of the trustee's claim. *United States v. A. William Erpenbeck, Jr.*, 682 F.3d 472 (6th Cir. 2012).

The trustee had never received direct notice to which he claimed entitlement. The Circuit Court reviewed the applicable statutes and determined that under 21 U.S.C. § 853(j), the civil forfeiture statute was incorporated including a requirement in the statute governing customs-related forfeitures that the government published notice and send direct written party who appeared to have an interest in the seized article. However, the direct-notice requirement governed only as long as it was not "inconsistent with" other provisions of the criminal forfeiture statute. The government relied on § 853(n)(1), which provided that after the order of forfeiture was entered, the United States shall "publish notice of the order and its intent to dispose of the property in such manner as the Attorney General may direct. The government may also, to the extent practicable, provide direct written notice to any person known to have alleged an interest in the property that is the subject of the order of forfeiture as a substitute for published notice as to those persons so notified." Therefore, the government argued that direct notice was discretionary. The Circuit Court rejected that argument in view of the custom statute which made direct notice mandatory. The Circuit Court explained that a party receiving direct notice could not complain about defects in the publication notice because the direct notice operated as a substitute – a safe harbor – for any publication notice otherwise required. The government's response was that under the criminal forfeiture statute's relation-back clause in § 853(c), title to the cash retroactively vested in the government pre-petition at the time of Erpenbeck's fraud. However, the Circuit Court held that the relation-back clause applied to only "tainted" property whereas the government sought forfeiture of the case as only "substitute property," for which reason the relation-back clause did not apply.

65. Uniform Fraudulent Transfer Act does not displace common law rule that self-settled spendthrift trusts are void

Prior to his death, Promissor established a spendthrift trust; he was both the settlor and a lifetime beneficiary of the trust, and he retained the right to remove trustees and veto any discretionary trustee actions. Also prior to his death, Promissor pledged \$1.5 million to plaintiff, a university hospital, for the construction of a new president's house on plaintiff's campus. In

reliance on this promise, plaintiff constructed the new house. When Promissor died, however, he had made no payments to plaintiff and his will also did not provide for the pledge.

Plaintiff filed a complaint in the probate court seeking to enforce Promissor's \$1.5 million pledge. The trustee of the spendthrift trust objected, arguing that trust funds were beyond the reach of Promissor's creditors. In response, plaintiff argued that under Illinois' long-standing common law, spendthrift trusts are void as to creditors when the settlor and beneficiary are the same person. The probate court agreed with plaintiff and entered summary judgment in its favor. The appellate court, however, held that Illinois' Fraudulent Transfer Act (FTA), enacted in 1990, displaced the common law rule against self-settled spendthrift trusts.

The Illinois Supreme Court reversed, holding that the common law can co-exist with statutory remedies concerning fraudulent transfers. The court began by stating that "[c]ommon law rights and remedies remain in full force in [Illinois] unless expressly repealed by the legislature or modified by court decision," and that "[t]he implied repeal of the common law is not and has never been favored." The court held that the FTA was not intended to repeal the common law in this instance for four reasons. First, the FTA expressly stated that "the principles of law and equity, including . . . the law relating to . . . fraud . . . supplement [the FTA's] provisions." Second, the FTA's "general purpose" is to protect creditors, while the common law rule addresses a specific instance of self-settled trusts, such that they have complementary goals. Third, the common law focuses on interests "retained" by the settlor, while the FTA concerns a fraudulent transfer of an asset or incurrance of an obligation. Finally, Illinois statutes had provided for the avoidance of fraudulent transfers in some manner for at least 100 years before Illinois enacted the FTA, and this "longstanding coexistence of the common law trust rule and the statutory provisions against fraudulent conveyances" led the court to believe that the Illinois legislature did not intend to abrogate the common law rule against self-settled trusts. *Rush Univ. Med. Ctr. v. Sessions*, Nos. 112906, 112993, 2012 WL 4127261 (Ill. Supr. Ct. 2012).

66. Trustee named loss payee on insurance policy is entitled to insurance proceeds

Debtor and car dealer had entered into a retail installment contract and security agreement for debtor's purchase of a car. Dealer duly perfected its security interest. After debtor filed for bankruptcy, chapter 7 trustee filed a complaint pursuant to section 547, requesting: (1) that dealer's lien be avoided in its entirety; (2) that dealer's claim be considered a general unsecured claim; (3) that dealer be required to return payments it received from debtor within 90 days prior to the petition date, as well as any post-petition payments; and (4) that dealer be required to turn over car to the trustee. The trustee moved for summary judgment; shortly thereafter, the car was destroyed in a fire. Dealer then filed, and received payment on, an insurance claim. The bankruptcy court granted the trustee's summary judgment motion, holding that the lien should be avoided and that the dealer should be treated as an unsecured creditor, but issued a later order setting aside its summary judgment order until it could conduct a full hearing. The trustee then filed a second motion for summary judgment, claiming entitlement to the dealer's insurance payment because the trustee should be considered the loss payee under the policy. The court granted the trustee's second summary judgment motion, ordering: (1) that the lien be avoided; (2) that the dealer's claim be considered an unsecured claim; (3) that the dealer pay the trustee the amount of the insurance payment plus interest; and (4) that the trustee was not entitled to prepetition payments received by dealer. Dealer appealed and the district court

affirmed. *Blackburn Pre-Owned Auto, LLC v. Johns (In re See)*, No. 2:10-cv-01066, 2012 WL 3637390 (S.D. W. Va. 2012).

67. Equity created through Chapter 13 plan payments not estate property upon conversion to Chapter 7

Debtors proposed to pay off liens on two vehicles in a Chapter 13 plan. There was no equity in either vehicle on the petition date. Four and a half years later the case was converted to Chapter 7, and the trustee sought turnover in order to liquidate the vehicles and realize the non-exempt equity for the bankruptcy estate. Debtors objected. The bankruptcy court ruled in favor of the debtors. *In re Robinson*, 472 B.R. 854 (Bankr. M.D. Fla. 2012). Judge Funk noted a fairly equal split of authority on the issue but chose to follow two earlier Florida bankruptcy court cases that had held such equity was not included in the converted Chapter 7 estate. The court concluded that the relevant date for determining property of the Chapter 7 estate after conversion from Chapter 13 is the original filing date at which time debtors had no equity in either vehicle. [Editor's Note: This case ignores the post-*Schwab v. Reilly* Circuit Court opinions of *In re Gebhart*, 621 F.3d 1206 (9th Cir. 2010) and *In re Orton*, 687 F.3d 612 (3rd Cir. 2012), which both recognized that all post-petition appreciation belongs to the bankruptcy estate, meaning the original filing date was not determinative of this issue. Neither of these cases was discussed or analyzed as part of the *Robinson* court's opinion.]

68. Tax refunds spent pre-conversion not part of estate

During their Chapter 13 case, debtors received and spent tax refunds that were property of the bankruptcy estate. They were unable to confirm a Chapter 13 plan, and the case was converted to Chapter 7. The trustee sought to recover that portion of the refund that represented pre-petition earned income. Debtors defended on the ground that they had already spent the refund prior to conversion and it was no longer in their possession or control. The bankruptcy court denied the trustee's motion, and the trustee appealed. The bankruptcy appellate panel affirmed. *In re Salazar*, 465 B.R. 875 (9th Cir. BAP 2012). Although the tax refund had not been scheduled by debtors, it was clearly property of their bankruptcy estate under § 541(a). It was stipulated that if the debtors had not spent the refund, they would have been compelled by § 341(f) to turn it over to the trustee. Here, the court concluded that under § 348(f)(2)(A), property of the estate would only be such property that "remains in the possession of or is under control of the debtor on the date of conversion...." Here, the tax refund was no longer in debtors' possession or control. However, the debtors' expenditure of such funds is still subject to "good faith" scrutiny under §§ 348(f)(2), 707(b)(3)(A) and 727(a)(2)(B). The court recognized the anomaly created by its holding. If a Chapter 7 case had been filed initially, debtors would have been required to turn over those funds to the trustee. In a Chapter 13 filing, they could neither get a plan confirmed nor obtain a discharge without making such funds available to their creditors. However, the appellate panel did not believe (as some courts have decided) that this anomaly equates to producing an absurd result. Therefore, the denial of the trustee's motion is affirmed.

69. Real estate commission earned pre-petition but paid post-petition is property of the estate

Debtor was a realtor with ReMax and obtained pre-petition a contract for sale of real

estate. The sale closed post-petition. Debtor maintained that the post-petition closing and pre-petition contingent nature of the contract resulted in the commission not being property of the bankruptcy estate. The bankruptcy court disagreed and the district court affirmed. *In re Prochnow*, 467 B.R. 656 (C.D. Ill. 2012). The court determined that under Illinois law, a broker was entitled to commission for the sale of real estate when he procured a buyer who was ready, willing, and able to purchase the real estate under terms prescribed by the seller. Thus, once the contract was "signed and the financing contingency set forth in the contract was met, ReMax as the broker in the transaction, had earned the commission." Moreover, the court cited *In re Yonikus*, 996 F.2d 866, 869 (7th Cir. 1993) for the following proposition: "A debtor's contingent interest in future income has consistently been found to be property of the bankruptcy estate." Finally, the court found that the commission, even if vested post-petition, was for pre-petition services and was therefore "sufficiently rooted in the pre-bankruptcy past" to render it property of the estate, quoting *Segal v. Rochele*, 382 U.S. 375 (1966). The court also analogized to the holding in *In re Jokiel*, 447 B.R. 868, 872 (Bankr. N.D. Ill. 2011) that the key issue to determining whether a post-petition severance payment was property of the bankruptcy estate was "whether the severance payment was rooted in pre- or post-petition services."

70. Bankruptcy code overrides LLC operating agreement

Michael and Richard LaHood were the sole members of FLLZ, LLC, each owning a 50% membership asset. The principal asset was certain real estate valued at \$1,180,000 against which was a mortgage in favor of Richard LaHood in excess of \$400,000. Two months after Michael filed a Chapter 7 petition, Richard executed a declaration of dissolution of the LLC without consulting the trustee or seeking approval of the bankruptcy court. That same day he caused the LLC to execute two deeds, one conveying one-half interest in the real estate to himself and the other conveying a one-half interest in the real estate to Michael. The trustee and a judgment creditor filed a lawsuit asserting that Richard's actions violated the automatic stay and that the trustee had the right to participate in any windup of the LLC. The bankruptcy court agreed, and Richard and the LLC appealed. The district court affirmed on those particular issues. *In re LaHood*, 437 B.R. 330 (C.D. Ill. 2010). The appellants had argued that debtor's disassociation was wrongful because of his bankruptcy filing and that they were at liberty to take the actions that they did as a result thereof. Indeed, the operating agreement did provide that the filing by a member of a petition for bankruptcy would give the LLC the option to purchase all or any part of the units owned by that member. The agreement also placed other limitations or restrictions on the debtor's interest as a result of his bankruptcy filing. The district court agreed with the bankruptcy court that those provisions were unenforceable under § 541(c)(1). The district court also agreed that the trustee had the right to participate in the windup of the LLC's affairs and that the stay was willfully violated. The court noted that the assets of the LLC had to be applied first to the discharge of the LLC's obligations to its creditors, including members who were creditors, with any surplus distributed to the members in accordance with their ownership percentages. The appellants acknowledged that the execution of the deeds was done to effect a merger so that the mortgage would be payable solely from the debtor's interest in the real estate. This was sufficient for the district court to conclude that a willful stay violation had occurred, with the court rejecting appellant's argument that the real estate was not an asset of the bankruptcy estate, but rather an asset of only the LLC. The district court held that it was a violation of § 362(a)(6), being an act to collect, assess, or, recover a claim against the debtor that arose before the commencement of the case. [*Editor's Note*: This case is a very useful summary of existing law

on several issues affecting trustees with respect to individual debtors who are members of a multiple member LLC.]

71. Assets of self-settled trust included in property of the estate

Several years prior to filing her bankruptcy case, debtor established a revocable, self-settled trust solely for her own benefit and under which she is the grantor, trustee, and beneficiary (the "Trust"). Later, when a corporation owned by the debtor borrowed money from the bank, the debtor and the Trust executed guaranties with respect to the bank's loan. After the bankruptcy filing, the bank filed a stay relief motion to pursue the assets of the Trust claiming first that they were not property of the estate and second that they were subject to a lien in favor of the bank. The court disagreed with the bank and denied stay relief. *In re Nichols*, 434 B.R. 906 (Bankr. M.D. Fla. 2010). First, Judge Williamson noted that the law was well settled that property held in such a self-settled trust was property of the estate. Further, because the Trust was revocable, it was subject to the claims of debtor's creditors. The bank, however, argued that the Trust was a *defacto* non-debtor entity with a separate indebtedness obligation to the bank. However, the court ruled that the bank simply held a general unsecured claim against the Trust based upon the Trust's guaranty. The Trust had never pledged its assets to the bank. Therefore, the bank, as a general unsecured creditor of the Trust, held no interest superior to those of general unsecured creditors of the debtor's bankruptcy estate. The assets of the Trust were therefore to be administered for the benefit of all creditors of the debtor.

72. Vehicles titled in debtor not excluded from property of the estate by reason of an asserted resulting trust

Upon filing her bankruptcy case, debtor claimed three vehicles as exempt on Schedule C. The trustee concluded that they were not exempt and timely filed an objection. Debtor responded by amending her Statement of Financial Affairs to list the owner of the three vehicles as her father as "Equitable Owner via potential resulting Trust." The debtor argued that the three vehicles were either exempt or not property of the bankruptcy estate. The basis for this argument was that debtor's father had purchased all three vehicles for use by debtor's daughters. He had paid for them in full with no financing and had no financial assistance from the debtor. However, all three vehicles were titled in only the debtor's name with no custodial notation that the debtor was titular owner for the benefit of her daughters. Debtor explained it was titled in her name to afford cheaper auto insurance. The court sustained the trustee's objections. *In re DiStefano*, 442 B.R. 146 (Bankr. S.D. Fla. 2010).

Judge Olson first noted that the decision to title a vehicle in one name or another has consequences and "invariably establishes presumptive ownership." If the debtor's father or daughters were in bankruptcy, the cars would presumptively *not* be property of their estates. Debtor had offered affidavits which the court found to be self-serving and in conflict with her own 341 meeting testimony as well as the notations on the checks used to purchase the vehicles, which simply indicated on the memo line, "New car for Lily," which was shorthand for the debtor. The court also rejected the debtor's alternative argument for a "resulting trust" as unpersuasive because the daughters did not contribute to the purchase price of the vehicles and the check notation on the memo line also indicated an express disclaimer of any retention of interest by the father. A resulting trust "arises by implication of law and is founded on the presumed intention of the parties that the one furnishing the money should have the beneficial

interest, while the other held title for convenience or for a collateral purpose. The uncontroverted evidence before me is that these three cars were driven by the Debtor and/or her daughters, not by [her father]. He was therefore neither the legal owner nor enjoying a beneficial interest in these cars.” Accordingly, the trustee’s objection was sustained.

G. CLAIMS

73. Chapter 11 "super-priority" claim primes Chapter 7 administrative expenses

Debtor filed its Chapter 11 petition on July 22, 2012. On October 19, 2012, debtor filed its emergency motion for DIP financing, seeking to borrow up to \$200,000, with \$120,000 of it carved out for professionals and the U.S. Trustee's fees. Debtor requested that the DIP lender receive a § 364(c)(1) super-priority administrative claim. Interim orders were entered by the court and a final order entered on December 4, 2012. Two days later, the court converted the case to Chapter 7 at the debtor's request. On February 6, 2013, the DIP lender filed its motion for allowance and payment of priority claim seeking to be treated ahead of Chapter 7 administrative expenses. The trustee and a creditor objected, but the court overruled the objections and granted the motion. *In re National Litho LLC*, 2013 WL 2303786, 2013 Bankr. LEXIS 2112 (Bankr. S.D. Fla. 2013). Judge Isicoff held that while Chapter 7 administrative expenses generally come ahead of even Chapter 11 super-priority administrative claims, pursuant to § 726(b), that is not true when the super-priority administrative expense claim is derived from § 364(c)(1). That code section expressly states that a claimant under that section would have priority over any or all administrative expenses derived from § 503(b) or § 507(b). In reaching this conclusion, the court distinguished or disagreed with prior case law and found it to be an unambiguous statute that must be interpreted according to its plain meaning notwithstanding policy arguments to the contrary. [*Editor's Comment: When a Chapter 11 case is converted to Chapter 7, it is imperative that the trustee to review and understand all orders entered in the Chapter 11 case as they often contain unwelcome surprises. If the trustee does confront an order granting a super-priority claim, the trustee might consider at the outset of the case reaching a carve-out with that lender to enable the administration of the estate to succeed.*]

74. § 503(b)(9) administrative expense may not be disallowed based on § 502(d)

Ameri-Source delivered steel to the debtor 14 days before its Chapter 11 bankruptcy petition. It filed an administrative claim for an administrative expense in the amount of \$185,348.95 based on § 503(b)(9). It then filed a motion for allowance and immediate payment of the claim as an administrative expense. The trustee objected, arguing that under § 502(d), Ameri-Source should be required to pay preferential payments received during the 90-day period preceding the petition date that totaled \$84,166.65 or its claims would have to be disallowed. Ameri-Source countered that § 502(d) was inapplicable to § 503(b)(9) administrative expense claims. The trustee further argued that even if it didn't apply, the court should use its discretion to delay any required payment until after the trustee's preference claim had been adjudicated. The court ruled against the trustee. *In re Energy Conversion Devices, Inc.*, 486 B.R. 872 (Bankr. E.D. Mich. 2013). Judge Tucker recognized a split of authority in both pre- and post-BAPCPA cases. Several pre-BAPCPA cases held that all administrative expense requests under § 503(b) were subject to disallowance under § 502(d) which would require "the court [to] disallow any claim of any entity" that is a transferee of an avoidable transfer. Those cases believe that the word "claim"

was broad enough to include even post-petition administrative expense requests. The leading case asserting the contrary view was from the Second Circuit Court of Appeals, *ASM Capital LP v. Ames Dep't Stores, Inc.*, 582 F.3d 422 (2nd Cir. 2009), holding as that (a) the Bankruptcy Code distinguished between "claims" and requests for administrative expenses under § 503(d) and (b), § 502(d) was an exception to the automatic allowance of claims under §§ 502(a) and (b) and its scope should be limited accordingly.

While *In re Circuit City Stores, Inc.*, 426 B.R. 560 (Bankr. E.D. Va. 2010) supported the trustee's argument, almost all other cases disagreed with the trustee's position. *Circuit City Stores* held that § 503(b)(9) administrative expenses were different because they were claims that arose pre-petition and were subject to the provisions of both § 502 and § 503 and therefore § 502(d). That court stated that such administrative expense claimants were required to file a proof of claim under § 501 in order to have such claim allowed as an administrative expense under § 503(b)(9). Cases to the contrary note that § 503 states an entity must "request" an administrative expense claim, not file a proof of claim. The court here held that those were the better reasoned cases and that § 502(d) did not apply to Ameri-Sources' § 503(b)(9) administrative expense request. The court further determined that it had no discretion to delay ordering the payment of that administrative expense claim because of the terms of the already confirmed Chapter 11 plan.

75. No preference recovery against administrative claimant

Debtor filed Chapter 11 intending a quick sale of the company. On the petition date, Almond Investment was owed \$518,786. Debtor proposed a sale of the business to a stalking horse bidder that included the assumption and assignment of executory contracts. The debtor and Almond established the amount of Almond's secured claim at \$367,385. The sale was approved by the court, and Almond received payment in the amount of \$367,385, which satisfied its secured claim. After closing the sale, Almond and the purchaser began performing under the supply agreement. After the case was converted to Chapter 7, the trustee commenced a preference action against Almond for recovery of \$1,445,659. The bankruptcy court granted summary judgment to Almond. *Guiliano v. Almond Investment Co. (In re Carolina Fluid Handling Intermediate Holding Corp.)*, 467 B.R. 743 (Bankr. D. Del. 2012). Judge Sontchi rejected the trustee's arguments that the supply agreement was not executory and had not been assumed and assigned. The court found the trustee failed to satisfy § 547(b)(5) because Almond held an administrative claim that would have been fully funded and it, therefore, did not receive less than it would have had the payments not been made. The court relied upon the holding in *In re Kiwi International Airlines, Inc.*, 344 F.3d 311 (3d Cir. 2003) that § 547(b)(5) cannot be satisfied if during the case an executory contract was assumed or assumed and assigned pursuant to a court order. The judge noted that it was irrelevant whether a critical trade vendor is a vendor, supplier, licensor, subcontractor, or counter party to an executory contract. "The basis and point of a critical trade order is to give a debtor authorization to pay pre-petition services and goods when necessary to preserve the debtor's estate. Indeed, one of the primary bases for issuing the relief is to avoid having to inquire or to litigate the details of the relationship of the parties, e.g. executory contract or supply agreement, because there is *no time to do so.*" [*Editor's Note: In a converted case, trustee must be mindful not just of all first day orders and their terms, but particularly other orders such as sale orders and related proceedings that have taken place prior to conversion in order to determine the feasibility of avoidance actions as well as super priority claims.*]

76. Secured creditors must comply with Rule 3002(c) bar date

A Chapter 13 debtor objected to a secured claim filed by a creditor on the basis that it was not filed prior to the claims bar date set forth in Rule 3002(c) and thus should be disallowed as untimely under § 502(b)(9). The creditor opposed the objection contending that it was not required to file a proof of claim as Rule 3002(a) expressly applied only to unsecured creditors and equity security holders. The court held that the secured creditor was required to comply with the claims filing deadline set forth in Rule 3002(c) and disallowed its claim as untimely. *In re Dumain*, 2013 Bankr. Lexis 1906, 2013 WL 1890256 (Bankr. S.D. N.Y. 2013). Judge Morris acknowledged that on its face, Rule 3002(a) seemed to suggest that secured creditors need not file proofs of claim. However, the court found this reading inconsistent with other sections of the Bankruptcy Code and Rules. The court reviewed the three "camps" on this issue. The first found that secured creditors need not comply with any bar dates, reasoning that the omission of such creditors from Rule 3002(a) meant that they should also be entirely exempt from Rule 3002(c). The second held that secured creditors must comply with the bar date, but not necessarily the bar date set forth in Rule 3002(c). The third required that secured creditors comply with the bar date imposed by Rule 3002(c). After reviewing the three approaches, the court determined that Rule 3002(c) applied to secured creditors in Chapter 13, concluding that § 502(b)(9) imposed a time limit requirement on every claim with no qualification as to whether the claim was secured or unsecured. The court determined that the omission of secured creditors from Rule 3002(a) was simply recognition of the longstanding principle that secured creditors need not file a claim for its lien to pass through bankruptcy. Finally, considering the policy considerations, the court determined: "Without a claims bar date, secured creditors could file a proof of claim at any time, which would disrupt distribution and lead to uncertainty of administration." [*Author's Comment*: Would this holding be equally applicable to Chapter 7 cases? It has become a challenge to get mortgagees to file claims in bankruptcy cases and difficult to determine who even owns the mortgage due to the frequency of unrecorded assignments.]

77. DSO status given to claim for overpaid child support

Debtor's ex-husband received a judgment for the amount of overpayments made to debtor for child support. He then filed a claim characterized as a DSO claim entitled to the highest priority in the amount of \$41,581.79. The trustee objected and sought to reclassify the claim as a general unsecured claim. The Bankruptcy Court analyzed various cases that reached different results and ultimately determined to overrule the objection and allow the claim as filed. *In re Knott*, 482 B.R. 852 (Bankr. N.D. Ga. 2012). In dealing with prior decisions, the court determined that the relative economic and other circumstances must be considered. Here, the repayment obligation to the ex-spouse could properly be characterized as intended for and in the nature of support for the child who was then living with the ex-spouse and had been living with him during the period of overpayments. Therefore, the court decided that the claim was entitled to priority under § 507(a)(1)(A). [*Author's Comment*: This case provides an excellent analysis of all other cases involving this issue. Ultimately, the *Knott* case is really about how you untie the knot.]

78. Litigation finance company had no enforceable claim against the Chapter 7 trustee

After an automobile accident, the debtor commenced litigation in the state court to recover compensation for her resulting injuries. While this action was pending, she entered into several agreements with litigation finance company PSF, which advanced a total of \$18,600. The debtor agreed that from the proceeds of her outstanding litigation, PSF would receive the total of its advances, together with processing fees of \$875 and interest calculated at an annual rate of 42.5%. There was no personal obligation of the debtor other than from what she might recover from her personal injury action. Hence, the obligation could be described as non-recourse. Further, in order to avoid a claim of usury, PSF structured the agreements not as loans, but as investments providing a contingent right of repayment that would arise only in the event of a recovery on account of the personal injury. While the action was pending, debtor filed her Chapter 7 petition. Trustee eventually moved for authority to settle the action for \$55,000 and sought authority to pay the fees and expenses of his special counsel and \$23,808 to PSF in full satisfaction of any secured claim. The court approved the settlement of the PI action and payment of special counsel but disallowed any settlement with or payment to PSF. *In re Minor*, 482 B.R. 80 (Bankr. W.D.N.Y. 2012). Judge Bucki held that PSF possessed at most an equitable lien which was unenforceable against the trustee. Therefore, it could have no secured claim. PSF then asked to be allowed a general unsecured claim which the court likewise denied. The debtor had no personal liability owing to PSF under the agreement so the "loans" established no liability for which PSF could receive a distribution from property of the Chapter 7 estate. The court found that even an unsecured claim cannot be allowed under § 502(b)(1) and disallowed the claim.

79. Substantial compliance with PACA sufficient for even non-PACA licensee

The Chapter 11 debtor objected to the PACA trust claim filed by an agricultural producer on the ground that the producer had not strictly complied with the notice requirements of the PACA and was not entitled to have its claim paid out of PACA trust funds held by the Chapter 11 estate. The claimant's invoices were very detailed and contained all the necessary language at the bottom of the invoice to satisfy the requirements of PACA if it had been licensed by the U.S. Department of Agriculture as a PACA licensee. However, it had never applied for such a license. The debtor, therefore, asserted that a separate notice containing the information set out in 7 U.S.C. § 499(e)(c)(3) was required. The court held for the claimant. *In re Superior Tomato-Avocado, Ltd.*, 481 B.R. 866 (Bankr. W.D. Tex. 2012). Judge Leif Clark viewed the legislative history and court decisions interpreting the relevant provisions and found a split in authority on whether the compliance needed to be strict or merely substantial. The court found that the weight of authority and the current trend in the case law was in favor of substantial compliance. He noted that the minority of courts favoring strict compliance held that PACA was in conflict with the fundamental goals of the Bankruptcy Code providing for equal treatment of similarly situated creditors and, therefore, had to be construed narrowly or strictly when such claims were asserted in a bankruptcy court. Judge Clark disagreed, finding that the Bankruptcy Code anticipated and provided for special treatment of such trusts and also that PACA was the more specific statute and, therefore, controlled over the general provisions of the Bankruptcy Code. Accordingly, the court held substantial compliance was sufficient and overruled the objection.

80. Bank denied super priority administrative expense claim

JPMorgan Chase Bank and the debtor corporation had entered into a pre-petition loan agreement and guaranty for \$50,000, secured by a blanket lien on all of the debtor's assets. After debtor filed for Chapter 11 relief, the court entered interim and final cash collateral orders authorizing the debtor's use of cash collateral pursuant to § 363(c). The orders provided the bank with replacement liens on the debtor's post-petition receipts. The bank filed a secured proof of claim. After the case was converted to Chapter 7, the trustee advised the bank that she had received post-conversion payments of \$7,423, including post-petition commissions and certain refunds. The bank filed a motion to establish a super priority administrative expense claim pursuant to § 507(b). The court denied the motion. *In re Mary Holder Agency, Inc.*, 2012 WL 4434362 (Bankr. D. N.J. 2012). Judge Kaplan noted that a § 507(b) super priority claim is intended to compensate the secured claimant for the difference between the adequate protection provided by the debtor and any actual decrease in value of the collateral occurring during the pendency of the bankruptcy case. That section establishes three requirements for allowance of such a claim in the event that adequate protection proves inadequate: (1) the court must have directed the debtor to provide adequate protection, (2) such adequate protection must have failed to preserve the creditor's interest in the collateral, and (3) the claim must be allowable under § 507(a)(2), and by reference, § 503(b). The court noted that the final cash collateral order was totally devoid of language suggesting that the replacement liens provided adequate protection or were intended to adequately protect the bank's interest in the collateral. At no time did the court direct the debtor to provide adequate protection nor did the court ever make a ruling as to the value of the underlying collateral or extent of the bank's lien against the debtor's assets, or the adequacy of the proffered replacement liens. Further, the court was not persuaded that the debtor's use of the bank's collateral even caused a decline in collateral value, there being a "myriad of potential reasons for the diminution of the collateral's value." Finally, the bank was not entitled to assert a § 503(b) administrative claim because the bank's claim did not arise from a post-petition transaction with the debtor. Instead, the bank was seeking to recover its entire secured claim which was grounded upon its pre-petition loan agreement with the debtor. The court rejected the proposition that the negotiation for continued possession of collateral in return for adequate protection was a post-petition transaction providing additional value to the estate. [Author's Comment: Although not addressed here, there is a split of authority over whether a super priority claim arising from the Chapter 11 estate has priority over its Chapter 7 administrative claims despite § 726(b). The better reasoned line of cases holds that its super priority status is only with respect to other Chapter 11 claims; otherwise, how is the Chapter 7 trustee to administer the estate of the converted case.]

81. No administrative expense claim despite Chapter 7 contribution

There is no question that the unsecured creditor had made a substantial contribution to the Chapter 7 estate as successor in moving to have the original Chapter 7 trustee removed and obtaining the appointment of a successor trustee who succeeded in recovering substantial assets that substantially increased the distribution to unsecured claims. Nevertheless, the court denied the application of the unsecured creditor for an administrative claim. *In re Connolly North America, LLC*, 479 B.R. 719 (Bankr. E.D. Mich. 2012). Judge Tucker noted that § 503(b) limited such administrative expense claims to substantial contributions made in cases under Chapters 9

and 11. Therefore, there was no statutory basis to allow the administrative claim and the application was denied.

82. Trustees barred from filing claims on behalf of creditors

More than four years after the trustee had filed a no-asset report, debtor's counsel notified the trustee of debtor's claim in a class action lawsuit against a drug manufacturer. The case was reopened and notice to file claims was provided to creditors, but only one creditor filed a claim in response. After the deadline expired, trustee filed claims on behalf of all of the other unsecured creditors listed in the debtor's schedules using the scheduled claim amount. Thereafter, the trustee filed an application for compensation and expense reimbursement. Debtor filed an omnibus objection to the proofs of claim, asserting that the Bankruptcy Code did not authorize a Chapter 7 trustee to file claims on behalf of creditors who, despite being provided with notice of the claims filing deadline, had not filed claims. The Bankruptcy Court sustained the objection. *In re VanCleef*, 479 B.R. 809 (Bankr. N.D. Ind. 2012). Judge Klingeberger noted that § 501(c) and Rule 3004 were not facially ambiguous and appeared to give the trustee such authority. Indeed, the trustee relied upon the plain language of the statute and rule as well as existing case law. The Bankruptcy Court referred to the trustee's approach as a "hose the debtor" position.

The debtor contended that the statute and rule were designed to allow a debtor to deal with nondischargeable debts, an approach the bankruptcy court referred to as the "put out the fire" approach. The court reasoned that the primary, if not only, reason for a trustee in a Chapter 11, 12 or 13 case to file claims on behalf of creditors was to benefit the debtor in the effectuation of a reorganization, and not to benefit a creditor that failed or chose not to file a claim. Claims will be filed in Chapter 13 for secured creditors or domestic support obligations the Court observed. However, the court stated: "If one reviews the duties of a Chapter 7 trustee under 11 U.S.C. § 704(a), one will be unable to discover a duty by a Chapter 7 Trustee to administer a case for the benefit of creditors who either sleep on their rights or, being fully awake, make a conscious decision to not even exercise them." Thus, once the deadline had expired, the court observed that the focus of the statute and rule shifted to benefiting the debtor and enabling the trustee to administer a case effectively.

The Court also noted that the statute and rule would not obviate the need to comply with the requirements for filing a proof of claim such as proper supporting information and documentation, which the Court observed was an impossible standard for a trustee to meet without expending a great deal of time. Further, the trustee could not rely on the debtor's schedules as hearsay, and the trustee lacked any personal knowledge. Thus, the trustee would be forced to object to the very claims the trustee had filed. The court found further support in the fact that allowed claims filed by a trustee would serve to increase a trustee's compensation and that of its counsel as well. The court concluded that the filing of claims on behalf of creditors by the trustee would violate the intent and purpose of § 501(c) and sustained the debtor's objection. [*Author's Comment: Talk about judicial activism! The court finds that the statute and rule are not facially ambiguous and then essentially rewrites them.*]

83. Service of claim objection held sufficient

The Chapter 7 trustee had objected to EMC's claim, noting that the claim did not indicate how EMC came to become the rightful owner and holder of the note. The objection provided a

negative notice and was served on EMC at the address listed on its proof of claim and also at the address of its counsel that had requested service of notices in the case. No response was filed and an order was entered disallowing the claim. EMC sought reconsideration of the disallowance of its claim for, among other reasons, improper service, claiming that the objection was required to be served in accordance with Rule 7004(b)(3) by serving the objection "to the attention of an officer, a managing or general agent, or an agent authorized by law." The bankruptcy court denied the motion. *In re Wilkinson*, 457 B.R. 530 (Bankr. W.D. Tex. 2011). Judge Leif Clark first noted that Rule 3007 provided that a "copy of the objection with notice of the hearing thereon shall be mailed or otherwise delivered to the claimant, the debtor or debtor-in-possession, and the trustee, at least thirty (30) days prior to the hearing." He recognized that some courts had read Rule 3007 in conjunction with Bankruptcy Rule 9014 which provided that: "The motion shall be served in the manner provided for service of a summons and complaint by Rule 7004." However, he also recognized case authority that held to the contrary, with which he agreed. Judge Clark concluded that (1) the specific Rule 3007 would govern over the more general Rule 9014; (2) the express language of Rule 9014 provided that it only applied to contest a matter "not otherwise governed by these rules," which were in effect governed by Rule 3007; (3) by filing the claim, the claimant had already submitted to the jurisdiction of the court' (4) even if the court were to conclude that Rule 7004(b)(3) applied, service upon EMC generally as well as a claimant's attorney satisfied the requirements of that rule which allowed for service to "any other agent authorized by appointment or by law to receive service of process." Accordingly, service was held to be valid and the motion for relief in consideration denied.

84. Severance claim denied an administrative expense priority

Debtor's CEO, Lubner, had been employed pursuant to a pre-petition employment agreement that provided if Lubner were terminated without cause, the debtor would pay severance in an amount equal to two years' salary. Three weeks after the petition date, the debtor terminated Lubner's employment and rejected the employment agreement. Lubner did not object to the rejection. The court awarded Lubner his post-petition salary and benefits for the three-week post-petition period. Lubner then filed an application for payment of \$1.3 million in severance pay as an administrative claim pursuant to § 503(b)(1). The court disallowed the claim, stating: "If an employee such as Lubner could work just a single day for the debtor post-petition and still be allowed to receive a large severance package . . . then payment of the severance compensation as an administrative expense would devour a large portion of money that would otherwise be available to pay more deserving creditors." *In re Robb & Stucky Limited, LLLP*, 2011 WL 3948805 (Bankr. M.D. Fla. 2011). Judge Delano further noted that the termination's occurrence post-petition did not alter the fact that the debtor's liability for severance compensation arose from the pre-petition act of entering into the employment agreement, and it was not sufficient that the right to payment arose post-petition. Finally, the court noted that § 503(b)(1) did not expressly include "severance" within the "wages, salaries, and commissions" that are treated as administrative expenses. This conclusion was supported by § 503(c)(2) which prohibits severance payments to insiders except in certain circumstances not applicable here.

H. CONVERSION

I. SECTION 362 STAY VIOLATION

85. Trustee recovers attorney fees and costs for willful stay violation

Debtor husband and his brother dismantled and sold a race car valued at \$30,000 while administration of the debtor's case was ongoing. At the time of the subject acts, they knew of the bankruptcy case and the court had already decided that the debtor held an interest in the race car at the time the bankruptcy was filed. The bankruptcy court held that the dismantling and selling of the race car constituted a willful violation of the automatic stay and that the trustee could recover that value plus attorney fees and costs. *In re Andrews*, 467 B.R. 173 (Bankr. E.D. Ark. 2011). Judge Evans noted that recovery under § 362(k) was an open question in the 8th Circuit, but that unquestionably the trustee could recover under § 105(a), the only limitation on this power being that the trustee could not recover punitive damages. "Because it is unclear whether a trustee will qualify as an individual for purposes of § 362(k), which allows for the award of both compensatory and punitive damages for willful violations of the automatic stay, and punitive damages may not be awarded under § 105(a), the Court awards the Trustee his attorney's fees and costs in bringing this action to recover the value of the Race Car for the benefit of Debtors' bankruptcy estate as compensatory damages." Accordingly, the court allowed the trustee 14 days to submit a separate application with an itemization of his fees and costs incurred in prosecuting the adversary proceeding.

86. Towns' tax lien procedures violated automatic stay

The Bankruptcy Court considered whether state law tax lien procedures violated the automatic stay under 11 U.S.C. §362. Debtors argued that New Hampshire town tax authorities violated the automatic stay by sending various notices of impending tax liens and arrearages, and subsequently executing liens for delinquent taxes. In addition, one chapter 13 debtor argued that one town was in contempt of the court order confirming its plan by imposing and collecting interest on its tax obligations.

The towns argued that they were only seeking to maintain their tax lien as permitted by § 363(b)(3), however, Judge Deasy noted that the towns used identical tax procedures for individuals both in and out of bankruptcy. The Bankruptcy Court held that their collection activities were not exempted from the automatic stay and had violated the automatic stay under §362(a)(4), (a)(5), and (a)(6). Further, the Court held that the one town was in contempt because it had applied post-petition payments by the chapter 13 debtor to a pre-petition arrearage and applied interest at a rate different from the rate dictated by the debtor's plan. The court scheduled a hearing on damages, but explained that, under 11 U.S.C. §106(a)(3), there could be no punitive governmental units. In addition, the court emphasized that its decision applied prospectively, rather than retroactively. *Doolan v. Town of Pembroke (In re Doolan)*, 447 B.R. 51 (Bankr. D. N.H. 2011).

87. Statements mailed out by loan servicer did not violate stay

Debtor executed a note and mortgage in favor of the couple who sold debtor her home. The mortgage was quickly assigned to a bank through a broker. Three years later, debtor filed a

Chapter 13 petition listing the loan servicer for the bank as a secured creditor holding the mortgage on her residence. The bank filed a proof of claim that included arrearages of \$9,373.39, which included pre-petition legal fees, escrow advances and property inspections. The claim was later amended. The confirmed Chapter 13 plan provided for payment of a portion of it with a balance to be resolved through the claims resolution process. A year later, debtor's house was destroyed by fire, and debtor received a check in the approximate amount of \$210,000 payable to debtor and servicer. The parties disagreed as to the payoff amount but eventually resolved the dispute with a consent order that left a portion of the funds in escrow pending a determination of the amount still owed to the servicer. Thereafter, debtor filed a complaint against the loan servicer seeking damages under RESPA, 12 U.S. § 2605 *et seq.*, for violation of the automatic stay, and for relief under § 105. Debtor moved for summary judgment of the latter two counts with the servicer cross-moving for summary judgment on all counts. The bankruptcy court granted summary judgment in favor of the servicer on the RESPA count and denied summary judgment to either party on the other two counts. Following a trial, the bankruptcy court ruled in favor of the servicer on the remaining counts. Debtor appealed to the First Circuit BAP, which affirmed. *In re Knowles*, 442 B.R. 150 (1st Cir. BAP 2011). The BAP first ruled that the bankruptcy court properly granted summary judgment on the RESPA count because RESPA did not apply where the loan involved was originated by private individuals. It was therefore not a "federally related mortgage loan" within the meaning of "creditor" as that term is defined under RESPA. Debtor's burden of proof included that the loan was a federally related mortgage loan and the fact that the servicer made the summary judgment motion on this count did not change that burden. Next, the BAP agreed there was no violation of the stay. Filing a claim to the extent it is an action against the estate is specifically allowed by the Code, citing *Campbell v. Countrywide Home Loans, Inc.*, 545 F.3d 348 (5th Cir. 2008) (holding that the automatic stay did not bar creditors from filing proofs of claim), and *In re Zotow*, 432 B.R. 252, 261 (9th Cir. BAP 2010) (same). Moreover, sending an annual tax statement did not violate the stay. Informational documents sent in the normal course of business that contain data the debtor needed to file a tax return could not be held to be a violation. There was no attempt to seek payment of the debt. Finally, delivery of payoff statements which debtor herself requested did not rise to any violation as there was also no demand for immediate payment. This § 105 count was also not actionable because the servicer's actions were expressly contemplated by the confirmed plan and not a violation of it.

88. Bank's "debit restraint" not a stay violation

After the Chapter 11 debtor filed its petition, Wachovia sent debtor's counsel a letter stating that the bank was required by § 542 to prevent the payment of pre-petition debts from non-debtor-in-possession accounts and that Wachovia had placed a "debit restraint" on the debtor's open deposit accounts that would remain until the bank was provided with a court order that allowed the debtor continued use of the specific account. The letter stated that until then, Wachovia would issue a cashier's check payable to the debtor as debtor-in-possession or transfer the funds to debtor-in-possession accounts opened with Wachovia. Debtor moved for sanctions against Wachovia for willful violation of the stay, arguing that Wachovia had taken acts that amounted to an exercise of control over estate property in violation of § 362(a)(3). The court disagreed. *In re Randolph Towers Cooperative, Inc.*, 458 B.R. 1 (Bankr. D. D.C. 2011). Judge Teel noted that at most Wachovia had failed to perform its contractual promise to pay. The court relied on *Citizens Bank of Maryland v. Strumpf*, 516 U.S. 16 995 (1995), which held that the

bank's freeze of an account to protect its right of setoff did not violate § 362(a)(3) because the bank account consisted of nothing more or less than a promise to pay. Here, the court also joined a trend in the case law that was in disagreement with *In re Mwangi*, 432 B.R. 812 (9th Cir. BAP 2010), which had found a stay violation.

89. Mortgagee's recalculation of debtors' post-petition escrow payments to include certain pre-petition escrow arrears violates § 362

The monthly payments on debtors' home mortgage included an amount to cover projected taxes, insurance, and other charges that were to be paid into an escrow account and used as needed by the mortgagee for payment. As permitted by RESPA, 12 U.S.C. § 2601 *et seq.*, the mortgagee required debtors to pay an amount into escrow that was a specified percentage higher than actually required to cover the costs of taxes, insurance, and other charges. After failing to make mortgage payments, debtors filed a Chapter 13 petition. In addition to the mortgage arrearage, there was an escrow arrearage of \$5,657.60, of which \$3,869.91 was attributable to payments that the mortgagee had already made for taxes, insurance, and other charges. The remaining \$1,787.69 represented the required cushion that was not made. Nevertheless, debtors' escrow account showed a projected surplus of \$2,492.89 on the petition date. Thereafter, the mortgagee revised the escrow analysis and demanded payment. The amount it demanded presumed that the escrow balance on the petition date was zero, thereby including in the escrow shortage the cushion that debtors had never, in fact, paid.

Debtors filed a motion to enforce the automatic stay, seeking to compel the mortgagee to cease post-petition collection of pre-petition escrow claims. The bankruptcy court denied the motion and the district court affirmed. The circuit court reversed. *In re Rodriguez*, 629 F.3d 136 (3rd Cir. 2010). The circuit court held that the mortgagee had a pre-petition "claim" for the amount of the shortage and violated § 362(a)(6) by its post-petition recalculation of the escrow payments to include this pre-petition escrow shortage, rejecting the mortgagee's argument that the lower courts' holding that an escrow is not a "claim."

The Third Circuit relied heavily on, and agreed with, *Campbell v. Countrywide Home Loans, Inc.*, 545 F.3d 348 (5th Cir. 2008) where the Fifth Circuit found that the lender had a claim against the debtors each time the debtors failed to make an escrow payment because the loan documents had provided the lender with recourse if the debtor failed to make an escrow payment. Both circuit courts rejected the lender's argument that forcing it to recoup the missed escrow cushion payments through the Chapter 13 process improperly modified the lender's rights under RESPA. The case was remanded to the bankruptcy court to determine whether the stay violation was willful under § 362(k). A strong dissent argued that the mortgagee acted in accordance with RESPA, which authorizes a lender to recalculate the future escrow fund payments at a variety of junctures to ensure the shortages are covered. The dissent argues that it will be difficult for a mortgage lender to recalculate escrow due in accordance with RESPA and not be in violation of the automatic stay, thereby essentially abrogating RESPA by the "irreconcilable conflict between two federal statutes."

J. STANDING

90. Trustee's settlement approved over debtor's objection

Pre-petition, the corporation entered into a sales-commission agreement with the debtor

and two of debtor's companies, whereby the corporation acquired vehicle fleet-leasing assets in exchange for a \$20 million payment, as well as a series of deferred, formula-based incentive payments. After approximately two years, debtor filed its Chapter 7 petition and scheduled the sales-commission agreement with an estimated value of \$6 million. Debtor did not claim the payments owed under the agreement as exempt property in the original schedules or in two subsequent amendments. The trustee and two secured creditors asserted claims against the corporation for monies allegedly owed under the sales-commission agreement. After extensive negotiations, the parties agreed to a settlement under which the corporation would pay \$2.07 million to the bankruptcy estate, \$500,000 to one of the secured creditors, and \$1.53 million to the other secured creditor, receiving in exchange a complete release of liability for all claims related to the agreement. Trustee filed a motion to approve the settlement under Rule 9019 to which the debtor objected on the basis that the sale-commission agreement was an employment agreement so some of the funds owing would constitute exempt earnings under state law. At the hearing, debtor requested a continuance in order to assert the exemption claim, but the request was denied. The bankruptcy court found that at the time of the hearing the debtor had no standing since no exemption had been claimed. When debtor's appeal reached the circuit court, the bankruptcy court's decision was affirmed. *In re Hecker*, 703 F.3d 1112 (8th Cir. 2013). The circuit court held the bankruptcy court had correctly overruled the objection because debtor had no legitimate basis to object to the settlement at the time of the settlement hearing. In addition to having never claimed an exemption, debtor had repeatedly represented to creditors that debtor was self-employed or unemployed and had no prospective "wages, salary or commissions." In reliance on such representations, the trustee and the secured creditors as well as the corporation had negotiated the multi-million dollar settlement. On this record, the circuit court held that debtor's "lack of diligence (if not outright deception)" was apparent, as was the prejudice to the parties to the settlement if a continuance had been granted. Accordingly, the lower court was affirmed.

91. Insolvent debtor lacked standing to object to claim

The Chapter 7 individual debtor was insolvent based on his schedules which reflected total assets of \$136,925 against total liabilities of \$478,220. The debtor objected to proofs of claim filed by an alleged assignee of mortgage debts on the theory that the individual executing the assignments on behalf of the original mortgage lender did not have authority to do so. *In re Riley*, 478 B.R. 736 (Bankr. D. S.C. 2012). Judge Duncan overruled the objection because debtor had no standing to assert it and further noted that even without regard to the debtor's insolvency, in his capacity as a mortgage borrower who was a third party to an assignment between the original mortgage lender and the lender's assignee, debtor did not have standing to attack the validity of the assignment in objecting to proofs of claim filed by the assignee.

92. Discharged trustee had standing to appear and be heard in debtor's motion to reopen chapter 7 case – motion to convert to chapter 11 denied

Debtors moved to reopen their chapter 7 case and convert it to chapter 11. The debtors had failed to disclose a motor vehicle accident claim on their schedules and at their 341. The trustee joined in the debtor's motion to reopen the case, but opposed the motion to convert based on their failure to disclose the claim. The debtors claimed they failed to disclose based on advice from their attorney. The bankruptcy court granted the motion to reopen the case, but denied the

motion to convert the case. The debtors appealed, arguing that the trustee had no standing to be heard because he had filed his final report and had been discharged. The Bankruptcy Appellate Panel (BAP) affirmed. *Levesque v. Shapiro (In re Levesque)*, No. 10-21796-BAM, 2012 Bankr. LEXIS 2970 (B.A.P. 9th Cir. 2012)

The BAP addressed the issue of first impression of whether the trustee had standing, looking to Rule 5010 to determine whether the trustee was a party in interest. The BAP followed the majority approach, which recognizes that a discharged chapter 7 trustee has standing to appear and is a party in interest in cases involving reopening a closed case for administration of undisclosed assets. While the discharge of the trustee with the original closing of the case raised “a technical question as to his authority to administer or otherwise deal with the claim”, the BAP noted that the trustee is the representative of the estate and the debtors had no authority to administer the claim on behalf of the estate. It was also the debtors, rather than the trustee, who filed the motion to reopen. Therefore, the trustee had standing to appear and be heard with respect to the motions. Further, the BAP held that the bankruptcy court did not abuse its discretion in denying the motion to convert to a chapter 11 under section 706(a). While the bankruptcy court did not find that the debtors committed fraud, it did find they did not tell the truth and signed untrue schedules under oath and penalty of perjury.

93. Debtor untimely in filing appeal and lacked standing.

The debtor appealed 11 orders through assistance of counsel. The Trustee, the mortgage company, and ground lease party moved to dismiss the appeal as untimely and based on lack of standing. The District Court dismissed the appeal. *In re Mondelli*, 2011 WL 1211433 (D.N.J. 2011).

First, the District Court looked to its jurisdiction to hear appeals under 28 U.S.C. § 158(a) and, under Federal Rule of Bankruptcy Procedure 8002, the fact that a party has fourteen days from the date of an order to file notice of appeal. The court explained that Rule 8002 is jurisdictional in nature such that the district court lacks subject matter jurisdiction if the appeal is not timely. Of the 11 orders, 10 of the orders did not meet the 14 day mark and were, therefore, untimely. After dismissing the appeals of 10 of the orders, the debtor’s had only filed one timely appeal – that of the appeal of the final decree. The District Court was clear that debtors could not join appeals as to the other orders based on the timely appeal of the final decree and, therefore, there was no subject matter jurisdiction over the 10 other orders.

As to the final decree, the District Court then determined that the debtor lacked standing to appeal, noting that standing is limited to persons aggrieved by an order. This requires debtors to show that the order diminished their property, increased their burdens, or impaired their rights. Here the final decree only ordered that the Trustee be discharged, a bond be terminated, and the case be closed. The debtors did not show that these things had a direct, pecuniary effect on them. Therefore, the court dismissed the appeal. The Court also approved Rule 11 sanctions based on the appeal against the debtor’s counsel and held his law firm, whose name appeared repeatedly throughout the appeal, jointly and severally liable for the sanctions fee.

94. Debtor lacks standing to appeal *in rem* stay relief order

The lender loaned \$400,000 to the LLC evidenced by a promissory note secured by a mortgage on real estate. Over the course of two years, the LLC filed three voluntary Chapter 11 petitions, all of which were dismissed prior to confirmation. Then the managing partner of the

LLC transferred title of the property to herself for a nominal consideration and filed her own individual Chapter 11 case just minutes prior to a foreclosure sale on the property. Shortly thereafter, the lender filed a motion for *in rem* stay relief essentially for bad faith and lack of adequate protection. Before the hearing date on the motion, the case was converted to a Chapter 7, and a trustee was appointed. The trustee was given an opportunity to respond to the motion. The trustee filed an opposition to the motion alleging, among other things, that there was equity in the property and that it should be marketed commercially. At the hearing, the trustee announced that she was withdrawing her opposition because she had determined that there was no equity in the property. As it was undisputed that there was no equity and debtor could not viably reorganize, stay relief was granted. Debtor appealed. *In re Aja*, 442 B.R. 857 (1st Cir. BAP 2011). The BAP found that the lender was correct in arguing that debtor had no standing to pursue the appeal because she had no pecuniary interest in the outcome as there was no equity in the property. The only party with standing to appeal the adverse ruling on the motion for stay relief was the trustee who had withdrawn a previous objection and not pursued the appeal. Thus, the bankruptcy court was affirmed.

95. Debtor has no standing to object to claims unless the case is a surplus case

The district court, in reliance on *In re 60 E. 80th Street Equities, Inc.*, 218 F.3d 109 (2d Cir. 2000), citing *Collier on Bankruptcy* § 502.02(2)(c), agreed with the bankruptcy court that a Chapter 7 debtor is a “party-in-interest” who has standing to object to a sale of the assets, or otherwise participate in litigation surrounding the assets of the estate, but only if there would be a surplus after all creditor claims were paid. This rule applies to a debtor’s standing to object to a claim against the estate. Since there was no surplus in this case, the debtor had no pecuniary interest. Accordingly, the debtor had no standing to object. So the district court affirmed the bankruptcy court’s decision that the debtor’s representative had no standing to object to claims. *Pascazi v. Fiber Consultants, Inc.*, 445 B.R. 124 (S.D.N.Y. 2011).

K. SECTION 363 SALES

96. Court approves sale of debtor's remainder interest in property over objection of relatives

Trustee sought to sell the debtor's one-half quarter remainder interest in certain residential real property for \$30,000. Debtor's mother who held a life estate in the residence objected as did her daughters who had the other remainder interests. The mother had obtained quitclaim deeds executed by each of her daughters. They were never recorded, and no consideration had been paid. The family members argued that debtor held bare legal title and had no equitable interest in the property. Debtor had never scheduled a remainder interest. After the trustee discovered the interest, debtor claimed a wild-card exemption therein. The court denied the objections and approved the sale, finding that debtor held both a legal and equitable interest in the residence. *In re Corse*, 486 B.R. 241 (Bankr. D.R.I. 2013). Judge Finkle held that ownership of real estate, unlike a bank account, cannot be challenged when the recorded deed is unambiguous. The relatives had also sought to have debtor disclaim her rights in the remainder interest, but the court held that only the trustee had the right to disclaim the interest post-petition as it was a property right of the estate. Finally, the relatives had argued that the debtor's homestead exemption, if asserted, would exceed the purchase price of the interest. However, the

court held that the relatives had no standing to assert the homestead exemption on behalf of the debtor and that under the circumstances of the case, it was inapplicable anyway.

97. Scope of "interest" covered by a § 363 sale

The Chapter 11 debtor's assets were purchased at a court-authorized sale free and clear of all interests. The purchaser moved for enforcement of the court's sale order against the Massachusetts Department of Workforce Development, Division of Unemployment Assistance (DUA) to prevent the DUA from imputing debtor's experience rating to purchaser as "successor employer" and determining the contributions that purchaser would have to make to the DUA. The bankruptcy court entered an order barring the DUA from taxing the purchaser at debtor's unemployment contribution rate. The DUA appealed to the Bankruptcy Appellate Panel, which affirmed. *In re PBBPC, Inc.*, 484 B.R. 860 (1st Cir. BAP 2013). The Appellate Panel held that the term "any interest" as set forth in § 363(f) authorizing a sale of debtor's assets free and clear of any interests, is not limited to *in rem* interests in property, but should be interpreted expansively to include other obligations that may flow from ownership of the property. The Appellate Panel also held that the DUA's right to tax the purchaser based on the debtor's experience rating was in the nature of an "interest" of which debtor's assets could be sold free and clear. [*Author's Comment:* The court provides an excellent discussion of the wide divergence of views of the term "any interest" and what it covers, but determined to follow the more expansive reading that had been advanced by the 7th, 4th, 3rd, and 2nd Circuits in cases discussed in the opinion.]

98. Credit bid equivalent to cash bid

The bank loaned SDG several million dollars to finance construction of a golf course. The loans were secured by liens on SDG's assets and limited guaranties executed by SDG's principals containing forum selection clauses. As additional collateral, a \$1.2 million certificate of deposit was pledged by the guarantors on the condition that it be returned upon payment in full of the senior indebtedness. After SDG filed Chapter 11, Fire Eagle purchased the senior indebtedness from the bank stipulating to an outstanding balance of \$9.1 million. After the bankruptcy court refused to confirm a plan, it ordered a sale of SDG's assets. There was active bidding with a final cash bid of \$9.2 million that was topped by Fire Eagle's credit bid of \$9.3 million. The bankruptcy court accepted the credit bid and ordered that the senior indebtedness had been paid in full. Fire Eagle asserted that it could still recover from the guarantors. The guarantors then filed an adversary action for declaratory judgment that the guaranties had been satisfied and for release of the CD. Fire Eagle moved to dismiss and sued the guarantors in the Eastern District of Louisiana contending that its credit bid had not paid it in full and that it could therefore still collect against the guarantors. The bankruptcy court granted summary judgment to the guarantors and the Louisiana court transferred venue to the bankruptcy court. Fire Eagle appealed. The district court affirmed. It then appealed to the Fifth Circuit Court of Appeals which also affirmed. *In re Spillman Development Group, Ltd.*, 710 F.3d 299 (5th Cir. 2013).

The circuit court first rejected Fire Eagle's argument under *Stern v. Marshall*, 131 S.Ct. 2594 (2011), that the bankruptcy court lacked constitutional authority to issue the judgment, holding that the issues were inextricably intertwined with the interpretation of a right created by federal bankruptcy law, *viz.* the effect of Fire Eagle's credit bid. It also rejected Fire Eagle's assertion that venue was improper due to the forum selection clause in the guaranty. Finally, the

court rejected Fire Eagle's contention that the credit bid did not result in the senior indebtedness being satisfied. Fire Eagle argued that the lower courts should have assessed the fair market value of the assets purchased at the 363(b) sale and that only this value should be credited against the senior indebtedness. The circuit court noted that if Fire Eagle had simply declined to credit bid, the cash proceeds from the auction would have been applied against the senior indebtedness. If such cash bid had paid in full the senior indebtedness, it would be absurd to suggest that Fire Eagle could separately proceed against the guarantors. The court saw no difference between such a cash bid and Fire Eagle's credit bid. The court further held that § 363(k) contemplated explicitly mixed bids of cash and claims, implicitly presupposing an equivalence with cash of the value of the credit bid. Finally, the circuit court rejected Fire Eagle's argument that modification or elimination of a debt in bankruptcy should not affect payment rights under guaranties of such debts, because it held that the debt had in fact been paid in full. Indeed, the guaranty agreements provided for their own termination on payment of the guaranteed debt. The circuit court found no reason for the bankruptcy court to have determined the fair market value of the assets sold and affirmed the lower courts.

99. Trustee seeks to recover amount of alleged overbid by credit bidding lender at foreclosure sale

The lender had obtained stay relief and proceeded with a non-judicial foreclosure sale as permitted by Georgia law. The lender credit bid in the amount of \$2,025,281. Its proof of claim had been filed in the amount of \$1,522,825.13 and purported to include principal, interest, late charges, and actual attorney fees. It further asserted the property value to be \$1,500,000. After the case was converted to Chapter 7, the trustee made demand for what he considered to be a bid in excess of the lawful amount owing to the lender, treating the credit bid as equivalent to a cash bid. The lender had followed Georgia law and included in its debt and credit bid statutory attorney fees which amounted to \$262,386.87, which was estimated to be ten times its actual attorney fees. Under controlling precedent from the 11th Circuit in *Welzel v. The Advocate Realty Invs. (In re Welzel)*, 275 F.3d 1308 (11th Cir. 2001), the statutory attorney fees are part of the lender's secured claim only to the extent of actual and reasonable fees, pursuant to § 506(b), and unsecured for the balance of the statutory amount. The trustee argued that this resulted in a credit bid in excess of the lender's secured claim and demanded that difference. The court, however, held that the outcome could only be determined by a valuation of the property. If the property value was less than the credit bid after deducting the statutory attorney fees, then the court held that the lender would not actually have received any surplus or a windfall. It would have merely satisfied its claim. Accordingly, the court ordered a further evidentiary hearing to determine the value of the property at the time of the foreclosure sale. *In re Solid Rock Development Corp., Inc.*, 481 B.R. 221 (Bankr. N.D. Ga. 2012)(Hagenau, J.).

100. Trustee's acceptance of lower bid approved

Debtor was the owner and operator of a 192-room hotel known as the Red Roof Inn-Atlanta Airport. Debtor leased the tract of real property from the city under a long-term lease. Early in its Chapter 11 case, the court had approved the debtor's assignment of the ground lease, which encompassed four parcels of the property. The ground lease was subject to a bank's perfected security interest. Later in the case the bank obtained stay relief and foreclosed on two of the leased parcels of the property and sold them to Khushal Hospitality, which began

operating the hotel. Later the case was converted to Chapter 7, and the trustee proposed a sale and assignment of the other two parcels governed by the ground lease to Khushal for \$22,500, which was later increased to \$55,000. In the meantime, a much higher bid of \$125,000 was offered by a different party in competition with the Khushal bid. The trustee proposed to sell and assign to Khushal at the lower bid price, and the trustee's motion to do so was granted by the court over the objection of the competing bidder. *In re Diplomat Const., Inc.*, 481 B.R. 215 (Bankr. N.D. Ga. 2012). Judge Diehl first determined that the applicable test was the "business judgment" test under which the trustee had the burden of proof. The trustee had presented evidence and testified in support of his proposed sale and assignment. The court found that the business judgment test was met. This was a case where it was demonstrated that the highest bid did not always equate to the best bid for the estate. First, the bank was only willing to consent to a sale to Khushal. Second, there were potentially insurmountable barriers to meeting the requirements for assignment under § 365(f) if the assignment were to a party other than Khushal because the ground lease could not be severed. It applied to all four tracts. Therefore, performance under the ground lease was impossible without the hotel owner, now Khushal, assuming the ground lease. Third, the City of Atlanta had also consented to the Khushal sale and assignment but opposed any other and threatened litigation if the trustee should try to sell to any other party. Minimizing further litigation was a valid consideration for the trustee. The court concluded: "The Trustee is responsible for the administration of the estate and his judgment on the sale and the procedure for the sale is entitled to respect and deference from the court, so long as the burden of giving sound business reasons is met."

101. Notice of sale did not satisfy due process

The bankruptcy court had granted the debtors' motion to sell real, personal, and intellectual property free and clear of all liens, claims, and encumbrances. Among this property was five domain names used in connection with the businesses of the debtor entities, which were allegedly in the possession and control of Baja's Web, Inc. Following approval of the sale motion, the buyer at the sale contacted Baja seeking a transfer of ownership of the domain names in question. Baja refused, disputing that the domain names were actually property of the bankruptcy estate or transferred pursuant to the sale motion. Baja had actually been served with the notice of the hearing, but the court found that that notice was insufficient to satisfy due process and would not enforce the sale order against Baja. *In re Reinert*, 467 B.R. 830 (Bankr. W.D. Pa. 2012). Judge Deller observed that due process required that third parties who maintained an interest in the property to be sold pursuant to § 363(f) be given "fair notice" and an opportunity to be heard. That notice must be "reasonably calculated, under all the circumstances, to apprise interested parties of the pendency of the action and to afford them an opportunity to present their objections." Here, the notice was insufficient as Baja was not listed as a respondent, the sale motion did not specifically describe or identify any of the domain names subject to the sale, and the sale motion did not assert any affirmative relief against Baja or explain that the sale would affect Baja's interest in the domain names, to the extent any such interest existed. Thus, Baja was not properly afforded an opportunity to present any objection it might have had to the impact of the sale on its alleged interest in the domain names and the court refused to enforce the sale order against it. Instead, the court determined that the issue of whether the domain names were property of the bankruptcy estate at the time of the sale had to be determined by the way of an adversary proceeding. [*Editor's Note*: This is a common mistake made by trustees and debtor counsel alike. A party whose interests are directly affected by a §

363(f) sale should always be named as a respondent in the sale motion itself and in the related notice as well as a more thorough description than was contained here.]

102. Forfeited deposit became part of sale proceeds subject to liens

Debtor owned and operated a real estate development project with liens against the project far in excess of its value. An adversary proceeding resulted in a bankruptcy court order and judgment determining the amount, validity and priority of the consensual and mechanic lien claims. The mechanic lien claims alone totaled more than \$17 million. The debtor obtained authorization to conduct an auction of the project free and clear of all lien claims to attach to the sale proceeds. The court approved the sale on that basis for \$10 million to WERC LLC, the prevailing bidder, plus approved VA West Properties as the backup bidder for \$9.5 million. Pursuant to the purchase agreement, WERC posted an earnest money deposit of \$1 million, but it failed to close and the debtor retained the deposit as liquidated damages. The sale to VA West did close. Debtor then moved for a determination of the secured status of the mechanic lien claims asserting that they did not attach to the deposit that would constitute an unencumbered asset of the bankruptcy estate. However, the bankruptcy court ruled that the deposit was part of the sale proceeds to which the mechanic lien claims attached. Debtor appealed to the bankruptcy appellate panel, which affirmed. *Trilogy Development Co., LLC v. J.E. Dunn Construction Co., et al.*, 468 B.R. 835 (8th Cir. BAP 2012). The Appellate Panel disagreed with the debtor that Missouri law was applicable and, instead, agreed with the bankruptcy court that the lien claims attached to the sale proceeds by virtue of the sale order and not by operation of Missouri law. The sale order provided the deposit was part of the sale proceeds, the ruling of the bankruptcy court was not clearly erroneous. [*Author's Comment*: This case illustrates the importance of specifying that any defaulted earnest money deposit would be forfeited to the bankruptcy estate free and clear of the lien interests that would attach to the rest of the sale proceeds.]

103. Trademark licensees do not lose their rights upon licensor rejection of trademark license agreement in bankruptcy

Debtor was a producer of consumer products that were covered by patents and trademarks. In 2008, debtor licensed its trademarks to licensee. Three months after the parties executed their contract, debtor's creditors filed an involuntary chapter 7 petition against it. The chapter 7 trustee sold debtor's assets, including its trademarks and patents, to a purchaser. The trustee subsequently rejected the executory portion of the licensing contract under section 365(a), and when the licensee continued to make and sell debtor-branded products, the purchaser filed suit against the licensee.

The bankruptcy court held that a trademark licensee can continue to use a licensed trademark after the trademark license agreement is rejected by the licensor in bankruptcy. Although the court determined that section 365(n) does not apply to trademark licenses, it nevertheless held that the licensee was not stripped of its trademark rights "on equitable grounds." On direct appeal, the Seventh Circuit affirmed. *Sunbeam Prods., Inc. v. Chi. Amer. Mfg., LLC*, 686 F.3d 372 (7th Cir. 2012) (Easterbrook, J.).

The Seventh Circuit criticized the bankruptcy court's reasoning, stating that a judge cannot override the Bankruptcy Code by declaring that following the Code would be "inequitable." It nevertheless affirmed the bankruptcy court's holding. Outside of bankruptcy, a breach by a licensor does not terminate a licensee's right to use intellectual property; rather, the

unfulfilled obligations are converted to damages. Section 365(g) classifies rejection as a breach and, therefore, “in bankruptcy, as outside of it, the other party’s rights remain in place.” Although certain avoidance actions can eliminate counterparties’ rights, the contract was not rescinded because the trustee used section 365(a) rather than one of his avoiding powers. The court recognized its departure from *Lubrizol Enterprises, Inc. v. Richmond Metal Finishers, Inc.*, 756 F.2d 1043 (4th Cir. 1985), where the Fourth Circuit reasoned that by rejecting an executory patent license, the debtor-licensor avoided the licensee’s right to use the licensed patent. The Seventh Circuit stated that *Lubrizol* is “uniformly criticize[d]” by scholars because “it confuses rejection with the use of an avoiding power.”

104. Co-broker commission denied to buyer

Trustee determined to sell debtor's real property and proceeded to have employed a real estate broker at a 5% commission. The employment application for the realtor specified that the commission could be shared if the successful buyer was produced through the efforts of "a buyer's agent/co-broker." Several months later, trustee moved for leave to sell the property for \$1.135 million in accordance with a purchase and sale agreement ("PSA") that was attached to the motion. The PSA set out the broker's commission of 5% subject to court approval. The notice of the intended sale invited interested persons to provide higher offers on the same terms and conditions provided in the existing PSA. Jeff Ross filed a counteroffer to pay a higher price, representing that it was in conformance with the sale notice and therefore on the same terms and conditions provided in the PSA. However, that was not actually true because in the "broker's fee" paragraph, it was provided that the commission would be divided equally between the trustee's realtor and Ross as the "co-broker." Nothing in the body of Ross's notice of higher offer alerted the court or other parties that the higher bid was not in conformance with the sale notice. The sale closed with Ross as the buyer at the higher bid. When the trustee filed the motion to pay the broker's commission, it was revealed that his realtor intended to divide the commission with Ross. The court granted one-half of the 5% commission to the trustee's realtor and considered the balance waived. He directed the realtor not to share any of the commission with Ross. Ross moved for reconsideration, which the court denied. *In re International Gospel Party Boosting Jesus Groups, Inc.*, 464 B.R. 78 (Bankr. D. Mass. 2012). Judge Boroff listed three reasons why Ross was not entitled to compensation as co-broker. (1) He did not make adequate disclosure to other parties of his co-broker agreement, particularly where his opening statement was that his higher offer was in conformance with the trustee's notice of sale. No party, including the court was obligated to hunt through all of the documents to determine if there were any discrepancies. (2) The sale order did not adopt the terms of the Ross proposal. Instead, it adopted the original PSA terms and conditions; and (3) the proposed payment to Ross could not be characterized as a broker's commission because Ross was not a broker in the proposed transaction as he did not act as an agent for anyone else.

L. SECTION 554 ABANDONMENT

M. JUDICIAL ESTOPPEL

105. Seventh Circuit expands use of judicial estoppel against trustee

In *Spehar v. Mayer Brown Rowe & Maw, LLP*, (7th Cir. June 21, 2013), a trustee attempted to collect on a malpractice suit. The suit failed and instead of just taking its victory, the defendant sought sanctions against the trustee and his counsel. The law firm failed in its attempts and both parties appealed.

The facts of *Spehar* are convoluted but quickly summarized involve the successful attempt of a creditor to obtain a default judgment and then convince the trustee to sue the law firm (based on a malpractice theory that the firm was negligent in allowing the default judgment to be entered) as such a suit was the only way the creditor could collect on its judgment. The district court granted the law firm summary judgment on a judicial estoppel theory because the only way the trustee (whose litigation was funded by the creditor) could prevail was to convince the court that the creditor's claim (the same claim that the creditor obtained a substantial judgment on) was actually meritless.

The Seventh Circuit affirmed the use of judicial estoppel against the trustee. The Seventh Circuit held that judicial estoppel is a "flexible" doctrine concerned with "protecting the integrity of the courts from the appearance and reality of manipulative litigation conduct" and can be applied against a litigant based on the litigation position of another party. Here, the court found that the true ringleader of the litigation was not the trustee, but the creditor and that to allow the trustee to prevail would be to allow the creditor to successfully engage in exactly the type of conduct judicial estoppel is designed to prevent.

Finally, the Seventh Circuit turned to the question of sanctions and affirmed the district court's decision not to award them. Of particular interest is the Court's discussion of whether the "willful and deliberate" standard for a trustee's personal liability for a breach of fiduciary duty also should be the standard for sanctions concerning a trustee's litigation conduct. The Seventh Circuit noted that a distinction between the two types of conduct makes "intuitive sense" but declined to go further than general ruminations.

106. Debtors judicially estopped from bringing civil claims for failure to disclose claims in bankruptcy proceeding

Joint debtors filed their chapter 11 petitions in September 2008. In May 2009, while the chapter 11 case was still pending, police conducted an investigation of debtors, which included a search of debtors' homes. In June 2009, debtors converted their case to one under chapter 7 and, shortly thereafter, they each filed separate pro se civil lawsuits in district court against government officials and the police, alleging violation of their constitutional rights and other claims arising from the search of their homes. Debtors did not amend their schedules to disclose the lawsuits, and they filed affidavits with the bankruptcy court stating that their original schedules were still true and accurate.

Debtors received their discharge in October 2009. Three months later, in January 2010, they filed with the bankruptcy court a Rule 1019 Report of Unpaid Chapter 11 Obligations in which they disclosed their civil lawsuits for the first time. The chapter 7 trustee then abandoned the lawsuits because he believed that they had no value to the estate.

Defendants in the civil suit sought dismissal of the action on the grounds of judicial estoppel due to debtors' prior failure to disclose the suit in their bankruptcy schedules. The district court granted summary judgment in defendants' favor, and the First Circuit affirmed. The court noted well-established precedent that failure to identify a claim as an asset in a bankruptcy proceeding is a prior inconsistent position that can serve as the basis for dismissal of a later civil claim on the grounds of judicial estoppel. In this case, the debtors satisfied the prerequisites for judicial estoppel because (a) their prior statements in bankruptcy court that they did not possess any potential lawsuits was clearly inconsistent with their position in the district court suit, and (b) the bankruptcy court accepted defendants' prior statements when it granted them a discharge. Finally, although debtors may not have benefitted from their failure to disclose the lawsuits, the court of appeals concluded that the debtors' abuse of the judicial process justified applying judicial estoppel in this case. The court of appeals therefore held that the district court did not abuse its discretion in applying the doctrine of judicial estoppel and affirmed the dismissal of debtors' civil claims. *Guay v. Burack*, 677 F.3d 10 (1st Cir. 2012),

N. TRUSTEE IMMUNITY/LIABILITY

107. Sixth Circuit rejects attempts to expand trustee's personal liability

Plaintiff law firm brought a complaint against chapter 11 trustee alleging malicious prosecution and abuse of process. The trustee had brought three adversary proceedings against the law firm and all three had been dismissed. *In re McKenzie*, 2013 WL 2274006 (6th Cir. May 24, 2013).

The Sixth Circuit began its discussion by noting that in the Sixth Circuit "a bankruptcy trustee is liable personally only for acts willfully and deliberately in violation of his fiduciary duties." Further, this quasi-judicial immunity protects the trustee "for actions taken in his official capacity." The plaintiff argued the typical protections of a trustee did not apply because the trustee's action was *ultra vires* and because the trustee acted without prior court approval. The court acknowledged that while pre-approval of a court may help shield a trustee, such pre-approval is not required for a trustee to invoke his personal immunity. The Sixth Circuit also rejected the *ultra vires* argument. The court noted that the only situations where this exception has been applied are cases where the trustee seized property that was not estate property. The Sixth Circuit refused to take the doctrine one step further and hold that it can apply to a trustee's *attempt* at seizing property that is not an asset of the estate such as through a failed adversary proceeding campaign.

108. Sanctions imposed for expenses charged to estate

The trustee in *In re Financial Corporation* (Bankr. S.D. Tex. May 13, 2013) secured a favorable judgment which his opponent appealed to the Fifth Circuit. The trustee represented himself in the appeal and traveled to New Orleans for the arguments. The bankruptcy court questioned the amount of the expenses incurred and the trustee explained that the trip was designed primarily to help the trustee prepare for argument. Upon further investigation, the court discovered that the trustee had traveled along with his family. The court found that several expenses did not appear to be related to the appeal and were more personal in nature and removed the trustee from the case.

The court's decision highlights that the trustee's tenure in the case had been a turbulent one concerning the trustee's actions regarding compensation and allegations of retaliatory conduct. In other words, the Court found a pattern of the trustee placing his own pecuniary interests ahead of the interests of the estate.

109. Trustee not limited to liquidating property necessary to satisfy creditors

After trustee sold sufficient estate property to pay all creditors in full, plus realized additional funds, one of the partners of the debtor partnership sought to have the trustee removed on several grounds including the breach of his fiduciary duty because he sold more "property than was necessary to satisfy the creditors." The bankruptcy court disagreed and an appeal was filed. The district court affirmed. *Rahmi v. Trumble (In re Bon-Air Partnership)*, 464 B.R. 710 (N.D. W.Va. 2011). The court reviewed the trustee's duties under § 704(a) and determined that the trustee had an affirmative duty to reduce property to money as expeditiously as possible but was not limited in doing so. Accordingly, the trustee was not removed.

110. Trustee not personally liable for negligently performing his duties

The debtor's landlord sued the chapter 7 trustee in his personal capacity for negligently failing to winterize the landlord's building after the building's water pipes had frozen and burst, resulting in water damage. The trustee moved to dismiss on the ground that he cannot be held liable in his personal capacity for negligent acts. The Sixth Circuit dismissed the claim, holding that a bankruptcy trustee is not personally liable for negligently performing his duties. *Warren Inv., Inc. v. Dery (In re J&J Video)*, No. 11-2013 (6th Cir. 2012).

111. Trustee not automatically reappointed in reopened case

In what appeared to be a routine case, trustee filed an NDR, following which an order was entered on December 7, 2009, granting the debtor a discharge, declaring the estate fully administered, discharging the trustee, and closing the case. On October 6, 2010, the trustee filed a motion to reopen the case after learning about an inheritance of approximately \$18,000. In the absence of an objection, the court entered an order reopening the case on October 27, 2010. On May 23, 2011, the trustee requested that the clerk set a claims bar date. When no claims were filed, the trustee filed a motion for authority to return the funds to the debtor, asserting that the motion was filed in his capacity as the Chapter 7 trustee. The court denied the motion because the trustee had no authority to bring it. *In re Trahan*, 460 B.R. 207 (Bankr. C.D. Ill. 2011). Judge Gorman acknowledged that the trustee had standing to bring the motion to reopen but could not reappoint himself as trustee. Under Rule 5010, only the U.S. Trustee had the authority to appoint a trustee in a reopened case after obtaining from the court an express finding that a "trustee is necessary to protect the interests of creditors and the debtor or to insure the efficient administration of the case." Here, the requisite finding from the court was never requested or obtained, and the U.S. Trustee never reappointed the trustee in the reopened case. Thus, the trustee had no authority to demand turnover of the inheritance or to retain the inherited funds.

The court proceeds to find that there was a systemic failure in the U.S. Trustee's procedures for reviewing case re-openings and determining when the court should be requested to authorize the appointment of a trustee in reopened cases. The court then audited reopened cases in the Springfield Division of the Central District of Illinois, finding that 89 cases had been

reopened between January 1, 2008 and September 30, 2011, mostly at the request of debtors to file financial management certificates, avoid liens, or amend schedules. However, 19 cases were reopened on the basis of a potential asset to be administered, but no request for a finding that the court determine the appointment of a trustee was necessary had occurred in any of them. Moreover, none of the orders reopening the 19 cases had included authorization for the U.S. Trustee to appoint a trustee. Nevertheless, the U.S. Trustee appointed trustees in 14 of the reopened cases, and in the other five cases, the trustees acted as trustees without ever receiving notices of reappointment. Importantly, the court points out that Chapter 7 trustees are entitled to quasi-judicial immunity for acts done within the scope of their statutory duties, but when they exceed their authority, they are not entitled to immunity and may be held personally liable for their conduct. Here, by not properly being appointed, the trustees put themselves at personal risk when administering these reopened bankruptcy estates. Although the motion was denied, the court suggested that the trustee in his individual capacity return the funds to the debtor posthaste.

112. Fourth Circuit upholds *Barton* Doctrine in dismissal of lawsuit

The disgruntled former officers of a Chapter 7 debtor sued the trustee's law firm and several attorneys from that firm, contending that the *Barton* Doctrine did not apply because the trustee had not specifically directed the challenged actions and because the allegedly wrongful actions exceeded the scope of the defendants' authority. The trustee in prior litigation had pursued the plaintiffs in bankruptcy court for preferential and fraudulent transfers, breach of fiduciary duty and unfair and deceptive trade practices. Here, the plaintiffs initiated the lawsuit in state court alleging civil obstruction of justice based on presentation to deponents during the discovery phase of that case of documents mistakenly identified as the debtor's tax returns and allegedly having expert witnesses rely on those mistaken returns. Also, they alleged conversion based on obtaining the personal tax returns of debtor's officers without their knowledge or permission and then refusing to return them. Defendants removed the lawsuit to the U.S. District Court and sought dismissal under *Barton v. Barbour*, 104 U.S. 126 (1881). The dismissal motion was granted and on appeal, the 4th Circuit affirmed. *James Mark McDaniel, Jr., et al. v. John M. Blust, et al.*, 668 F.3d 153 (4th Cir. 2012). The circuit court first concluded: "[W]e know of no reason why the trustee must have directed counsel to take the specific actions that are the subject of the [plaintiffs'] suit." Next, the court determined that even assuming that the challenged actions by defendants were wrongful, they were clearly taken in the context of defendants' attempt to prove the trustee's adversary proceeding and therefore within the scope of their authority. The allegations that the challenged conduct was wrongful is certainly not unexpected in such a lawsuit and did not preclude application of the *Barton* Doctrine. "[B]ankruptcy trustees and their counsel require protection against suits that are based on unfounded allegations regardless of whether there is a claim that the alleged wrongdoing was intentional."

113. Bankruptcy Court had jurisdiction over removed state court claims against trustee; trustee had immunity

Debtor contested the trustee's sale of his residence and other decisions of the bankruptcy court. Debtor sought relief from the trustee's actions in California state court, alleging fraud, interference with contractual relations, and abuse of process. Trustee removed the California action to the bankruptcy court, which dismissed the claims and the debtor appealed. The Ninth Circuit Bankruptcy Appellate Panel (BAP) held that the bankruptcy court had jurisdiction over

the alleged wrongs committed by the trustee while he was acting in the scope of his duties. The actions the debtor attacked were all related to his actions under the Bankruptcy Code and some were, in fact, approved by the court in its approval of a settlement. Debtor did not obtain advance permission to sue the trustee in state court or bankruptcy court, which the BAP explained justified dismissal because a person seeking to sue a court officer such as a bankruptcy trustee must first obtain permission of the court. The BAP also held that the trustee had an absolute defense of immunity where the complaint only referred to him in his capacity as case trustee. The Ninth Circuit affirmed in an unpublished decision. *Law v. Siegel (In re Law)*, 435 Fed. Appx. 702 (9th Cir. 2011)(Judges Pregerson, Thomas, and Paez).

114. Court denies law firm leave to file malicious prosecution claim against trustee in state court

Law firm sought leave to file a state court action for malicious prosecution and abuse of process against a bankruptcy trustee and attorneys for the trustee. The law firm argued that the trustee's pursuit of causes of actions despite a one year statute of limitations and due to a bankruptcy court ruling finding a *prima facie* case of malicious prosecution and abuse of process, warranted grant of leave to file an action in state court. The court disagreed. *In re McKenzie*, No. 08-16378, 2011 WL 3439081 (Bankr. E.D. Tenn. 2011, Judge Rucker).

First, the court found that the law firm had to seek leave to sue, because the trustee's acts were taken in pursuit of possible assets of the estate. Therefore, his actions were within the broad scope of the trustee's duties under § 704. The narrow "carrying on business" exception under 28 U.S.C. § 959(a) did not apply, because administering and liquidating the estate did not constitute carrying on business. Judge Rucker also cited policy considerations, such as efficient use of judicial resources and protection of a trustee from the distraction of litigation during a bankruptcy case. Therefore, the court denied the motion and found that the claims should be heard in the bankruptcy court.

O. SETTLEMENT

115. Trustee entitled to deference in settlement decisions

Court of Appeals for the First Circuit affirmed District Court and Bankruptcy Court approval of Trustee's settlement of debtor's pre-petition legal malpractice claims. The Debtor objected to the settlement of the malpractice claims for \$25,000 against his former attorney as being "too low."

The First Circuit cited precedent holding that the Trustee is to be given deference for decisions and that settlements are favored in bankruptcy. The bankruptcy judge must determine whether the settlement falls within the lowest point in the range of reasonableness. The court held that the settlement fell within the range of reasonableness and the Bankruptcy Court did not abuse its discretion in approving it. On the other hand, the First Circuit hinted that Bankruptcy Court should have drafted a decision with more than "only four sentences" to explain its decision to approve the settlement. However, the First Circuit noted that this did not preclude affirming the bankruptcy Court's decision, because the Trustee had conducted an investigation of the claim and offered an explanation for the settlement decision, the record supported the Trustee's decision, and the Bankruptcy Court had been fully briefed and held a hearing before approving

the settlement. *Yacovi (In re Yacovi) v. Rubin and Rudman LLP*, 411 Fed. Appx. 342 (1st Cir. 2011).

116. Settlement did not violate priority scheme – creditor financial services firm not entitled to proceeds

Debtor was a Chicago towing company that owned and operated a tug boat service on Lake Michigan. Debtor filed a chapter 11 bankruptcy, which was converted to a chapter 7 the following year. A dispute arose over the sale of property where the debtor operated its business. There were competing claims to the property, including among the debtor's principals, who were in the middle of a bitter divorce. The debtor had brought claims against these principals for breach of fiduciary duty and usurping corporate opportunities, seeking to have the property at issue declared an asset of the bankruptcy estate. The parties reached a settlement that divided up the proceeds from the sale of the property. The principals each received 25% and the bankruptcy estate received the other 50%. The principals paid the debtor's bankruptcy attorneys from their personal share as part of the agreement. Creditor financial services firm that had provided financial consulting services to the creditors' committee during the chapter 11 bankruptcy proceedings objected to the payout in the settlement agreement, arguing that a portion of those funds should have been distributed to it and the other chapter 11 creditors. The creditor challenged the bankruptcy court order approving the settlement. The district court upheld the settlement agreement and the Seventh Circuit affirmed. *In re Holly Marine Towing, Inc.*, No. 11-1787, 2012 U.S. App. LEXIS 239 (7th Cir. 2012).

The creditor had standing to challenge the order approving the settlement, because it had a pecuniary interest in the outcome of the proceeding – there was no dispute that the creditor provided services to the estate during the chapter 11 proceedings. But the creditor's argument that the settlement violated the Bankruptcy Code's priority scheme failed because the amounts paid to the attorneys were never property of the estate. Therefore, the priority scheme simply did not apply. Finally, the bankruptcy court did not abuse its discretion in approving the settlement because 50 percent of the value of the property was within the reasonable range of possible litigation outcomes and was in the best interests of the estate.

117. Trustee cannot settle claims owned by creditors as derived from alter ego claims

Prior to the debtor's bankruptcy, two parties sued the debtor and three insiders in state court for causes of action arising from a breach of contract. The chapter 7 trustee sought to settle those claims against the debtor's insiders, contending that the claims were "alter ego" claims subject to administration by the trustee. The plaintiffs in the action objected to the compromise, arguing that the claims against the insiders did not belong to the estate. *In re Xenerga, Inc.*, 449 B.R. 594 (Bankr. M.D. Fla. 2011) (Judge Jennemann).

Examining §541(a), the court noted that property of the estate includes legal causes of action the debtor had against others as of the commencement of the bankruptcy case. But the trustee has standing to assert only causes of action that belong to the estate. The trustee has no right to bring claims that belong solely to the estate's creditors.

The court followed the Eleventh Circuit Court of Appeals, which had held that an alter ego claim belongs to the bankruptcy estate if (1) it is a general claim common to all creditors; and (2) state law allows the corporate entity to bring an alter ego action against its principal.

The court found that the allegations were common to all creditors and Florida law allowed the trustee to bring an alter ego action, but that not all of the plaintiff's claims were derivative of its alter ego allegations. "The Claims are derivative if they rely upon a finding of alter ego liability against the Principals but are direct if the Principal's liability is entirely independent of any alter ego finding." Therefore, the court held that the trustee could not settle the direct claims and the proposed settlement improperly attempted to settle claims that were not property of the estate.

P. SECTION 523 AND 727 DISCHARGE

118. "Defalcation" construed by U.S. Supreme Court

Section 523(a)(4) provides that an individual debtor cannot obtain a discharge from a debt for "fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny." The circuit courts are widely divided over the meaning of defalcation in that context. In this case, the Supreme Court reversed the 11th Circuit applying a scienter requirement. Writing for the court, Justice Breyer stated that where the debtor's conduct does not involve bad faith, moral turpitude, or other immoral conduct, "defalcation" requires an intentional wrong. "We include as intentional not only conduct that the fiduciary knows is improper but also reckless conduct of the kind that the criminal law often treats as the equivalent. Thus, we include reckless conduct of the kind set forth in the Model Penal Code." Hence, if the fiduciary lacked actual knowledge of wrongdoing, the conduct would be equivalent if the fiduciary consciously disregarded or was willfully blind to a substantial and unjustifiable risk that his conduct would turn out to violate a fiduciary duty. *Randy Curtis Bullock v. Bankchampaign, N.A.*, 133 S.Ct. 1754 (May 13, 2013).

119. Non-dischargeability complaint filed two minutes and 44 seconds late not permitted

Plaintiff and debtor had entered into two consent orders extending the deadline for plaintiff to file a complaint relating to discharge objection. As the deadline approached, debtor refused to extend the deadline a third time. The plaintiff had already deposed the debtor and his wife and had pursued settlement negotiations. Those agreements terminated 25 days before the deadline. No further motion was filed. At 11:45 p.m. on the night of the deadline, plaintiff attempted to file its complaint electronically but had computer difficulties, delaying the filing. Only after three attempts did the complaint get filed. Unfortunately for the plaintiff, the time stamp for the filing was 12:02:44, just two minutes and 44 seconds beyond the extended deadline. The debtor promptly filed a motion to dismiss. The plaintiff sought allowance of the complaint under principles of equitable tolling. The court denied that request finding it "hard to accommodate a creditor's request for equitable tolling of a hard and fast deadline when that creditor sat on its hands and waited until the last moment to meet said deadline." Further, equitable tolling usually is based on misconduct of some kind by the debtor which did not exist here. There was very little discussion of Rule 9006(b) and the grounds for excusable neglect. Instead, the court held that it had no discretion to consider the merits of the complaint under the prior 11th Circuit precedent of *Byrd v. Alton (In re Alton)*, 837 F.2d 457 (11th Cir. 1988). Accordingly, the motion to dismiss the complaint was granted. *In re Harper*, 489 B.R. 251 (Bankr. N.D. Ga. 2013)(Drake, J.).

120. Trustee's discharge objection complaint filed one day late allowed *nunc pro tunc*

Trustee and debtor had two agreed orders entered extending the original deadline to object to discharge as set forth in Rule 4004(a). The motions seeking such extended deadlines were timely filed. The final deadline was August 8, 2012. The trustee filed her adversary proceeding objecting to debtor's discharge under several subsections of § 727, but she filed it one day after the court's deadline established by agreement of the parties and court order. The court nevertheless allowed the complaint by extending the deadline *nunc pro tunc* by one day on an excusable neglect basis under Rule 9006(b)(1). *In re Soler*, 490 B.R. 629 (Bankr. S.D. Fla. 2013). Judge Isicoff recognized that under 11th Circuit precedent, *Byrd v. Alton (In re Alton)*, 837 F.2d 457, 459 (11th Cir. 1988), the bankruptcy court would have no authority to extend the deadline if the motion seeking such extension was filed after the expiration of the deadline in Rule 4004(a). However, where, as here, the established deadline was extended by court orders "the court for cause may at any time in its discretion . . . on [a] motion made after the expiration of the specified period permit the act to be done where the failure to act was the result of excusable neglect." Rule 9006(b)(1). Thus, the court agreed with an earlier decision *In re Chira*, 343 B.R. 361, 369-371 (Bankr. S.D. Fla. 2006), *aff'd*, 378 B.R. 698 (S.D. Fla. 2007), *aff'd*, 567 F.3d 1307 (11th Cir. 2009), where the court had concluded that once it extended a deadline in accordance with Rule 9006(b)(1), a court may further extend that deadline due to a party's excusable neglect. In determining excusable neglect, the court would consider (1) the danger of prejudice to the debtor, (2) the length of the delay and its potential impact on judicial proceedings, (3) the reason for the delay, including (4) whether it was within the reasonable control of the movant, and (5) whether the movant acted in good faith. Here, the delay of several hours was not prejudicial to the debtor and was not done in bad faith. Accordingly, the deadline was extended *nunc pro tunc*. [Author's Comment: The same analysis should be applicable to the deadline for objecting to exemptions if previously extended by court order.]

121. Discharge denied for failure to disclose recent financial transactions

Trustee filed an adversary proceeding objecting to debtor's discharge pursuant to sections 727(a)(2)(A) and 727(a)(4)(A), alleging that the debtor concealed assets and made false oaths. During the trial, it came to the court's attention that the debtor may not have reviewed the electronic version of his petition and schedules that had been filed with the court. The hard copy signed by the debtor had certain sections crossed out and words written in, which did not appear on the electronically filed version. Because of the ambiguity as to which document the debtor had signed, the court did not consider the debtor's signature on the electronic petition as a statement made under oath. Instead, the court relied on debtor's statements under oath at the section 341 meeting and Rule 2004 examination that the petition and schedules were accurate. The court then denied the discharge under section 727(a)(4)(A), finding that the debtor had made a "false oath or account." The court found that the debtor had failed to disclose a variety of transactions – including a substantial transfer from a joint checking account to his non-filing spouse, misstatements about income earned in the most recent three years, transfer of a 401K account, debt to his father-in-law, and ownership of a life insurance policy – and the court found that this series of omissions and errors constituted intent to deceive and the omitted information was material to the bankruptcy case. *Warren v. Moore (In re Moore)*, No. 11-00294-8-JRL, 2012 WL 3564168 (Bankr. E.D.N.C. 2012).

122. Debtor's discharge revoked for failure to turn over tax refund

The debtor had already received a discharge. After the trustee was unable to recover the non-exempt portion of a tax refund from the debtor, he moved to compel the turnover of that amount, \$1,887.27. The court entered an order granting the trustee's motion in directing the turnover of that sum. After the debtor failed to obey the court's order, the trustee sought to have the debtor's discharge revoked under § 727(d)(3) and (a)(6)(A). After commencement of the adversary proceeding, debtor remitted \$1,300, leaving a balance of \$587.27. The court granted summary judgment to the trustee and revoked the debtor's discharge. *In re Gates*, 2012 Bankr. LEXIS 1681 (Bankr. N.D. Ohio). Judge Harris noted that some courts required a finding of willful and intentional refusal to obey the court's orders, whereas other courts treated it similar to a charge of civil contempt, thus negating the intent requirement. Here, the trustee had established the three steps for civil contempt: (1) the debtor had knowledge of the order; (2) the debtor did in fact violate the order; and (3) the order was specific and definite. This shifted the burden to the debtor to explain her non-compliance, and to provide supporting evidence. Mere assertions by the debtor are insufficient. Here, however, the debtor failed to explain her failure to comply and, therefore, summary judgment was granted to the Trustee.

123. Debtors should have been given opportunity to present evidence to justify valuation and list of property on schedules

Trustee objected to debtors' amended claim of exemptions. The debtors represented a value of \$2,000.00 on their schedules as the value of "household goods and furnishings" and a \$200.00 value for "wearing apparel." The debtors exempted the entire value of these items under section 522(d)(3). The trustee held a 341 meeting and filed a no asset report on the same day. Then a fire destroyed the debtors' home and its contents. The debtors filed a claim with their insurer for, among other things, \$45,924.88 in household goods and furnishings, wearing apparel, medical equipment and living expenses. The U.S. Trustee filed an adversary proceeding against the debtors seeking to revoke their discharge on the grounds that they had undervalued their household goods on Schedule B. The debtors then sought to amend their schedules, but the trustee objected stating that the listed values should be binding on the debtors. The bankruptcy court sustained the objection on estoppel grounds. *Rossi v. Westenhoefer (In re Rossi)*, 2012 Bankr. LEXIS 1168 (B.A.P. 6th Cir. 2012).

On appeal, the BAP determined that the bankruptcy court erred in applying equitable and judicial estoppel to disallow the debtors to amend the exemptions. According to the BAP, the court should have been given the opportunity to present exculpatory evidence showing that the initial property valuation was the result of mistake or inadvertence and that they lacked bad faith in making such valuation. As to equitable estoppel the BAP explained that it could not conclude that the parties relied to their detriment on the debtors' original schedules and that unsecured creditors would be "substantially prejudiced" if the debtors succeeded in amending their exemptions. The BAP did affirm the bankruptcy court's determination, however, that the insurance policy was property of the estate and because it was not scheduled it could not be abandoned by the trustee.

124. Fifth Circuit affirms debt as non-dischargeable under section 532(a)(2)(A) despite fact that debt arose from settlement agreement

Debtor appealed a bankruptcy court ruling, affirmed by the district court, that a claim by insurance company against debtor as indemnitor of his corporation's obligations was not dischargeable in bankruptcy under section 523(a)(2)(A). The bankruptcy court held that the over \$3 million debt of the debtor as indemnitor was not dischargeable because he had obtained surety bonds for his corporation from the insurance company through actual fraud. The debtor had not only signed for himself, but had forged signatures of his spouse, his brother, and his brother's spouse as indemnitors. After he testified he forged the signatures, the debtor entered into a settlement on the basis of which the district court issued a \$3 million consent judgment. The debtor then filed for bankruptcy and sought discharge of this indebtedness. The Fifth Circuit affirmed the decision that the debt was not dischargeable. *Kapetanakis v. First Nat'l Ins. Co. of Am. (In re Kapetanakis)*, No. 11-20306, 2012 U.S. App. LEXIS 11879 (5th Cir. 2012).

The court found the debtor's argument that the insurance company released the non-dischargeable fraud claim through settlement foreclosed by the Supreme Court's decision in *Archer v. Warner*, 538 U.S. 314 (2003). In addition, the insurer showed it would not have issued the bonds without an indemnity signed by the owners of all outstanding stock and by the spouses of those stockholders. The court's determination that the debtor forged the signatures with the intent to deceive the insurer was also supported by the record because, for example, the signatures were affixed at the same time but in different styles and in different colored ink. Finally, the record supported the determination that the insurer actually and justifiably relied on the indemnity in issuing the bonds.

Q. TAX ISSUES

125. Workers compensation taxes not entitled to priority

The debtor, a not-for-profit, ran into financial difficulty and failed to make certain payments to the State of Michigan to reimburse the State for various unemployment benefits. The State of Michigan filed proofs of claim seeking the recoupment of these monies. The State alleged the claims were entitled to priority under §507(a)(8) as an excise tax. The Bankruptcy Court noted that the First Circuit in *Massachusetts Div. of Employment and Training v. Boston Regl' Med. Ctr.*, 291 F.3d 111 (1st Cir. 2002) and the Third Circuit in *Reconstituted Comm. Of Unsecured Creditors v. New Jersey*, 396 F.3d 247 3d Cir. 2005) held that unemployment taxes were not entitled to priority and joined those courts in holding the same. *In re Community Memorial Hospital*, Case No. 12-20666 (Bankr. E.D. Mich. May 26, 2013). The court held that in order for a tax to be considered of the kind entitled to priority, it must: (1) be an "involuntary exaction" that is universally applicable to similarly situated persons; and (2) according priority status will not disadvantage private creditors with similar claims. The court found that the tax failed step 2 of the test as under Michigan law private parties could post a surety bond that would diminish the State's obligations. While there was no class of creditors who actually had posted such a bond, the court found the existence of a hypothetical creditor to be sufficient to deny priority status.

126. Bankruptcy Code does not extend the deadline to challenge state ad valorem taxes on real estate

Twenty-nine days after the estate property appraiser certified the 2009 tax rolls to the state tax collector, debtor filed a Chapter 11 petition. The tax collector filed a proof of claim in the bankruptcy 36 days later for unpaid real property ad valorem taxes calculated on the appraised value of debtor's investment properties. A person owing such taxes had 60 days after the certificate of the tax rolls to file a challenge to the valuation of the property under applicable state law. Once the deadline had run, state courts would be deprived of jurisdiction to consider the claim. Here, debtor did not timely challenge the assessment with the state agency but did file an objection to the tax claims in the bankruptcy court about four months after the state law deadline, claiming that the actual property values were less than those determined by the state property appraiser. The bankruptcy court held that the debtor's request to have the court re-determine debtor's state ad valorem tax liability was timely filed under §§ 108(a) and 505. The state taxing authority appealed to the district court, which affirmed. However, on further appeal to the 11th Circuit, the ruling was reversed. *In re Read*, 692 F.3d 1185 (11th Cir. 2012). The circuit court determined that under § 505(a)(2)(C) of BAPCPA, Congress had intended to create an exception to the general extension provisions set forth in § 108(a) and that § 505(a)(2)(C) specifically restricted bankruptcy courts from determining the legality or amount of an ad valorem tax on real estate after the period for contesting such a tax had expired. Therefore, the circuit court reversed the lower courts. [*Author's Comment*: This is an important decision for trustees as it makes it very difficult to timely file in many states a challenge to over-assessed properties.]

127. Court compels IRS to marshal on exempt residence

Trustee requested that the court compel the IRS to marshal on exempt assets of the debtor on which the United States held tax liens in order to preserve funds of the bankruptcy estate for unsecured creditors, and the Bankruptcy Court agreed. *In re Szwyd*, 444 B.R. 10 (Bankr. D. Mass. 2011). The debtor had a valid homestead exemption under 11 U.S.C. § 522(c) and Massachusetts law, which precluded the Trustee from selling the residence for additional funds for the bankruptcy estate. The Massachusetts homestead exemption law specifically excluded tax claims from the exemption. The Trustee filed an adversary proceeding against the United States requesting that the United States marshal its collateral and forcing the IRS to proceed against the debtor's residence. The IRS argued that the United States could not be compelled to marshal its collateral.

The Bankruptcy Court heard the issue on remand from the District Court. The Bankruptcy Court dismissed the IRS's argument that it should not be required to marshal its assets, because the Trustee would only have enough funds to pay priority unsecured claims, noting that the Trustee represents all unsecured creditors, whether priority or general unsecured. Judge Boroff concluded that "marshaling will go some way toward allowing creditors who would otherwise receive nothing to realize something without burdening the creditor who has everything."

128. Seventh Circuit considers tax refund allocations

Debtor filed Chapter 7 on September 25, 2007, the 268th day of that year, representing a passing of 73.42% of the year on the petition date. The debtor was entitled to a refund for 2007 in the amount of \$3,322 federal and \$216 state. The trustee filed a motion for turnover seeking a pro-rata portion by days method less exemptions to which the debtor was entitled. The debtor objected to the motion seeking a smaller portion as subject to turnover based on *In re Donnell*, 357 B.R. 386 (Bankr. W.D. Tex. 2006). The bankruptcy court overruled the objection and agreed with the trustee's calculation of pro-rata by days method. Debtor appealed and the district court affirmed. Debtor further appealed and the circuit court affirmed. *In Meyers*, 616 F.3d 626 (7th Cir. 2010). The Seventh Circuit noted that the trustee had likely made a *prima facie* case simply by identifying the value of the refunds and proper calculation by pro-rata by days share. Here, the trustee went further and had shown that debtor's income and withholding advanced at a fairly steady rate throughout the tax year and that there were no income or withholding spikes after she filed her petition that would be swept in unfairly by the pro-rata method. The court rejected the *Donnell* methodology and agreed with the trustee. The circuit court also noted that "[a]sking the trustee to engage in extensive investigations and complicated calculations before filing a turnover order will necessarily result in increased costs to the bankruptcy estate."

129. Allocation of tax refund between spouses must include refundable credits attributable to each spouse

Debtors claimed fully exempt a tax refund of approximately \$7,000, and the trustee objected. The court determined that in states where there is no presumption of equal ownership of property the refund would be divided between the spouses with each receiving a percentage of the refund equivalent to his or her proportion of the withheld tax payments, representing the majority view on the issue. However, the court further noted that with lower income debtors, the tax refund was more likely to result from refundable tax credits than withholdings from wages or estimated tax payments. *In re Evans*, 449 B.R. 827 (Bankr. N.D. Ga. 2010). Judge Drake determined to follow *In re Crowson*, 431 B.R. 484 (10th Cir. BAP 2010), whereby determining the ownership of the refund included a calculation of the amount of the refundable credits attributable to each spouse. Judge Drake set out the formula for computing the allocation of the refund based on the withholding contributions, earned income tax credit, additional child tax credit, making work pay credit and other items that would contribute to the refund. *See also, In re Palmer*, 449 B.R. 621 (Bankr. D. Mont. 2011). [*Editor's Note: These are excellent cases which provide a mathematical formula for calculating the proportion of each credit attributable to each spouse and for the determination of the overall refund allocation.*]

130. Joint tax refund allocated entirely to debtor husband

Debtor's joint tax return resulted in a refund in the amount of \$10,388. The spouses each claimed half of the refund and attempted to exempt the entire amount by doing so. The trustee made demand for turnover of the refund and debtors responded with a motion to retain it, to which trustee objected. Spouses in Georgia neither hold property as community property nor as tenants-by-the-entirety. Debtors argued that in a state court divorce proceeding, the refund would be allocated equally. The bankruptcy court rejected that argument and others, ruling in favor of the trustee. The entire refund was allocated to debtor husband only who could not exempt more

than half of the refund. *In re Hraga*, 467 B.R. 527 (Bankr. N.D. Ga. 2011). Judge Sacca note that the objective of the law in a marital dissolution was the equitable distribution of assets between spouses whereas the objective of bankruptcy law is the equitable distribution of each of a debtor's assets to each of that debtor's creditors. Under Georgia law, there is no presumption of equal ownership of property between spouses. While agreeing with the majority of courts holding that the refund should be apportioned based on the respective tax withholdings of the spouses, the court did not agree that there was "an irrebuttable presumption that the joint tax refund is owned in proportion to the amount of tax withholdings." Even if one spouse did not contribute withholdings, that spouse may be entitled to a portion of the refund due to tax credits to which that spouse would be entitled, agreeing with the court in *In re Evans*, 449 B.R. 82 (Bankr. N.D. Ga. 2010). Here, however, the debtor wife had no tax credits and contributed no withholdings and therefore was not entitled to any allocation of the refund.

131. Entire tax refund subject to turnover where debtor's wife was unemployed

Chapter 7 trustee filed a motion to compel turnover of the debtor's income tax refund pursuant to 542(a). The issue was whether the debtor's wife, who did not join in the bankruptcy, owned half of the tax refund. As the court explained, if so, her share would not be payable to the trustee. The bankruptcy court found, however, that the debtor owned the entire tax refund at the time of filing. The debtor's wife was not employed and the tax refund came entirely from the debtor's withheld wages. The bankruptcy court examined Illinois law, determining that the tax return was the debtor's property. Therefore, the bankruptcy court concluded that the entire tax refund became property of the estate and was subject to turnover by the trustee. The bankruptcy court granted the trustee's motion for turnover. *In re Ruhl*, No. 09 B 45933, 2012 Bankr. LEXI 3001 (Bankr. N.D. Ill. 2012).

R. ERISA ISSUES

132. Bankruptcy court has core jurisdiction over trustee's fees relating to 704(a)(11) duties

After the Chapter 11 case was converted to Chapter 7, the trustee moved for authority to terminate the debtor's 401(k) plan and for authority to establish a reserve out of plan assets for the cost of administering and terminating the plan. The court granted the motion. Once the trustee completed that task, trustee moved for approval of his fees and those of his counsel for services rendered in connection with termination of the plan. The Department of Labor challenged the jurisdiction of the bankruptcy court to decide the motion. The court ruled in favor of the trustee. *In re Franchi Equipment Co., Inc.*, 452 B.R. 352 (Bankr. D. Mass. 2011). Judge Hoffman noted that § 704(a)(11) required the trustee to perform the obligations required of the administrator of an employee benefit plan where the debtor had previously served as the administrator. The "Code and Rules provide no further directives as to how to meld the trustee's bankruptcy and ERISA responsibilities." Here, the court held that the court had core jurisdiction over the award of fees to a Chapter 7 trustee and his professionals in connection with performing, or assisting the trustee in performing, duties under § 704(a)(11). The court concluded that "trustees literally 'arise under' the Bankruptcy Code. Their oversight an

compensation are, without significant exception, within the core federal bankruptcy power delegated to the bankruptcy court.”

133. Post-petition ERISA Withdrawal Liability is an Administrative Expense

The Third Circuit held that Employee Retirement Income Security Act (“ERISA”) withdrawal liability attributable to time post-petition constitutes an administrative expense entitled to priority. *In re Marcal Paper Mills, Inc.*, 650 F.3d 311 (3d Cir. 2011).

Debtor participated in a pension fund for the benefit of its union truck drivers. Debtor filed for relief under chapter 11 and eventually sold its assets to a company that ceased to employ the union drivers. So the union pension fund determined that the debtor had made a “complete withdrawal” from the pension fund under ERISA and assessed the debtor with almost \$6 million in total withdrawal liability. The pension fund moved for allowance of an administrative claim in that amount. Debtor objected to the claim’s classification of withdrawal liability as an administrative expense and moved to reclassify it as a general unsecured claim. The pension fund, therefore, altered its claim and only sought administrative priority for the portion of the withdrawal liability attributable to post-petition services provided by the union employees.

The court considered §503(b)(1)(A), defining administrative expenses as “the actual, necessary costs and expenses of preserving the estate including . . . wages, salaries, and commissions for services rendered after the commencement of the case.” The court stated that an administrative expense must (a) arise from a post-petition transaction with the debtor-in-possession; (b) be beneficial in the operation of the business and (c) be actual and necessary.

Next, the court noted that the purpose of withdrawal liability was to ensure that employers could not avoid their obligation to provide a promised benefit by withdrawing from a plan. In addition, the court considered that withdrawal liability is calculated by first determining the shortfall between plan assets and benefits the plan owes and then withdrawing the employer’s share by calculating the proportionate share owed to the employees based on the employer’s contribution share over the prior five years.

The court concluded that the union employees were required to continue to work post-petition to keep the debtor in operation, which conferred a benefit on the estate. The portion of the withdrawal liability that corresponded to the post-petition work was owed by the purchaser of the debtor’s assets who assumed the promise to provide pension benefits in exchange for necessary work when it purchased the debtor’s assets. [*Editor’s Note:* This case highlights yet another potential trap for a chapter 11 trustee. Consider withdrawal liability carefully if operating a debtor subject to an ERISA pension fund plan.]

S. COMPENSATION/SURCHARGE

134. Commission base excludes funds distributed to co-owner of property sold by trustee

The trustee sold property that was owned by debtor and his non-debtor spouse. Trustee applied for the statutory commission including for a calculation based on the amounts distributed both to the spouse and the bankruptcy estate. The bankruptcy court disallowed the portion distributed to the non-debtor spouse. *In re Eidson*, 481 B.R. 380 (Bankr. E.D. Va. 2012). Trustee had argued that the distribution to the spouse was a distribution to a party in interest and therefore includable in the commission base. The court disagreed. Judge Kenney looked to §

363(j) governing sales of co-owned property which required distribution to the non-debtor co-owner of his or her interest in the proceeds with no deduction for compensation to the trustee. Finding that provision to be the more specific statute, the court held that it would control over the more general statute of § 326(a). [*Author's Comment:* The court misconstrues § 363(j), which has no bearing on the commission amount, only the source of its payment.]

135. Trustee's commission base includes distributions to ERISA plan participants

Trustee will have disbursed a total of \$9,560,215.70 in ERISA Plan assets, building a statutory commission, based on § 326(a) of \$310,056.47. Trustee sought \$177,678.24 as the commission compensation. The Department of Labor objected to the court's jurisdiction, to pay any compensation on a statutory basis under § 326(a), and having such an award paid out of the Plan's assets as opposed to the bankruptcy estate. The court ruled in favor of the trustee. *In re The Robert Plan Corp., et al.*, 2012 WL 3597564, 2012 Bankr. LEXIS 3838 (Bankr. E.D. N.Y. 2012). Judge Grossman first disagreed with the Department of Labor that ERISA controlled. Instead, he found that the trustee's responsibility for the ERISA Plan was contained in the Bankruptcy Code and not in ERISA. Moreover, ERISA contained no requirement that an ERISA plan fiduciary such as the trustee even obtain court approval prior to receiving compensation for administering the plan. The DOL took the position that the trustee was improperly setting "his own fees." However, the court found that not to be the case because the trustee did not have the authority to do so under the Bankruptcy Code and was merely complying with the applicable Bankruptcy Code and rules in making an application to the court to approve his compensation and that of his professionals. It is that very process that enabled the DOL to have an opportunity to participate in determining reasonable compensation for the trustee before the trustee had taken any money for the services. "By applying the Bankruptcy Code over the ERISA statutes, the Court is in effect adding a layer of review to a process that is otherwise absent of judicial review." The court noted that Congress could have included a different compensation scheme for Chapter 7 trustees performing the duties set forth in § 704(a)(11), but the fact it did not do so, led the court to conclude that Congress intended to compensate Chapter 7 trustees in the same way they were compensated for all other work under the Bankruptcy Code. Accordingly, the requested commission was approved. The DOL has filed a notice of appeal.

136. Trustee entitled to statutory commission

The U.S. Bankruptcy Appellate Panel for the 9th Circuit in *In re Salgado-Nava* Id-11-1389-MkHJu (9th Cir. BAP 2012) reversed the decision of the Bankruptcy Court and entered judgment for the trustee stating that absent extraordinary circumstances, the trustee is entitled to the commission listed in 11 U.S.C. § 326.

The case trustee had originally found that the debtor's case was a no-asset case but sent a routine notice to the taxing authorities advising them of the debtor's bankruptcy and asking them to turn over any tax refunds. In this case, trustee recovered a significant refund and reopened the estate and filed a final report in which he proposed to make a significant distribution to creditors. As part of his final report, he filed a detailed trustee's fee application and sought the full commission, \$1,315.41. The Bankruptcy Judge cut it to \$750.00 concluding that absent extraordinary circumstances, a trustee should never receive the full commission. In addition, the Bankruptcy Court noted the trustee had earned a lot of commissions that year anyway. Trustee appealed and the NABT and the U.S. Trustee filed *amici* briefs in support and participated in the

oral argument.

11 U.S.C. § 330(a)(7) states: In determining the amount of reasonable compensation to be awarded to a trustee (the dependent clause), the court shall treat such compensation as a commission, based on section 326 (the independent clause). The Bankruptcy Appellate Panel first concluded that § 330(a)(7) was a sea change in the law. The percentages were no longer to be treated as a cap, but instead a "commission" as that word is commonly understood. However, the Court concluded that the independent commission clause does not stand alone. The introductory dependent clause states: "In determining the amount of reasonable compensation to be awarded to the trustee...." The Bankruptcy Appellate Panel felt that this dependent clause also has meaning as well. In refining this meaning, the Court noted that Chapter 7 trustees are no longer required to satisfy the *Johnson* factors found in 11 U.S.C. § 330(a)(3). The Court then attempted to harmonize the "reasonableness" required of the dependent clause with the commission standard of the independent clause that follows it. The Court determined that there must be a rational relationship between the commission and the work performed. Therefore, the Court concluded that absent absurd or other extraordinary circumstances, the statutory commission rate is presumptively reasonable.

As an added bonus to the trustee, the Court did not remand this matter to the Bankruptcy Court. It found the trustee established a *prima facie* entitlement to the full commission and entered judgment in his favor.

137. Trustee paid on "constructive disbursement" theory

The trustee was appointed in the Chapter 11 case at the request of the petitioning creditors based on civil and criminal investigations by the SEC and the State of Arizona. The trustee successfully confirmed a reorganization plan in which the trustee did not make distributions in a monetary sense but did distribute property interests valued at almost \$200 million dollars. The trustee sought compensation based only on his actual time of 307.6 hours at his \$475 hourly rate resulting in an application of \$176,035. Objections were filed to the trustee's application by 275 investors. The court determined that the application was reasonable based on the lodestar but still had to address the commission cap in § 326 that limits compensation to "all monies disbursed or turned over in the case by the trustee to parties in interest." The court awards the compensation on a constructive disbursement basis. *In re Radical Bunny, LLC*, 459 B.R. 434 (Bankr. D. Ariz. 2011). Judge Case traces the history of § 326 back to section 48 of the Bankruptcy Act and finds that the phrase "all monies disbursed or turned over" has been part of the Bankruptcy Act and Code since 1910. He then traces cases since that time to the present. He notes an interesting split in authority on awards to trustees based on *quantum meruit* but finds that he lacks the authority to make such an award on that basis in the Ninth Circuit. However, he does find support for a constructive disbursement theory. In particular he notes that under § 704(a)(1), the job of a Chapter 7 trustee is to monetize all assets for payment to creditors; whereas, there is no such directive for a Chapter 11 trustee whose job is to operate the business and confirm a plan of reorganization using as many of the tools in § 1123 as may be appropriate to achieve the desired result under § 1129. In so holding, the court notes that prior to the adoption of § 330(a)(7), the percentage formula was well understood to be a cap on a trustee's compensation. "However, the use of the word 'commission' in that section strongly suggests, at least in Chapter 7 cases, a presumption entitlement to [the] amount so calculated, rather than simply a cap." Although the "constructive disbursement" analysis would produce a fee cap far in

excess of the amount being sought, so the court had no problem awarding the trustee the requested amount based on the lodestar approach.

138. Credit bid not part of commission calculation

Secured creditors purchased the debtor's condominium development from the Chapter 7 trustee with a credit bid totaling \$1.5 million as authorized by § 363(k). When the trustee submitted his final report in the case, he represented that his disbursements totaled \$2.72 million, an amount which included the \$1.5 million credit bid. The trustee requested the maximum compensation under § 326(a). The U.S. Trustee objected to inclusion of the credit bid amount, contending that "moneys disbursed" for purposes of § 326(a) do not include the credit bid amount. The bankruptcy court ruled in the Chapter 7 trustee's favor. The Ninth U.S. Circuit Bankruptcy Appellate Panel reversed and remanded. *U.S. Trustee v. Tann (In re Hokulani Square, Inc.)*, 460 B.R. 763 (9th Cir. BAP 2011). The BAP applied the plain meaning of the term "moneys disbursed" and held it could not include credit bids. The trustee tried to get around this problem by conveying title to the secured creditors as nominee entities, but the BAP found that approach to be "disingenuous." The BAP recognized that the trustee may have done an excellent job, but nevertheless held that any judicial attempt to equitably relax the § 326(a) cap would undermine congressional intent.

139. Debtors' counsel ordered to disgorge his fees paid to him from debtor's tax refund

Here, the issue was whether an attorney representing a Chapter 7 debtor who took a pre-petition security interest in a future federal tax refund received after the bankruptcy filing may enforce the security agreement. The attorney had his debtor client sign a promissory note and security agreement pledging an interest in their 2010 tax refund to secure payment of outstanding attorney fees. Those documents were signed on January 28, 2011. At 8:00 a.m. on January 31, 2011, counsel filed a U.C.C. Financing Statement and filed the bankruptcy petition later that day. A 2010 tax refund was listed in Schedule B, but the Rule 2016 Disclosure did not reference the arrangement or mention the tax refund at all. Nor was there any reference to the security agreement or transfer in response to Questions 9 and 10 of the SOFA. The trustee sought turnover of the tax refund against both the debtors and their counsel, which was granted by the court. *In re Alfieri*, 468 B.R. 414 (Bankr. M.D. Fla. 2011). Judge Jennemann first noted that nothing in the Bankruptcy Code or Florida law directly precluded attorneys from entering into an agreement to secure their fees with debtors' property interest. Here, however, nothing in the record established compliance with the high standards of the Florida Bar rules in entering into security agreements with clients nor were the disclosure requirements of the Bankruptcy Code and rules met. Accordingly, on these facts, counsel was ordered to immediately disgorge the fees he had collected from the tax refund and debtors were ordered to disgorge the portion of the tax refund they retained as well.

140. Willingness to accept retainer does not obviate need for a fee application

A Tampa-based attorney served as Chapter 11 debtors' counsel in a number of cases. The U.S. Trustee discovered that the attorney had failed to file fee applications in numerous Chapter 11 cases in which he sought no fees in excess of the pre-petition retainer received. Some

of these cases had been confirmed, some converted, some dismissed, and in one, a Chapter 11 trustee had been appointed. In the instant proceeding, the U.S. Trustee sought an order requiring the attorney to file applications for compensation for fees and reimbursement of expenses in all of these cases. The attorney believed that his willingness to accept the retainer amount in full satisfaction of fees incurred eliminated the need to file these applications, particularly since he contended that the fees in each case were far greater than the retainer received. The attorney also contended that his practice was consistent with an informal local practice that had evolved among the local bar. The court granted the relief sought by the U.S. Trustee, refusing to condone a “no harm, no foul” approach to compliance with the statutory and rule-based scheme for determination of fees in Chapter 11 cases. *In re Ford*, 446 B.R. 550 (Bankr. M.D. Fla. 2011).

Judge Williamson held: “The court cannot assume that the retainer amount will always be less than the reasonable value of the services rendered in a Chapter 11 case. Rather, a professional employed to represent the debtor-in-possession in a Chapter 11 may be awarded compensation for services rendered in a case under title 11 only after notice and a hearing. This includes any amounts received as a retainer for the services. Without the professional filing a fee application, the notice and hearing requirement outlined above cannot be met. Importantly, without such compliance, the United States Trustee cannot perform his statutory obligation to review applications filed for compensation under § 330. And the Court cannot conduct its own independent review of a professional’s fees and services. These are all prerequisites for a professional to obtain compensation in a bankruptcy case.”

141. Attorney sanctioned for routinely seeking to have clients pay filing fee in installments

Even though counsel had her clients pay her in full for the filing fee, she would routinely ask the court to permit the filing fee to be paid in installments, thereby providing her with interest-free loans. The attorney was suspended from practice in the bankruptcy court for 45 days and fined \$10,000. “Not only was the allegation that the client was unable to pay the filing fee except in installments false, ... but Simmons filed the application electronically with the representation that her clients had signed it when in fact they had not, and knew nothing of it.” The court found this to be a violation of Rule 9011(b)(3) because she falsely swore that her clients could not afford to pay the filing fee in full. Judge Jaroslovsky noted that counsel’s fees were lower than the average fees for her services, but found that was counter-balanced by her general lack of ability. *In re Simmons*, 2011 WL 3957439 (Bankr. N.D. Cal. 2011).

142. Objection to trustee surcharges overruled

Over debtor’s possible objection, a Chapter 11 trustee was appointed by order of the court that also provided that all creditors secured by assets to be sold by the trustee had agreed that “the fees of the trustee and expenses of sale can be surcharged against the first proceeds of each sale.” The order was not appealed. Thereafter, the trustee moved to sell real estate free and clear with the taxes being paid from the sale proceeds. The court entered an order authorizing the trustee to surcharge the sale proceeds for payment of taxes. The order was not appealed. When the trustee moved for authority to distribute the proceeds, debtor’s counsel moved to vacate portions of the prior orders as being entered through mistake and inadvertence because counsel was not aware that there would be insufficient funds to pay his fees and other administrative expenses in full. The court denied the motion for reconsideration. Appeal was taken to the 8th

Circuit BAP, which affirmed. *In re Burival Richard, et al.*, 449 B.R. 371 (8th Cir. 2011). The BAP found that this was not a case of mistake, inadvertence, or excusable neglect under F.R.C.P. 60(b)(1) or any other subsection of that rule. The trustee had repeatedly requested the surcharge, which showed his obvious concern about the administrative insolvency of the case. This was not an instance where parties in interest were misled by the trustee and there was no basis to set aside the prior approved surcharges.

143. Florida Condominium Act preempted by § 506(c)

The debtor was a Florida condominium association with 232 residential units, almost all of which were encumbered by first mortgages and many by second mortgages. The average first mortgage debt was \$218,000 while the average value of a unit was only \$48,000. Hence, every second mortgage and all assessment liens were completely unsecured. The debtor was obligated to maintain the common elements which it would attempt to fund through assessment liens. At the time of the Chapter 11 confirmation hearing, more than 100 mortgage foreclosure proceedings were instituted by various first mortgagees and had been pending for an average of 736 days. During that time, the lenders had not paid assessments but the debtor had continued to incur the cost of maintaining the common elements since the petition date. Pursuant to its confirmed plan, the debtor moved to surcharge the collateral of numerous first mortgagees. The sole mortgagee who responded relied upon the Florida's Condominium Act, which shields the holder of a first mortgage on a condominium from paying assessments until the mortgagee takes title to the condominium. Judge Hyman granted the debtor's motion with respect to the objecting lienholder, finding that § 506(c) preempted the Condominium Act, and that the requirements of §506(c) were satisfied. *In re Spa at Sunset Isles Condominium Association, Inc.*, 454 B.R. 898 (Bankr. S.D. Fla. 2011).

144. Surcharge imposed for broker's fee even though sale does not close

The Chapter 11 debtors' real estate agent produced a cash buyer for the property at \$800,000. This would have entitled the broker to a \$48,000 real estate commission based on its 6% commission. However, the sale did not close because the bank credit bid for the property at \$1.75 million. Nevertheless, the court granted a surcharge against the property in favor of the broker for \$48,000. *In re A-1 Plank & Scaffold Mfg., Inc.*, 437 B.R. 689 (Bankr. D. Kan. 2010). Judge Nugent noted that the broker's commission agreement specified that he would receive a commission on "any sale or exchange of the property which closes." Here, the broker procured a ready, willing, and able buyer who did not close due to circumstances beyond its control because of the credit bid of the bank. The court found that the broker aided in the disposition of the property by marketing the property and supplying a cash bidder. Moreover, the bank had avoided the costs and expenses of marketing the property itself, as well as the risk that it might have to hold the property for a lengthy period without being able to sell it for a favorable price. Further, the bank was in negotiations with the cash bidder to sell it the property and all the equipment therein for \$1.975 million. Accordingly, the court ordered the surcharge to be assessed against the property prior to its conveyance to the bank. The court finally noted that "professionals would be discouraged from providing services to debtors or trustees if their fees could be circumvented by credit bidding."

T. IFP WAIVERS (28 U.S.C. § 1930(f))

145. Reasons for denial of IFP waiver articulated

The bankruptcy court had denied the debtor's application to waive the filing fee, but allowed her to pay it in installments. After making two of the installments, the pro se debtor wrote a letter to the court asking why her fee waiver application had been denied. The court took the opportunity to explain its reasoning. Judge Halfenger noted that § 1930(f)(1) provided that the bankruptcy court "may waive the filing fee." Therefore, it was a discretionary decision of the court and not mandatory. Even so, there were two prongs to the waiver analysis. The first was if the debtor's income was below 150% of the applicable poverty guideline. The second prong, less often seen articulated, was that the debtor must still demonstrate that she is "unable to pay that fee in installments." The court stated that its analysis included whether the debtor had collateral sources of income, such as from family and friends, excessive or unreasonable expenses, whether an attorney or petition preparer was being paid, whether the debtor had property such as tax refunds from which the fee could be paid, and whether there were any extraordinary circumstances. The court explained that a waiver resulted in the case trustee having to administer a no-asset estate for free, which was a substantial disincentive to serve as a trustee and a threat to the ability of the bankruptcy court to provide Chapter 7 debtors with the discharges they seek. "Those desiring a fee waiver must show they face special circumstances establishing that a bankruptcy discharge will afford them out-of-the-ordinary benefits." The court concluded that debtor did not carry her burden of showing she was unable to pay the filing fee in installments despite her financial difficulties and was, therefore, not entitled to a fee waiver. *In re Williams*, 2013 Bankr. LEXIS 1610 (Bankr. E.D. Wis. April 17, 2013)(Halfenger, J). [Author's Comment: another excellent opinion on fee waivers is *In re Brooks*, 475 B.R. 343 (Bankr. W.D. N.Y. 2012) (Bucki, J.).

146. Application to waive filing fee is denied

Along with filing her Chapter 7 petition, debtor filed her application for waiver of the \$306 filing fee on the basis that her income was less than 150% of the official poverty line. The bankruptcy court denied the waiver application. *In re Brooks*, 475 B.R. 343 (Bankr. W.D. N.Y. 2012). Judge Bucki held that debtor was unable to meet the second prong of the waiver statute, i.e., that she could not pay the filing fee even in installments. This conclusion was reached on the basis that debtor was entitled to a tax refund of \$9,046, against which she had obtained a tax refund anticipation loan of \$8,600. The court noted that the \$446 fee for the loan was in itself more than enough to have paid the filing fee. Moreover, the court noted that granting a fee waiver was permissive, not mandatory, and the court would not exercise its discretion to grant a filing fee waiver to a debtor who filed for Chapter 7 relief only days after learning about her entitlement to tax refunds totaling approximately 90% of the unsecured debts listed on her bankruptcy petition.

U. MISCELLANEOUS

147. Fourth Circuit permits "Chapter 20" lien-stripping

The debtors in two separate Chapter 13 cases, who previously had received discharges in

Chapter 7 cases, proposed Chapter 13 plans in which junior liens on their principal residences would be "stripped off." The bankruptcy court in each of the cases entered an order confirming the plan, and an appeal was taken to the district court, which consolidated the cases and affirmed. The trustee appealed, arguing that BAPCPA created a per se rule barring lien-stripping in a so-called Chapter 20 case, being cases filed within four years of a Chapter 7 bankruptcy that concluded with a discharge. The Fourth Circuit summarized the issue as follows: "The question presented is whether BAPCPA precludes the stripping off of valueless liens by Chapter 20 debtors ineligible for a discharge." After noting that bankruptcy courts were split on the question, the Fourth Circuit also affirmed in its own divided opinion. *In re Davis*, 2013 U.S. App. Lexis 9535, 2013 WL 1926407 (4th Cir. 2013). The majority opinion agreed with the debtors that a Chapter 13 debtor need not be eligible for a discharge in order to take advantage of the protections afforded by that chapter. "Therefore, if the Bankruptcy Code provides a mechanism for stripping off worthless liens absent a discharge, a debtor may avail himself of that relief." The majority opinion found that under § 506(a), an entirely valueless or worthless junior lien was not an "allowed secured claim." The majority held that Congress intended to leave intact the normal Chapter 13 lien-stripping regime where a debtor could otherwise satisfy the requirements for filing a Chapter 20 case. The court further found that a per se rule against lien-stripping was not necessary to prevent abuse of the bankruptcy process given that courts were bound to confirm only plans filed in good faith. The dissent maintained that it was wrong to apply § 506(a) because the allowed claim of the junior lienholder was certainly secured. The dissent reasoned that the majority had "turn[ed] on its head the basic bankruptcy principle that secured creditors are treated more favorably than unsecured creditors."

148. Wholly unsecured lien "stripped off" in Chapter 7

Chapter 7 debtor valued her home at \$141,416 subject to a first mortgage of \$176,413 and a second mortgage of \$44,444. She sought to avoid the second mortgage as wholly unsecured, but the bankruptcy court denied her motion on the basis that § 506(d) did not permit the "strip off" of a wholly unsecured lien. The district court affirmed. On appeal, the 11th Circuit reversed and remanded in an unpublished opinion. *McNeal v. GMAC Mortgage, LLC, et al. (In re McNeal)*, 2012 WL 1649853, 2012 U.S. App. LEXIS 9589. The Circuit Court followed its 1989 decision, *Folendore v. U.S. Small Bus. Admin.*, 862 F. 2d 1537 (11th Cir. 1989), which held that § 506(d) did provide for the "strip down" of a wholly unsecured lien, whereas the U.S. Supreme Court in *Dewsmup v. Timm*, 502 U.S. 410 (1992), held that "strip down" was not permitted on partially secured liens. A petition for rehearing *en banc* has been filed. [*Editor's Note: This case is important for trustees attempting to overcome objections by wholly unsecured lienholders to a trustee's sale of property under §§ 363(b) and (f).*] *Contra, In re Woolsey*, 696 F.3d 1266 (10th Cir. 2012); *Wachovia Mtg. v. Smoot*, 478 B.R. 555 (E.D.N.Y. 2012).

149. The WARN Act loses some power

Simply put, the WARN Act requires certain employer to give employees 60 days' notice of plant closings or large layoffs. If the employer fails to do so, the employee can sue for damages. One exception to the WARN Act's provisions is what is known as the "faltering company" exception which applies if the shutdown was due to "unforeseen business circumstances."

Flexible Flyer was already experiencing financial trouble when it was hit with a product recall. Soon after, its lending dried up. This led to filing of bankruptcy. The Fifth Circuit held that the debtor did not have WARN Act liability because the layoffs were caused by the unexpected and dramatic actions of its lenders. *In re Flexible Flyer Liquidating Trust* (5th Cir. Feb. 11, 2013). The court rejected the argument that the product recall should have put the debtor on notice that the end was near and rejected the argument that the lenders' actions were not all that surprising given that the parties already and engaged in workout negotiations. The Fifth Circuit also considered the fact that the debtor appeared to have acted in good faith and acting on a not unreasonable belief that the closings would not have to occur.

150. Objections to motion for default judgments overruled

Trustee filed a lawsuit against several defendants. The deadline to file an answer expired without a response from any of them. The clerk entered default. Trustee then obtained a second summons and re-served at different addresses several of the defendants. Again, the deadline expired with no response. The trustee filed a motion for default judgments and served all defendants at all addresses previously utilized. No timely response was filed. After the deadline, an objection was filed by several defendants. The court overruled the objections and entered the default judgments. *Messer v. GMR, LLC, et al. (In re F3, LLC)*, 2013 WL 1003383, 2013 Bankr. LEXIS 979 (Bankr. S.D. N.Y. 2013). The court followed the precedent set in *Enron Oil Corp. v. Diakuhara*, 10 F.3d 90 (2d Cir. 1993), for finding good cause to set aside entry of the default through a three factor test for determining the existence of good cause: (1) was the default willful; (2) would setting aside default prejudice the adversary; and (3) was a meritorious defense presented. Here, the court found that the defendants did not satisfy their burden of establishing good cause. The court first found that for a willful default to have occurred, service must have been proper. Here, the trustee proffered evidence that created a presumption that proper mail service was received by all defendants. Defendants failed to revoke that presumption, making only conclusory denials of receipt of service or speculating why they did not receive it. The court further found that the defendants' failure to file responsive pleadings amounted to a willful default – a strategic decision on the defendants' part. The court also found that the trustee had adequately stated the prejudicial consequences that would result from the defendants' measures to frustrate recovery in the lawsuit. The trustee alleged that the defendants owed \$1.5 million, plus interest accruing at 20% per annum, and that the delay due to the defendants' failure to respond increased the risk that the trustee would not be able to recover. Finally, the court noted that the defaulting parties had failed to present a meritorious defense.

151. District court had to take trustee's allegations as true and trustee's inconsistent pleadings proper, but *in pari delicto* defense state law issue that could apply to trustee

Trustee for a group of mutual funds brought action against the funds' auditor, arguing that the auditor was negligent in failing to discover that the funds were investing in a business without customers and were, in fact, investing a Ponzi scheme. The United States District Court for the Northern District of Illinois dismissed the action against the auditors and the trustee appealed. *Peterson v. McGladrey & Pullen, LLP*, 2012 U.S. App. LEXIS 6608 (7th Cir. 2012).

The district court dismissed the complaint without determining whether the auditor had done its task competently, based on the doctrine of *in pari delicto*. The district court concluded

that the funds' manager knew about the scheme and that, therefore, the trustee stepped into the shoes of the funds and could not assert the claims against the auditor. But the Seventh Circuit reversed, holding that the district court could not assume that the manager knew about the scheme on a motion to dismiss. The trustee's suit related to audits in 2006 and 2007 and alleged that the manager knew about the scheme in 2008 and 2009, when he pled guilty to wire fraud. The district court had to accept the Trustee's allegations. In a separate lawsuit, the trustee alleged that the manager committed fraud during 2006 and 2007, but the Seventh Circuit noted that there is no rule against inconsistent pleadings in different suits. The Seventh Circuit refused, however, to hold that *in pari delicto* does not apply to bankruptcy trustees. State law provides for an *in pari delicto* defense and the trustee and NABT, who filed an amicus brief on the subject, could not point to a provision of the Code overriding state-law limits on the claims against the auditors. Therefore, the Seventh Circuit vacated the district court's judgment and remanded.

152. Trustee stepped into shoes of debtor so that banks could assert *in pari delicto*

In pari delicto prevents a party from suing another for a wrong where that party participated in the wrong. This case involved an Italian dairy company that collapsed after discovering a massive internal fraud, involving the understating of debt and overstating of assets. A wholly owned subsidiary of that company sought damages for the accountants and banks for their alleged roles in the scheme. The subsidiary argued that *in pari delicto* was not available against it because it was now controlled by the trustee rather than corrupt insiders. The Second Circuit explained that, under North Carolina law, there was no exception for the *in pari delicto* defense for the Trustee, who steps into the shoes of a debtor. Therefore, the Court held that the *in pari delicto* doctrine was available against the subsidiary and barred the claims against the bank. Although the subsidiary attempted to argue that they had abandoned the dairy company, the Court held that it did not bring forth admissible evidence to show abandonment as a defense to *in pari delicto*. *Parmalat Capital Finance Ltd. v. Bank of America*, 412 Fed. Appx. 325 (2d Cir. 2011).

153. Loss allocated between defrauded parties

The parties retained Marc Dreier as their counsel to collect monies from the defendant. Dreier negotiated a \$6.3 million settlement. After forging his clients' signatures to a revised settlement agreement, he obtained the settlement funds and comingled them with the proceeds of his Ponzi scheme. Dreier never paid the plaintiffs the settlement monies. In Dreier's Chapter 11 case, plaintiffs sued the defendant and the trustee seeking declaratory and other relief regarding the validity of the settlement. The court granted the defendant's motion for summary judgment. *Gardi, et al. v. JANA Partners, LLC, et al. (In re Dreier LLP*, 450 B.R. 452 (Bankr. S.D.N.Y. 2011). Judge Bernstein found that both sides were victims of Dreier's forgery and fraud. It was not an issue of apparent authority to settle because he did not sign his own name, but rather that of his clients, a clear case of forgery. Although the parties were duped, agency law dictated as between two innocent parties, the risk of loss from the unauthorized acts of a dishonest agent fell on the principal that selected the agent. Here, the defendant was justified in believing that the version of the settlement agreement that it received from Dreier contained the plaintiffs' signature. Since the plaintiffs had retained Dreier, the loss had to be borne by plaintiffs.

154. Judge orders trustee to sell debtor's condo

The Nashville debtor's condo was severely damaged in a "1,000-year flood." She moved out of the condo and filed bankruptcy proposing to surrender the condo to her mortgage holder. She received a discharge in January 2011. However, the lender, despite changing the locks and posting a no-trespassing notice, did not foreclose and would not accept a deed in lieu of foreclosure. Under § 523(a)(16), the unpaid post-petition HOA fees were nondischargeable, thereby prejudicing the debtor's fresh start. The court determined to fashion its own remedy for the benefit of all parties under its authority in § 105(a). *Pigg v. BAC Home Loans Servicing, et al. (In re Pigg)*, 453 B.R. 728 (Bankr. M.D. Tenn. 2011). Judge Paine determined to temporarily set aside the debtor's discharge, reappoint the trustee, and order him to sell the property pursuant to § 363. "The bank will receive whatever it would have received had it foreclosed upon the property, but will not have any continuing interest in the property unless the bank so chooses." The HOA's claim was to be paid as a first priority claim after the trustee's administrative costs. The debtor would be relieved of any further interest in the flooded property and truly receive a fresh start. "The HOA, bank, and the debtor all receive benefit from the trustee's sale of the property." Finally, the court directed that after the sale and disbursement of the proceeds, the debtor's discharge would be reinstated and the trustee discharged.

155. Ninth Circuit reverses course and holds that courts can recharacterize debt as equity

In 1986, a Ninth Circuit BAP opinion held that bankruptcy courts could not recharacterize purported debt as equity other than as expressly allowed under §510. *In re Pacific Express, Inc.*, 69 B.R. 112 (B.A.P. 9th Cir. 1986). *Fitness Holdings* did away with the *Pacific Express* rule and holds that a bankruptcy court may recharacterize debt as equity to the extent allowed under state law. *In re Fitness Holdings International, Inc.*, 2013 WL 1800000 (9th Cir. Apr. 30, 2013).

Fitness Holdings involved a complaint filed by the unsecured creditors' committee to recover, as fraudulent transfers, payments made on a promissory note and to characterize certain financing provided by the defendant as equity investments rather than loans. In addressing the reasonably equivalent value prong of §548, the court held that a transfer is not constructively fraudulent, "to the extent the transfer constitutes repayment of the debtor's antecedent or present debt." Consequently, if the transfer is made to satisfy a "right to payment," then the transfer is made for reasonably equivalent value. The issue in *Fitness Holdings* was whether the loan payment should be considered a "right to payment" under state law and the Ninth Circuit affirmatively rejected the holding in *Pacific Express* and held that a bankruptcy court has the authority to recharacterize purported debt as equity under state law.

156. Debt converted to equity

A non-insider "creditor" had "loaned" money to the debtor company for \$200,000 and then \$150,000 to be repaid from royalties and "equity placements." There was no specified interest rate, term of repayment, or maturity date. Two years later, the debtor company filed for Chapter 11 and confirmed a liquidating plan. The bankruptcy court had sustained the trustee's objection to these claims, holding that they actually asserted common equity interests at best and that insufficient evidence of the value of those interests was presented. The district court

reversed, applying a *per se* rule that recharacterization could only apply to insiders. The district court cited the 11-factor test for distinguishing between debt and equity set out in *Jones v. United States*, 659 F.2d 618 (5th Cir. 1981), but did not apply those factors because it perceived the rule to prohibit recharacterization for non-insiders. The Fifth Circuit reversed. *Grossman v. Lothian Oil, Inc., et al. (In re Lothian Oil, Inc.)*, 650 F.3d 539 (5th Cir. 2011). The circuit court recognized that four other circuits had approved recharacterization grounded in the bankruptcy court's equitable authority under § 105(a). *In re Submicron Systems Corp.*, 432 F.3d 448 (3d Cir. 2006), *In re Dornier Aviation, Inc.*, 453 F.3d 225 (4th Cir. 2006), *In re Hedged Investment Associates*, 380 F.3d 1292 (10th Cir. 2004); and *In re Autostyle Plastics, Inc.*, 269 F.3d 726 (6th Cir. 2001). The Fifth Circuit determined that *Butner v. United States*, 440 U.S. 48 (1979) and § 502(b)(1) supported the bankruptcy court's authority to recharacterize claims without resort to § 105(a). The circuit court noted that the bankruptcy court had properly applied the multi-factor test imported from federal tax law to distinguish between debt and equity and had considered the factors listed in *Jones*. Accordingly, the circuit court determined that the bankruptcy court did not err in recharacterizing the claims as equity. [Author's Note: This is important to trustees because without recharacterization there might not be any cause of action for a loan repayment outside of the preference period. However, if payments are made to equity interests rather than on antecedent debt, fraudulent transfer actions can be utilized. Additionally, in certain circumstances, it can reduce the ability of an alleged creditor to credit bid.]

157. Blog posts critical of trustee held not libelous

A financial advisory firm and its senior principal had been appointed the trustee in the bankruptcy case of a third party. A self-proclaimed “investigative blogger” began blogging about the trustee under the heading “**Bankruptcy Corruption – Trustee Corruption Blog by Investigative Blogger [name].**” In the blog postings made by the blogger over a two-month period, the blogger called the firm's principal, *inter alia*, a liar, a criminal, a thief, a thug, and “the Crookedest Lawyer ever” and accused him of corruption, fraud, deceit, conflicts of interest, money laundering, defamation, harassment, and more. Some of the entries also questioned whether he had hired a hit-man to kill the blogger. The trustee brought a defamation action under Oregon law, asserting that the statements made by the blogger on two websites were false and caused reputational damage. The District Court determined that blogs were a subspecies of online speech which inherently suggested that statements made thereon were not likely provable assertions of fact. A “blog,” the Court noted, is a frequently updated website consisting of personal observations, excerpts from other sources, or, more generally, an online journal or diary. Moreover, a reader of the statements would be predisposed to view them with a certain amount of skepticism and with an understanding that they would likely present one-sided viewpoints rather than assertions of provable facts. Consequently, summary judgment was granted to the defendant. However, as to statements made on a separate site, summary judgment was denied as several statements contained or implied assertions of fact. *Obsidian Finance Group, LLC v. Cox*, 2011 WL 3734457 (D. Or. 2011).

158. Same sex married couples may file a joint bankruptcy petition

The debtors were legally married in Vermont and later filed a joint chapter 7 petition as married debtors. The United States Trustee (UST) moved to dismiss the case pursuant to § 707(a) as an “improper joint petition.” *In re Somers*, 488 B.R. 677 (Bankr. S.D.N.Y. 2011).

Judge Morris analyzed §707(a), under which there are three enumerated grounds for cause to dismiss a case. The UST argued that the filing of an “improper joint petition” also constituted “cause” for dismissal. The court examined §302(a) of the Bankruptcy Code, permitting “the filing with the bankruptcy court of a single petition . . . by an individual that may be a debtor under such chapter and such individual's spouse.” The UST argued that the debtors were not “spouses” because DOMA defines the term “spouse” to be “a person of opposite sex who is a husband or a wife.”

The court held that the debtors, a legally-married couple, could file a joint petition but for the DOMA. The court noted that the constitutionality of DOMA had been questioned in other cases, but declined to address its constitutionality. However, the court found that DOMA did not remove the duty on the court to find “cause” to dismiss a case.

When dismissal of a case is not premised upon one of the enumerated reasons in § 707(a), the Second Circuit requires a case-by-case analysis of “whether dismissal would be in the best interest of all parties in interest.” Dismissal was not shown to be in the best interests of all parties. Dismissal would result in increased administrative costs and duplicative work for the UST, the court, and the debtors. So the bankruptcy court found insufficient cause to dismiss.

159. Executory contract had not terminated prior to bankruptcy and so it could be assumed by the trustee.

Trustee for a coal mining company moved to extend the time within which to assume or reject an operating agreement. The other party to the agreement (COP) argued that there was no operating agreement to assume because the debtor had not cured its defaults prepetition, so the agreement automatically terminated. The bankruptcy court granted the trustee’s motion. COP appealed to the BAP, which affirmed. COP appealed to the Tenth Circuit Court of Appeals. *C.O.P. Coal Dev. Co. v. C.W. Mining Co. (In re C.W. Mining Co.)*, 641 F.3d 1235 (10th Cir. 2011).

11The bankruptcy court had determined that the agreement had not automatically terminated and, thus the trustee could assume it. The Tenth Circuit agreed that the agreement did not provide for automatic termination. COP would have had to take an additional step and exercise its discretionary authority to terminate the agreement after a 60-day notice period had expired in order to effect termination. By the time the 60-day notice period had run, the involuntary bankruptcy had been filed and the automatic stay prohibited COP from taking action to terminate the agreement. Therefore, the Tenth Circuit affirmed the decision of the bankruptcy court.

Separately, the Court of Appeals addressed the trustee’s position that the appeal was moot under Bankruptcy Code 363(m). The Tenth Circuit denied the trustee’s appeal on this ground but did affirm on the merits.

160. Reaffirmation agreement was void under state law where it was premised on the mutual mistake that bank was secured creditor

Debtors signed a reaffirmation agreement with their mortgage lender to allow them to stay in their home, obligating them to continue making their full mortgage payments after bankruptcy. This agreement was premised on the fact that the lender had properly perfected the mortgage, but the lender had not. The bankruptcy court held that the reaffirmation agreement was unenforceable under Kentucky law because it was premised on the mutual mistake that the

bank was a secured creditor. The Eastern District of Kentucky and the Sixth Circuit affirmed. *Salyersville Nat'l Bank v. Bailey (In re Bailey)*, 2011 U.S. App. LEXIS 24560 (6th Cir. 2011) (Judges Keith, Sutton, and McKeague).

The court noted that reaffirmation agreements bind parties if they are “enforceable under applicable nonbankruptcy law” including state contract law. 11 U.S.C. § 524(c). The bank argued that even if it was an unsecured creditor, it had the right to enforce the reaffirmation agreement. The court explained that a debtor generally would not choose to reaffirm an unsecured debt and a court also generally would not approve such an agreement as being in the best interest of the debtor. While the bankruptcy code allows reaffirmation of both secured and unsecured debts, in this case the court concluded that the reaffirmation agreement was unenforceable under state contract law. A reaffirmation of unsecured debt, the court explained, was not the bargain the parties made. The Sixth Circuit agreed with the bankruptcy court that it “defie[d] logic” that the debtors would have reaffirmed the debt had they known it was unsecured. “People generally do not agree to pay more than \$150,000 in exchange for nothing.”

161. Mortgage servicer sanctioned for “egregious conduct”

The facts in this case were so surreal, that Judge Houston began his opinion by quoting from the movie, *The Hospital*, a “black comedy” written by Paddy Chayefsky. “In short, a man comes into this hospital in perfect health, and in the space of one week, we chop one kidney, damage another, reduce him to coma, and damn near kill him.” In this case, debtors were paying their taxes and insurance directly and the lender had waived any requirement for an escrow account. Debtors were timely paying their insurance payment and all monthly installments of principal and interest. American Home Mortgaging Servicing, Inc. began rejecting the debtors’ installment payments claiming not to have received a hazard insurance renewal certificate and claiming that the policy had expired, which it had not. The debtors’ insurance agent faxed a copy of the insurance policy to AHMSI evidencing that it was still in force. The servicer sent another letter announcing that force placed insurance had been obtained at a cost to the debtors of \$2,002 and that it had established an escrow account that now had a negative \$2,002 in it. Debtors continued making monthly payments but they were applied to the escrow “arrearage” and late payments that were now being assessed monthly. Eventually, AHMSI hired counsel to foreclose on the debtors’ home. Debtors hired counsel who provided AHMSI with all the necessary information to show that it was incorrect in almost every respect in its servicing of this account. Nevertheless, the foreclosure proceeded and debtors were forced to file a chapter 13 petition in order to stop it. Debtors objected to the claim of AHMSI, and AHMSI objected to confirmation of debtors’ plan. The court ruled in favor of the debtors. *In re Cothorn*, 442 B.R. 494 (Bankr. N.D. Miss. 2010). Judge Houston concluded: “AHMSI’s incompetent servicing tactics converted a loan transaction that was being paid like ‘clockwork’ to a loan that was virtually impossible to pay, particularly for modest income borrowers.” AHMSI was ordered to treat the loan as current and write off all accrued late charges, attorney fees and costs, title costs, inspection fees, and appraisal fees as being unreasonable and unnecessary. Additionally, the debtors were awarded their attorney’s fees and costs. *See also, In re Jackson*, 442 B.R. 469 (Bankr. E.D. Va. 2010), where pro se debtors had unsuccessfully challenged in state court the credit union’s contention that their mortgage loan was in arrears. When debtors filed bankruptcy, the credit union filed a claim for \$212,108.30, which included \$149,000 for pre-petition attorney’s fees and expenses to which the debtors had objected. The court found much of the work excessive and unnecessary and the hourly rates charged also excessive for the level of work

that was done and reduced the allowed attorney fees to just \$8,000. [*Author's Note:* These cases demonstrate that a trustee, as well as a debtor, must thoroughly analyze the claims being filed by mortgage lenders and servicers. Junior mortgage holders in particular are being wiped out by the foreclosures of senior lien holders and filing unsecured claims in chapter 7 bankruptcy cases. All such claims should be closely scrutinized.]

V. STERN V. MARSHALL

162. District Court holds that Bankruptcy Courts have no authority to hear fraudulent transfer cases

Trustee brought adversary proceeding seeking recovery of fraudulent transfers under Illinois state law as well as additional state law torts. Trustee sought to withdraw the reference based on *Stern v. Marshall* concerns. The district court granted the Trustee's motion. *In re Swanson*, 2012 U.S. Dist. Lexis 181947 (N.D. Ill. Dec. 26, 2012). First, the district court held that a bankruptcy court cannot enter a final order on fraudulent transfer claims because such claims are private, not public, rights. The district court relied heavily on the Ninth Circuit's recent decision in *In re Bellingham Ins. Agency, Inc.*

The district court, however, then went one step farther. Based on the 7th Circuit's 2011 decision in *In re Ortiz*, that a bankruptcy court does not even have the authority to hear a fraudulent conveyance action and issue proposed finding of fact and conclusions of law. The court held that a bankruptcy court only can enter proposed findings in a "non-core" matter. Fraudulent transfers, however, are "core" matters and the only statutory authority given in "core" matters is to issue final order (which, of course, the court held that constitutionally the bankruptcy court cannot do). Consequently, the bankruptcy court cannot do anything regarding matters, like fraudulent transfers, that are "core" but run afoul of *Stern v. Marshall*. While the position taken in *Swanson* is in the minority, it joins a growing number of cases that hold that there is a bankruptcy black hole in certain "core" matters that render the bankruptcy courts powerless to do anything.

163. Bankruptcy court can enter final orders on avoidance actions

Liquidation trust filed an adversary complaint seeking to avoid and recover preferential transfers under section 547 of the Bankruptcy Code and fraudulent transfers under sections 544 and 548. Defendant filed a motion to dismiss based on *Stern v. Marshall*, 131 S. Ct. 2594 (2011), arguing that the bankruptcy court could not enter final orders or proposed findings of facts and conclusions of law on the trust's avoidance actions because the claims only seek to augment the size of the bankruptcy estate. Specifically, defendant argued that the court could not adjudicate the preference action unless it is inextricably linked to the creditor's proof of claim and that defendant had not filed a claim against the debtors in this case. Additionally, defendant contended that the court could not hear the fraudulent transfer claims because those claims are rooted in state contract law. *KHI Liquidation Trust v. Wisenbaker Builder Servs., Inc. and Wisenbaker Builder Servs. Ltd. (In re Kimball Hill, Inc.)*, Adv. No. 10 A 00824 (Bankr. N.D. Ill. Oct. 12, 2012).

The bankruptcy court rejected defendant's arguments, holding that the court had jurisdiction over the claims and that it could enter final orders. First, the court analyzed *Stern*, concluding that *Stern* had a "narrow" holding, limited to counterclaims brought by the

bankruptcy estate. Nevertheless, one could nevertheless infer a broader ruling from *Stern*, and the bankruptcy court stated that the broader question would be “(i) whether the action at issue stems from the bankruptcy itself or (ii) would necessarily be resolved in the claims allowance process.” Second, the court considered *Ortiz v. Aurora Health Care, Inc. (In re Ortiz)*, 665 F.3d 906 (7th Cir. 2011), in which the Seventh Circuit held that bankruptcy courts do not have jurisdiction over state law claims for improper disclosure of health care records. Although *Ortiz* contained “troubling” language regarding bankruptcy courts’ jurisdiction to hear any action that would augment the size of the bankruptcy estate, the bankruptcy court concluded that this language was non-binding *dicta*. Third, the court stated that a preference action “stems from the bankruptcy itself” and therefore passes jurisdictional muster under *Stern*. Finally, the court determined that fraudulent transfer actions also “stem” from bankruptcy and that state law fraudulent transfer claims find their roots in bankruptcy law. Accordingly, the court held that it had jurisdiction to hear and enter final orders on the trust’s avoidance actions.

164. Court did not have authority to enter final judgment on debtors' state law claims based on defendant's filing of proofs of claim

Defendant medical provider filed proofs of claim in 3,200 bankruptcy cases that included debtors’ medical treatment information and were publically available on the courts’ dockets. Two groups of debtors filed separate class action lawsuits against defendant under a Wisconsin statute allowing individuals to sue if their health records are disclosed without permission. The bankruptcy judge granted the defendant summary judgment in both cases. The Seventh Circuit granted direct appeal, but then held that the decision to grant direct appeal was “improvident” due to the Supreme Court’s decision in *Stern v. Marshall*. The Seventh Circuit explained that like the debtor’s counterclaim in *Stern*, the debtors’ claims were based on state law and “not necessarily resolvable by a ruling on the creditor’s proof of claim in bankruptcy.” The Seventh Circuit determined that because the bankruptcy court lacked authority to enter summary judgment or any final judgment, the Seventh Circuit lacked appellate jurisdiction. *Ortiz v. Aurora Health Care, Inc. (In re Ortiz)*, Nos. 10-3465, 10-3466, 2011 U.S. App. LEXIS 26009 (7th Cir. 2011) (Judges Williams, Tinder, and Gottschall).

The court explained that debtors’ claims were core matters that Congress gave bankruptcy judges authority to decide, but *Stern* provided a “definitive answer” that such congressional authorization was not constitutional. The claims, like the counterclaim in *Stern*, involved “‘private parties’ disputing interests ‘defined by state law.’” The right to relief did not flow from a federal statutory scheme and the provider’s act of filing proofs of claim did not give the bankruptcy judge the authority to adjudicate the debtors’ state law claims. The Seventh Circuit explained that the bankruptcy judge had to make several factual and legal determinations that were not disposed of in determining the proofs of claim, such as interpreting a Wisconsin statute. “The debtors’ action owes its existence to Wisconsin state law and will not necessarily resolve in the claims allowance process.” Therefore the court held that the bankruptcy judge lacked authority to issue a final judgment on the claims. The court went on to note that the bankruptcy judge’s orders could not function as proposed findings of fact or conclusions of law, because the proceedings were core, and not related to. Because it also could not find that all parties consented, the Seventh Circuit remanded to the bankruptcy court.

165. Upon reconsideration, court amends order holding that it did not have subject matter jurisdiction over fraudulent conveyance claims based on *Stern*

***v. Marshall* – determination that it did not have the power to hear the claim was in error**

Trustee filed an adversary proceeding against defendants, including debtor's ex-husband, to set aside a marital settlement agreement and avoid other transfers. The bankruptcy court held that it did not have subject matter jurisdiction to determine the adversary complaint, based on the Supreme Court's recent decision in *Stern v. Marshall*. The court explained that the proceeding was core, but that because the fraudulent conveyance claims were essentially common law claims that did not stem from the bankruptcy itself and would not be resolved in the claims allowance process, so the claims had to be determined by an Article III court. Further, the court concluded that it had no statutory authority to render findings of fact and conclusions of law for core proceedings that it could not constitutionally hear (as opposed to non-core proceedings). Therefore, the bankruptcy court granted the parties time to move the District Court to withdraw its reference or it would dismiss the claims for lack of subject matter jurisdiction. The district court declined to withdraw the reference and the ex-husband moved for reconsideration. On reconsideration, the court amended its previous order based on the District Court judge's comments at the withdrawal hearing. *Samson v. Blixseth (In re Blixseth)*, 2012 Bankr. LEXIS 19 (Bankr. D. Mont. 2012) (Judge Kirscher).

The court held that it erred when it made reference to subject matter jurisdiction in its previous ruling, explaining that subject matter jurisdiction refers to the court's power to hear a case and that *Stern v. Marshall* "did not implicate questions of subject matter jurisdiction." The court pointed out that bankruptcy jurisdiction is prescribed by 28 U.S.C. § 1334 and that its determination that it could not hear the fraudulent conveyance claim was in error. The court concluded that because the District Court would have the requisite subject matter jurisdiction so too did the bankruptcy court.

166. Court rejects narrow view of *Stern* – applies analysis to fraudulent conveyance claims

Trustee filed adversary proceedings against various defendants including claims for fraudulent transfers, preferences, unjust enrichment, breach of fiduciary duty, equitable subordination, recovery of property of the estate, disallowance of claims, unfair trade practice under North Carolina law, and accounting. The issue was whether the court had constitutional authority to enter final judgments on those causes of action.

The court held that as against defendants who had filed proofs of claim against the debtor, the claims for fraudulent transfers and preferences were core proceedings and the court could enter a final judgment. The court cited section 502(d), noting that a court must disallow the claim of an entity from which property is recoverable and explaining that it is well settled that a bankruptcy court can enter final orders in avoidance actions against a party who has filed a proof of claim – such counts must be determined as part of the claims allowance process due to section 502(d). As to the parties that did not file claims, however, the court explained that after *Stern* the court may only hear a fraudulent conveyance action and submit proposed findings unless the court had consent of the litigants. The claims were in the nature of common law actions, did not stem from the bankruptcy code, and were not involved in the claims resolution process. The court rejected a "narrow" view of *Stern*, explaining that the holding of *Stern* applied to other core matters under the statute. Although *Stern* did not address fraudulent conveyance actions, according to the court that did not mean *Stern* should not be applied to the other provisions of 28

U.S.C. § 157(b)(2). As to the recovery of estate property claims, the court held that they were core proceedings and stemmed from the bankruptcy itself, because actions for turnover occur exclusively under the Bankruptcy Code. Therefore, the court had authority to enter final judgments on the turnover claims. As to the breach of fiduciary duty, unjust enrichment, accounting, and unfair trade practice claims, the court held that these claims did not stem from the bankruptcy and the court could only submit proposed findings of fact and conclusions of law. Finally, the court found that the equitable subordination and disallowance counts were counterclaims by the estate against proofs of claims, they necessarily arise in the bankruptcy, and were necessary to the claims allowance process such that the court could enter final orders as to those claims. *Burns v. Dennis (In re Southeastern Materials, Inc.)*, 467 B.R. 337 (Bankr. M.D. N.C. 2012)

167. Eighth Circuit B.A.P. holds that *Stern v. Marshall* decision is limited to 24 U.S.C. § 157(b)(2)(C)

Former president of debtor company appealed decision of bankruptcy court holding that the debtor's estate was contractually entitled to receive the cash value of a life insurance policy. The president filed a motion to dismiss consisting of a one sentence statement that the court lacked subject matter jurisdiction, citing *Stern v. Marshall*. The bankruptcy court held that the adversary was a core proceeding and that it was constitutional for the court to determine it. On appeal, the president renewed the argument that the bankruptcy court lacked jurisdiction. The Bankruptcy Appellate Panel for the Eighth Circuit rejected the argument, explaining that it represented "a basic misunderstanding of both bankruptcy jurisdiction and the Supreme Court's opinion in *Stern v. Marshall*." *Badami v. Sears (In re AFY, Inc.)*, No. 11-6065, 2012 Bankr. LEXIS 47 (B.A.P. 8th Cir. 2012) (Judges Kressel, Schermer, and Venters).

The court explained that whatever jurisdiction Congress vested in the district court was referred to the bankruptcy court. Congress limited bankruptcy courts' authority over these referred cases due to constitutional limitations – "It is the scope of the authority granted by Congress to bankruptcy judges that was the issue in *Stern v. Marshall*." So according to the court, the first question was whether the matter was core. Because the proceeding was core, then the "real question" was whether or not the authority granted by Congress was constitutional. The BAP noted that the *Stern* decision was narrow and limited to 28 U.S.C. § 157(b)(2)(C). "Unless and until the Supreme Court visits other provisions of Section 157(b)(2), we take the Supreme Court at its word and hold that the balance of the authority granted to bankruptcy judges by Congress in 28 U.S.C. § 157(b)(2) is constitutional."

168. Court adopts "narrow" interpretation of *Stern v. Marshall*

Trustee filed adversary proceeding under sections 544, 547, 548, and Delaware law against defendants, who filed a motion to dismiss. The court applied a narrow interpretation of *Stern v. Marshall*, holding that it had jurisdiction under 28 U.S.C. § 157 to hear the trustee's claims. *Burtch v. Seaport Capital, LLC (In re Direct Response Media, Inc.)*, 2012 Bankr. LEXIS 41 (Bankr. D. Del. 2012) (Judge Gross).

The court rejected a broad interpretation of *Stern*, that the decision "strips bankruptcy courts of the authority to enter a final judgment in any case where the debtor is bringing any action which seeks to augment the estate because they are legal actions that seek to take another's property and can only be finally adjudicated by an Article III judge." Instead, the court

adopted the narrow interpretation that the decision was based on a “unique set of facts” and that the Supreme Court “did not divest bankruptcy courts of authority to enter final orders on core matters, other than a Debtor’s state law counterclaim.” The court concluded that *Stern* only removed a bankruptcy court’s authority to finally adjudicate a debtor’s state law counterclaim under section 157(b)(2)(C) and not to enter final judgments on other core matters, like the preference and fraudulent conveyance claims at issue in this case. This decision sets out a detailed analysis of both the broad and the narrow interpretations of *Stern*.

W. PONZI SCHEME CASES

169. Second Circuit affirms grant of preliminary injunction in Ponzi scheme

After the Madoff Ponzi scheme was exposed, numerous creditors sought to bring fraudulent transfer actions under state law. The Madoff Trustee sought to enjoin those causes of action under §105 of the Bankruptcy Code and the bankruptcy court granted the Trustee’s motion. On appeal, the Second Circuit affirmed. The court held that but for the preliminary injunction, “there would ensue a chaotic rush to the courthouse—or rather, multiple courthouses—of those seeking assets that the trustee claims are properly part of the . . . estate.” The Second Circuit also held that but for the injunction, the individual creditor’s claims would “draw down assets almost all of which could otherwise be expected to return to the . . . estate.” *In re Bernard L. Madoff Investment Securities, LLC*, 2013 WL 616269 (2d Cir. Feb. 20, 2013).

170. Interest payments in connection with a Ponzi Scheme do not constitute "value"

The debtor, a Ponzi scheme operator, entered into and paid principal and interest on various promissory notes prior to the Ponzi scheme’s collapse. The trustee sought to recover these payments as fraudulent transfers. Defendant moved for summary judgment arguing that the payment of principal and “reasonable” interest constitutes value under the Bankruptcy Code. *In re Consolidated Meridian Funds*, 2013 WL 366223 (Bankr. W.D. Wash. 2013). The bankruptcy court held that the return of principal does constitute value, but the return of interest, even if reasonable, is still just a payment of “false profit” and therefore does not constitute value under the Code.

171. District Court finds extra statutory exception to safe harbor defenses of section 546

In a previous decision arising out of the Madoff Ponzi scheme, the district court held that nothing in the text of §546(e) precluded it from protecting from avoidance as preferences or constructive fraudulent transfers, transfers that are tainted with fraud and illegality. Further, in a previous decision, the district court declined to read an extra-statutory limitation on the types of transfers that may be protected by the safe harbor provisions of §546.

In this most recent opinion, however, the district court did impose an extra-statutory limitation to the applicability of §546 in denying motions to dismiss. *In re Bernard L. Madoff Investment Securities LLC*, 2013 WL 1609154 (Apr. 15, 2013)

In this case, the trustee alleged that some defendants had actual knowledge that Madoff was running a fraudulent scheme and that §546 should not apply to these types of bad faith

defendants. The district court agreed. The district court explained that its initial opinion applied §546 for two reasons. *First*, the transfers were protected because they were made in connection with a securities contract by a stockbroker (Madoff). *Second*, the transfers were settlement payments because they were the completion of a securities contract between Madoff and the defendants.

The court, however, makes a distinction for those defendants whom the trustee alleges knew that Madoff was a fraud. The court reasons that for these defendants the “securities contracts” between Madoff and the defendants is meaningless because “because if they knew that Madoff Securities was a Ponzi scheme, then they must have known that the transfers they received directly or indirectly from Madoff Securities were not “settlement payments.” Similarly, since such defendants are alleged to have known in effect that the account agreements never led to a transaction for the “purchase, sale, or loan of a security,” they therefore also must have known that the transfers could not have been made in connection with an actual “securities contract.”

The district court also used legislative history and the underlying purpose of the statute to support its ruling. The district court held that the “purpose of [§546] is minimiz [ing] the displacement caused in the commodities and securities markets in the event of a major bankruptcy affecting those industries.” The court that “[i]n the context of Madoff Securities' fraud, that goal is best achieved by protecting the reasonable expectations of investors who believed they were signing a securities contract; but a transferee who had actual knowledge of the Madoff Ponzi scheme did not have any such expectations, but was simply obtaining moneys while he could. Neither law nor equity permits such a person to profit from a safe harbor intended to promote the legitimate workings of the securities markets and the reasonable expectations of legitimate investors.”

172. Ponzi scheme distributions up to principal amount of investment are not recoverable fraudulent transfers

The debtors were formed to manage and operate as hedge funds, with each debtor structured as either as an LLC or an LP. However, the debtors actually were operated as the instruments of a Ponzi scheme, which ultimately collapsed. The post-confirmation liquidating trustee filed numerous adversary proceedings against investors, alleging that the transfers to them from the debtors prior to the collapse of the Ponzi scheme were fraudulent. The defendant investors had received transfers representing returns of principal and/or purported profits on their equity investments. The investors asserted an affirmative defense under § 548(c) claiming that the transfers were "for value." The bankruptcy court denied the trustee's motion for partial summary judgment, effectively upholding the availability of this affirmative defense. On direct appeal, the 11th Circuit Court of Appeals affirmed. *William F. Perkins v. Aunay Haines, et al.*, 661 F.3d 623 (11th Cir. 2011). The circuit court observed that transfers made in furtherance of a Ponzi scheme were presumed to have been made with the intent to defraud but noted the general rule was that a defrauded investor gives "value" to the debtor in exchange for the return of the principal amount of the investment but not as to any payments in excess thereof. This is because transfers up to the amount of the principal investment would satisfy the investors' fraud claim – an antecedent debt – and would be made for "value" in the form of the investor's surrender of the tort claims. Thus, the circuit court agreed with *In re AFI Holding, Inc.*, 525 F.3d 700 (9th Cir. 2008), and declined to distinguish between equity investments and debt based claims when applying the general rule to fraudulent transfer actions arising out of a Ponzi scheme.

173. No immediate appeal of safe harbor rulings granted for Madoff trustee

The Madoff trustee sought to immediately appeal three rulings of the district court that dismissed claims and narrowed certain claims against defendants. The trustee moved to have the court certify the rulings for interlocutory appeal under 28 U.S.C. § 1292(b) or enter a final judgment as to those that were dismissed under Federal Rule of Civil Procedure 54(b). The district court denied the motion. *Picard v. Katz*, 2012 U.S. Dist. LEXIS 5143 (S.D.N.Y. 2012).

Many of the rulings related to the application of section 546(e) safe harbor protections. The court held that the trustee failed to demonstrate the kind of extraordinary circumstances that would warrant granting the motion under either 54(b) or section 1292(b). Trial was set to begin in two months and granting the motion would delay, rather than advance the ultimate termination of the litigation. The trustee made arguments about the impact of the decision on other adversary proceedings, but no one proceeding was so far advanced as the proceedings in this case. The appellate court could review all relevant rulings on a full record after the trial was completed and a final judgment entered. This would materially advance all of the Madoff adversary proceedings and avoid piecemeal litigation. The factual record would be relevant to the safe harbor issues, and the court concluded that none of the authorities or arguments presented by the Trustee persuaded the court that there was a "substantial ground for difference of opinion" with respect to the court's interpretation of section 546(e). The court, therefore, denied the trustee's motion in its entirety.

174. Trustee recovers "profit" payments in Ponzi scheme

Defendants had invested money into a Ponzi scheme. Each defendant received not only transfers of funds as repayment of their investments but also recovered more than the full balance of their investments into the Ponzi schemes, an amount labeled by the trustee as "profit." The trustee filed complaints seeking to avoid and recover only the profits, alleging actual and constructively fraudulent transfers avoidable under §§ 544(b), 548, applicable Florida statutes, and § 550. Defendants moved to dismiss, which the court denied. *Kapila v. Bennett, In re Louis J. Pearlman, et al.*, 2012 WL 2072835, 2012 Bankr. LEXIS 2858 (Bankr. N.D. Fla. 2012). Judge Jennemann first determined that the defenses of *in pari delicto* did not apply to a trustee seeking to avoid fraudulent transfers under the Bankruptcy Code, and that the trustee therefore had standing to pursue these causes of action. The court also rejected the argument that the trustee had failed to state causes of action for which relief could be granted, as the undisputed facts had established the debtors' fraudulent intent as they transferred funds to the defendants in furtherance of a Ponzi scheme. With respect to constructive fraudulent transfer and the issue of reasonably equivalent value, the court observed that defrauded investors give "value" back to the debtor to the extent a debtor repays the principal amount of its obligation to the investor, but no value is attributed to payments made to investors in excess thereof. Fictitious profits cannot be made for value. The court also found that the trustee had stated a valid cause of action for unjust enrichment.

175. Ponzi scheme presumption applied to related entity

The trustee brought adversary proceedings to avoid the grant of security interests in the debtor's intellectual property, including trademarks. The debtor's ownership was traceable to a Ponzi scheme and one of the members of that scheme executed the documents that granted the

security interest. The trustee sought to avoid the grant of the security interests as actually and constructively fraudulent. The trustee invoked the Ponzi scheme presumption and the court addressed whether the presumption could be applied only as to transfers made by entities that directly purveyed the Ponzi schemes, or whether it could apply to related entities as well.

The bankruptcy court first dismissed any flat rejection of the Ponzi scheme presumption. The court next concluded that a Ponzi scheme was present and operated within an enterprise structure, which include acquisition of the debtor. Finally, the court applied the Ponzi scheme presumption to the transfer, which was made by a related entity (the debtor) and was outside the main operation of the scheme. The court determined that the Ponzi scheme operator's intent was attributed to the debtor as transferor because he controlled the artificial entity. While the court noted that the inference can always be rebutted by proof of contrary intent, "a credible motivation to make the transfer that is grounded in good economic reason, *as to the transferor-entity*," it found that there was no probative, direct, admissible evidence to defeat the inference that the pledge was made in furtherance of the scheme. Therefore, the court held that the trustee was entitled to judgment on his fraudulent transfer claims. *Stoebner v. Ritchie Capital Mgmt., L.L.C. (In re Polaroid Corp.)*, 472 B.R. 22 (Bankr. D. Minn. 2012).

176. Reasonably equivalent value affirmatively shown in complaint where payments did not exceed amount of investor's fraud claim against debtor Ponzi scheme operator

Debtor was sole shareholder of fictitious business and a group of creditors filed an involuntary petition against debtor. Trustee commenced an adversary proceeding against, in this case, an investor in the scheme under section 548 and the North Carolina Fraudulent Transfer Act. The investor filed a motion to dismiss. *Ivey v. Swafford (In re Whitley)*, 463 B.R. 775 (Bankr. M.D.N.C. 2012).

The court found that the trustee established the Ponzi scheme presumption that payments made in furtherance of a Ponzi scheme were made with the actual intent to defraud creditors. The trustee alleged that investors transferred money to invest in factoring programs that were nonexistent and the debtor conducted little or no legitimate business activity. None of the returns were made with funds from the fictitious factoring program and were, in fact, funds from other investors. In addition, the trustee sufficiently alleged the other necessary elements – that there was a transfer of an interest of the Debtor made within two years before filing. The trustee also satisfied rule 9(b). The court however, dismissed the constructive fraud claims because, according to the court, the general rule is that investors give reasonably equivalent value in exchange for a return of principal. The court declined to distinguish between "income" and "interest" and repayment of principal, but regardless of how the debtor characterized the payments, the payments were made for "value," because the payments did not exceed the amount of the defendant's fraud claim against the debtor. Therefore, the complaint failed to establish constructive fraud and affirmatively showed that there was reasonably equivalent value.

177. Defendants not "transferees" under dominion test and trustee lacked standing to bring aiding and abetting fraudulent transfer claims

Debtor Ponzi scheme operator held accounts at defendant bank and bank provided assistance to debtor, including making false representations to victims that debtor was a practicing attorney, sending letters of reference on his behalf, permitting debtor to use its

conference room to meet with victims, and referring customers to debtor. The bankruptcy court dismissed trustee's complaint against the bank for fraudulent transfers and damages for aiding and abetting intentionally fraudulent transfers. *Hoskins v. Citigroup, Inc. (In re Viola)*, 2012 WL 1191926 (B.A.P. 9th Cir. 2012).

The Bankruptcy Appellate Panel (BAP) first held that the bank defendants were not transferees pursuant to the Ninth Circuit's dominion test, because the defendants did not have dominion (legal title and ability to do with them what they wished) over the funds transferred to the accounts. While the BAP found many of the allegations "disturbing," the BAP affirmed the bankruptcy court's determination that the defendants were not transferees. The BAP also affirmed the decision that the trustee did not have standing to bring a claim for aiding and abetting because the trustee was not a real party in interest. Any recovery of funds would go straight to the investors, the estate had no independent claim against the defendants, and allowing the trustee to go forward would raise the risk of inconsistent actions brought outside of bankruptcy by the investors themselves. Finally, the BAP affirmed the bankruptcy court's decision that the trustee could not avoid a transfer for the purchase of defendant's preferred stock because it was made through another an entity protected under 546(e). The BAP rejected the trustee's argument that the entity was a "mere conduit", because 550(a) did not limit the safe harbor provision of 546(e) and the entity was a transferee, not a mere conduit.

178. Net Investment method applied in Madoff case

Determining allowable claims, the Madoff trustee concluded that each customer's net equity should be calculated by the Net Investment Method, crediting the amount of cash deposited by the customer into his or her account, less any amounts withdrawn from it. Under this method, the class of customers who would have allowable claims would be limited to those who deposited more cash into their investment accounts than they withdrew. Some customers objected, arguing that the trustee should calculate net equity by employing the Last Statement Method under which customers would be entitled to recover the market value of the securities reflected on their last customer statements. The bankruptcy court ruled in favor of the trustee. On direct appeal, the circuit court affirmed. *In re Bernard L. Madoff Investments Securities LLC*, 654 F.3d 229 (2d Cir. 2011). The circuit court held that the last customer statements were "not useful" to determine net equity because the final customer statements did not reflect "securities positions" that could be "liquidated" because the account statements were wholly the invention of Madoff and were a complete fiction.

179. Statute of Limitations

The Bankruptcy Court in *In re Petters Company, Inc. et al* (Bankr. D. Minn. June 19, 2013) issued a 58-page opinion on the issue of statutes of limitation in avoidance actions. Although the first part of the opinion dealt with an issue of which limitations period under Minnesota law applied the second part of the opinion dealt with an encyclopedic discussion of the theories of "discovery of fraud", "adverse domination" and "equitable tolling". The last part of the opinion dealt with the questions of whether the applicable statute of limitations under Section 544 are tolled when the petition is filed or does the trustee have an extra two years and whether it is the filing of the adversary or the service of complaint which tolls the running of the statute. Bottom line: Trustee prevails.