



AMERICAN  
BANKRUPTCY  
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# 2018 Midwestern Bankruptcy Institute

## Bankruptcy Law Round-Up

**Hon. Robert D. Berger**

*U.S. Bankruptcy Court (D. Kan.); Kansas City*

**Hon. Katherine A. Constantine**

*U.S. Bankruptcy Court (D. Minn.); St. Paul*

**Crystanna Cox**

*First American Title Insurance Company; Overland Park, Kan.*

**Diana Spuhl Daugherty**

*Office of Standing Chapter 13 Trustee (E.D. Mo.); St. Louis*

**Hon. Dennis R. Dow**

*U.S. Bankruptcy Court (W.D. Mo.); Kansas City*

**Hon. Brian T. Fenimore**

*U.S. Bankruptcy Court (W.D. Mo.); Kansas City*

**Richard V. Fink**

*Office of the Chapter 13 Trustee; Kansas City, Mo.*

**Hon. Teresa J. James, Magistrate  
Judge**

*U.S. District Court (D. Kan.); Kansas City*

**Kathleen A. Laughlin**

*Chapter 13 Trustee (D. Neb.); Omaha*

**Hon. Cynthia A. Norton**

*U.S. Bankruptcy Court (W.D. Mo.); Kansas City*

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**Hon. Kathy A. Surratt-States**

*U.S. Bankruptcy Court (E.D. Mo.); St. Louis*

**Hon. Eugene R. Wedoff (ret.)**

*Oak Park, Ill.*

**BUT THERE ARE NO OBJECTIONS!**

**Hon. Katherine A. Constantine**  
U.S. Bankruptcy Court, District of Minnesota

**I. Service**

- A. To whom?
- B. How?
  - 1. Motions
    - a. Rule 9013 or Rule 9014
    - b. Is “notice” sufficient?
  - 2. Adversary Proceeding: Rule 7004
    - a. Service on United States: Rule 7004(b)(4)
    - b. Service on Insured Depository Institution: Rule 7004(h)

**II. *Espinosa***

A. “Failure to comply with this self-executing requirement should prevent confirmation of the plan even if the creditor fails to object, or to appear in the proceeding at all . . . . That is because § 1325(a) instructs a bankruptcy court to confirm a plan only if the court finds, *inter alia*, that the plan complies with the ‘applicable provisions’ of the Code. § 1325(a) (providing that a bankruptcy court ‘shall confirm a plan’ if the plan ‘complies with the provisions of’ Chapter 13 and with ‘other applicable provisions of this title’) . . . . [T]he bankruptcy court must make an independent determination of undue hardship before a plan is confirmed, even if the creditor fails to object or appear in the adversary proceeding.” *United Student Aid Funds, Inc. v. Espinosa*, 130 S.Ct. 1367, 1380-1381 (2010).

B. Impact beyond Chapter 13 confirmation

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**Hypotheticals**

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**1. Chapter 11 Plan Confirmation**

- a. Section 1129(a) provides: “The court shall confirm a plan only if all of the following requirements are met:
  - (1) The plan complies with the applicable provisions of this title.  
    . . .
  - (11) Confirmation of the plan is not likely to be followed by . . . liquidation, or the need for further financial reorganization . . . .”  
11 U.S.C. § 1129(a).
- b. **Questions**
  - i. May the plan be confirmed if e.g. the plan provides for assumption of a

lease after the lease is deemed rejected under § 365(d)(4)(A)?

- ii. What if the plan's lease assumption provision violates § 365(b)(1)(A) (doesn't cure pre-petition lease defaults)?
- iii. What if the evidence does not support a finding of feasibility?

**2. Disclosure Statement**

- a. § 1125 provides: a court may only approve a disclosure statement if it contains "adequate information."
- b. **Question:** Can there be adequate information if the body of the disclosure statement contains information that contradicts the attached exhibits?

**3. Use of Cash Collateral**

- a. What if the movant fails to plead that expedited authorization is necessary to avoid immediate and irreparable harm? *See* Rule 4001(b)(2)?
- b. What if the record does not demonstrate the funds at issue constitute "cash collateral" under § 363(a)?
- c. What if the motion does not state the amount of cash collateral to be used and end date for its use? *See* Rule 4001(b)(1)(B).

**4. Lien avoidance**

- a. § 522(f) provides: "...the debtor may avoid the fixing of a lien on an interest of the debtor in property to the extent that such lien impairs an exemption which the debtor would have been entitled . . . if . . . the sum of (i) the lien; (ii) all other liens on the property; and (iii) the amount of the exemption that the debtor could claim if there were no liens on the property; exceeds the value [of the property] in the absence of any liens."
  - i. **Question:** But what if the calculations use obviously incorrect inputs?
- b. § 506 (applied by Rule 3012) provides: "An allowed claim . . . is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property . . ."
  - i. **Question:** But what if there is an incomplete chain of title or an appraisal at an incorrect valuation date?

**5. Professional Persons compensation under § 330**

- a. Is it "reasonable" to award compensation that exceeds the recovery obtained from the services without an explanation? Should reasonableness be addressed?
- b. Should fees be awarded when a professional person's employment was not approved under § 327 and the standards for *nunc pro tunc* approval are not addressed?

**6. Motion for Default Judgment**

- a. Adequately pled?
- b. Adequately supported?

**REVERSE MORTGAGES IN BANKRUPTCY**

**I. What is a reverse mortgage?**

- A. Age requirement: The youngest borrower must be 62 years of age or older
- B. Borrowers must live in the home as their primary residence.
- C. Home must have equity.
- D. Loan proceeds may be:
  - 1. Paid as a future stream of income.
  - 2. Drawn down over time as needed (similar to a line of credit).
  - 3. Paid as a lump sum (used to pay off existing debt or invested).
  - 4. Some combination of the above.
- E. Because the borrower makes no payments to the mortgage holder, there is no escrow and the borrower must pay taxes and insurance.
- F. The loan becomes due in full when the last borrower dies or leaves the home for a period of more than 12 months.
- G. Home Equity Conversion Mortgages are insured by the federal government and most reverse mortgages are issued under this program.
  - 1. Insurance allows borrows to access the authorized loan funds even if the balance of the loan exceeds the home value.
  - 2. Lenders will be repaid in full when the home is sold regardless of the loan balance and collateral value.
- H. Intended to turn home equity into a future stream of income to allow people to remain in their homes until death or until a move to skilled care.
- I. A 2012 report to Congress from the CFPB found that:
  - 1. Today most reverse mortgages take the full amount as a lump sum to refinance an existing mortgage.
  - 2. 50% of reverse mortgage borrowers are under 70.
  - 3. Reverse mortgages are difficult for consumers to understand. In part, non-borrower spouses and heirs may not understand the risk of losing the home upon the borrowers death.
  - 4. In February of 2012, 9.4% of reverse mortgage borrowers were at risk of foreclosure because of unpaid taxes or insurance.

**II. Reverse mortgage issues in bankruptcy**

- A. What constitutes a default under the note and, if a default has occurred, can it be cured?
  - 1. Failure to pay taxes and insurance.
  - 2. Filing the bankruptcy petition.
- B. Stream of payments.
  - 1. Does the bankruptcy filing stop the stream of payments?

2. Are the payments income or an asset of the estate?
3. To whom does the stream of payments belong--Debtor or Estate?

C. Chapter 13 issues.

1. Providing for payment to creditor of taxes and insurance advanced pre-petition.
2. Making sure the Trustee does not pay the reverse mortgage.
3. Providing for payment of post-petition taxes and insurance.
4. Can a debtor enter into a reverse mortgage while in a Chapter 13?

D. Bankruptcy and the heirs of a deceased borrower on a reverse mortgage.

1. If the heir is a trust or estate, it cannot file bankruptcy to protect the home.
2. Heirs can cram down mortgage or pay mortgage in full over life of plan because the debt accelerated upon borrower's death. Heirs CANNOT continue with mortgage.

Lamar, Archer & Cofrin, LLP vs Appling,  
Case No. 16-1215 (\_\_\_ U.S. \_\_\_, June 4,  
2018), affirming 848 F.3d 953 (11<sup>th</sup> Cir. 2016).

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Issue:

- ▶ What constitutes a “statement respecting the debtor’s financial condition” under 11 U.S.C. §523(a)(2)(B)?
  - ▶ Does a statement about a single asset qualify and must the statement be in writing?
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## Facts:

- ▶ Debtor fell behind on legal bills and told the firm ("Lamar") that he was expecting a tax refund of "approximately \$100,000" to cover past due and future legal fees.
- ▶ Lamar relied on this statement and continued to represent him.
- ▶ Debtor received \$59K tax return and spend it on his business, not fees.
- ▶ After, he told Lamar he had not received the refund yet and Lamar agreed to complete the litigation.
- ▶ 5 years later, Debtor still had not paid and Lamar obtained judgment for \$104K.

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## Facts (continued):

- ▶ Debtor filed bankruptcy, Lamar initiated adversary alleging debt nondischargeable under § 523(a)(2)(A) as "false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's...financial condition."
- ▶ Debtor argued the statement was with respect to his financial condition so governed by § 523(a)(2)(B) which requires the statement to be "in writing."

## Facts: (continued)

- ▶ Bank. Ct. M.D. Ga. held a statement regarding single asset is not a “statement respecting the debtor’s financial condition” and denied motion to dismiss.
- ▶ After trial, court held debt was nondischargeable under §523(a)(2)(A). District court affirmed.
- ▶ 11<sup>th</sup> Circuit reversed. Held that statements “respecting” debtor’s financial condition may include a statement about a single asset. Because statements about tax refund not in writing, not non-dischargeable under §523(a)(2)(B).
- ▶ Supreme Court granted cert and affirmed the 11<sup>th</sup> Circuit.

## Supreme Court Rationale

- ▶ The Court based its ruling on: statutory construction; the implications of a narrow interpretation; and legislative history
- ▶ The word “respecting” means “related to” and has been broadly construed
- ▶ Based on the ordinary meaning of “respecting,” the Court rejected Lamar’s statutory construction that a statement respecting the debtor’s financial condition means only a statement that captures debtor’s overall financial status- Congress could have used narrow language if that was the intent
- ▶ A statement is “respecting” a debtor’s financial condition if it has a direct relation to or impact on a debtor’s overall financial status and a single asset does so and qualifies as a “statement respecting a debtor’s financial condition.”

## Supreme Court Rationale

- ▶ Also, Lamar's interpretation would yield incoherent results in that a formal misrepresentation of a single asset on a balance sheet would constitute a statement under §523(a)(2)(B), but the same misrepresentation made on its own would not.
- ▶ Lastly, statutory history of a "statement respecting the debtor's financial condition" corroborates the Court's interpretation. Lower courts have consistently construed the phrase to include statements addressing just one of a debtor's assets or liabilities.

## Implications

- ▶ Easier for a debtor to have a fraudulent debt discharged
- ▶ Statement about a single asset can be one "respecting financial condition"
- ▶ Will prompt litigation about meaning of "respecting"
- ▶ Blurs the distinction between financial statement fraud and non-financial statement fraud
  - ▶ Supreme Court addresses and rejects, pointing out (a)(2)(A) still has broad application, citing *Huskey*
- ▶ Creditors will be forced to require all representations made by a debtor to be in writing

Bankruptcy Round-Up

Midwest Bankruptcy Institute

### ZONE OF INTEREST

What is the Zone of Interest Doctrine? See *In re Peeples*, 880 F.3d 1207 (10<sup>th</sup> Cir. 2018)

- Not merely a matter of standing
- Asks whether a particular cause of action “encompasses a particular plaintiff’s claim”
- No single test applies
- Instead, “the breadth of the zone of interests varies according to the provisions of law at issue”
- Use traditional tools of statutory interpretation to decide whether a claim falls within a particular statute’s zone of interests

The Zone of Interest Doctrine as applied to bankruptcy cases

- Impose a “stringent” zone of interests requirement for appeals from bankruptcy court orders
- Appellants must generally show “the order [appealed from] diminishes their property, increases their burdens, or impairs their rights” *Lopez v. Behles (In re Am. Ready Mix, Inc.)*, 14 F.3d 1497, 1500 (10<sup>th</sup> Cir. 1994)
- *Lopez, Id.* – “the automatic stay is for the sole benefit of the debtors’ estate... [and] it could subvert the [bankruptcy] trustee’s powers to allow a creditor to appeal if the trustee chooses not to.”
- *Peeples, supra* – Plaintiff Lee, although a creditor, was not within 11 U.S.C. §362(a)’s zone of interests because his claim to recover his attorney’s fees in a separate state court action was not seeking to avoid a harm/injury incurred *in his capacity as a creditor*. The recovery sought by Lee would not benefit the bankruptcy estate
- Nor did Lee’s claim for damages fall within §362(k)’s zone of interests. §362(k) creates a cause of action for debtors and creditors – to protect debtors from collection efforts and creditors from inequitable treatment. Congress did not create the automatic stay to protect a creditor such as Lee from an award of attorney’s fees by a state court.

See also the seminal U.S. Supreme Court case addressing the Zone of Interest Doctrine, *Lexmark International, Inc. v. Static Control Components, Inc.*, 134 S.Ct. 1377, 186 L.Ed. 392, 572 U.S. 118 (2014).

In re Peeples, 880 F.3d 1207 (2018)

65 Bankr.Ct.Dec. 33, Bankr. L. Rep. P 83,203

880 F.3d 1207

United States Court of Appeals, Tenth Circuit.

IN RE: Adam PEEPLES;

Jennifer K. Peeples, Debtors.

Adrian J. Lee; Angela Lynn Noyes Lee,  
Plaintiffs Counter Defendants—Appellants,

v.

Scott J. McCardle, individually and as  
trustee of the Jack and Ruth McCardle Trust,  
Defendant Counterclaimant—Appellee.

No. 17-4046

Filed January 26, 2018

**Synopsis**

**Background:** Judgment creditors who, in an effort to enforce their judgments against Chapter 7 debtors, had obtained writs of garnishment directed to trustee of trust in which debtor allegedly held an interest, filed adversary complaint against trustee, seeking declaratory judgment that the automatic stay applied to a state-court proceeding that judgment creditor-husband had brought against trustee and seeking damages from trustee for willfully violating the automatic stay. Judgment creditors filed motion for partial summary judgment, and trustee filed cross-motion for summary judgment, for attorney fees, and for award of sanctions. The United States Bankruptcy Court for the District of Utah, R. Kimball Mosier, J., denied judgment creditors' motion for partial summary judgment, granted trustee's motion for summary judgment, and denied trustee's fee motion, 553 B.R. 892, and separately denied trustee's motion for sanctions. Judgment creditors appealed, and trustee filed cross-appeal. The District Court, Jill N. Parrish, J., 566 B.R. 68, affirmed, and judgment creditors appealed.

**Holdings:** The Court of Appeals, Moritz, Circuit Judge, held that:

[1] judgment creditor-wife lacked Article III standing to bring these claims;

[2] judgment creditor-husband's claim for a declaratory judgment that the Bankruptcy Code automatically stayed

the state-court lawsuit did not fall within the Code's zone of interests; and

[3] judgment creditor-husband's claim for damages did not fall within the Code's zone of interests.

Affirmed in part, vacated in part, and remanded with instructions.

West Headnotes (24)

[1] **Bankruptcy**

↔ Scope of review in general

When hearing an appeal from a district court's review of a bankruptcy-court order, the Court of Appeals independently reviews the bankruptcy court's decision, applying the same standard as the district court.

1 Cases that cite this headnote

[2] **Bankruptcy**

↔ Conclusions of law; de novo review

Court of Appeals reviews bankruptcy-court orders granting summary judgment in adversarial proceedings de novo, and affirms if there is no genuine dispute as to any material fact and the movant is entitled to judgment as a matter of law. Fed. R. Civ. P. 56; Fed. R. Bankr. P. 7056.

1 Cases that cite this headnote

[3] **Bankruptcy**

↔ Conclusions of law; de novo review

Scope of the automatic stay is a question of law that the Court of Appeals reviews de novo regardless of the case's posture. 11 U.S.C.A. § 362.

Cases that cite this headnote

[4] **Federal Courts**

↔ Jurisdiction

In re Peeples, 880 F.3d 1207 (2018)

65 Bankr.Ct.Dec. 33, Bankr. L. Rep. P 83,203

Court of Appeals reviews jurisdictional questions de novo.

Cases that cite this headnote

[5] **Federal Civil Procedure**

☞ In general;injury or interest

Article III standing is jurisdictional; thus, where the record reveals a colorable standing issue, courts have a duty to undertake an independent examination, sua sponte if necessary, of that issue. U.S. Const. art. 3.

1 Cases that cite this headnote

[6] **Federal Civil Procedure**

☞ In general;injury or interest

**Federal Civil Procedure**

☞ Causation;redressability

Article III standing requires that a plaintiff must have (1) suffered an injury in fact, (2) that is fairly traceable to the challenged conduct of the defendant, and (3) that is likely to be redressed by a favorable judicial decision. U.S. Const. art. 3.

1 Cases that cite this headnote

[7] **Federal Civil Procedure**

☞ In general;injury or interest

Plaintiff bears the burden of demonstrating that the requirements for Article III standing are met, and must do so before a federal court can review the merits of a case. U.S. Const. art. 3.

Cases that cite this headnote

[8] **Bankruptcy**

☞ Parties

Judgment creditor-wife lacked Article III standing to file adversary complaint against trustee of trust in which Chapter 7 debtor allegedly held an interest, for trustee's alleged willful violation of the automatic stay in a state-court proceeding brought against him by judgment creditor-husband in an attempt

to collect judgment debt; judgment creditors' alleged injury was the award of attorneys fees the state court had assessed against husband, husband was the sole plaintiff in the state-court lawsuit, the state court entered judgment for attorneys fees against husband alone, and judgment creditors failed to demonstrate that wife suffered any injury-in-fact. U.S. Const. art. 3; 11 U.S.C.A. § 362.

Cases that cite this headnote

[9] **Federal Civil Procedure**

☞ In general;injury or interest

Although traditionally viewed as a prudential- or statutory-standing requirement, the zone-of-interests doctrine is not actually a matter of standing at all; instead, it merely asks whether a particular federal cause of action encompasses a particular plaintiff's claim.

1 Cases that cite this headnote

[10] **Action**

☞ Statutory rights of action

Courts presume that a statute ordinarily provides a cause of action only to plaintiffs whose interests fall within the zone of interests protected by the law invoked.

1 Cases that cite this headnote

[11] **Action**

☞ Statutory rights of action

There is no single test to determine whether a cause of action falls within a statute's zone of interests; rather, the breadth of the zone of interests varies according to the provisions of law at issue.

1 Cases that cite this headnote

[12] **Administrative Law and Procedure**

☞ Interest in general

In the context of the Administrative Procedure Act (APA), under which zone-of-interests issues often arise, the test for whether a cause of action falls within the statute's

In re Peeples, 880 F.3d 1207 (2018)

65 Bankr.Ct.Dec. 33, Bankr. L. Rep. P 83,203

zone of interests forecloses suit only when a plaintiff's interests are so marginally related to or inconsistent with the purposes implicit in the statute that it cannot reasonably be assumed that Congress authorized that plaintiff to sue. 5 U.S.C.A. § 551 et seq.

Cases that cite this headnote

[13] **Administrative Law and Procedure**

☞ Interest in general

What comes within the zone of interests of a statute, for purposes of obtaining judicial review of administrative action under the generous review provisions of the Administrative Procedure Act (APA), may not do so for other purposes. 5 U.S.C.A. § 551 et seq.

Cases that cite this headnote

[14] **Action**

☞ Statutory rights of action

Courts must use traditional tools of statutory interpretation to decide whether a claim falls within a particular statute's zone of interests.

Cases that cite this headnote

[15] **Bankruptcy**

☞ Notice to creditors; commencement

Bankruptcy Code imposes an automatic stay when a debtor files a bankruptcy petition. 11 U.S.C.A. § 362(a).

Cases that cite this headnote

[16] **Bankruptcy**

☞ Judicial proceedings in general

Judgment creditor's claim that Bankruptcy Code automatically stayed a state-court lawsuit that he had brought against trustee of trust in which Chapter 7 debtor allegedly held an interest did not fall within the stay provision's zone of interests; trustee's alleged stay violation in obtaining award of attorneys fees against judgment creditor from state court did not impair any of judgment

creditor's claims against the bankruptcy estate, creditor instead sought to protect himself from having to pay fee award, a goal that fell outside the stay's zone of interests, and it was not suggested that remedying judgment creditor's injury would benefit the bankruptcy estate. 11 U.S.C.A. § 362(a).

Cases that cite this headnote

[17] **Bankruptcy**

☞ Right of review and persons entitled; parties; waiver or estoppel

Court of Appeals imposes a "stringent" zone-of-interests requirement for appeals from bankruptcy-court orders, whereby appellants generally must show that the order appealed from diminishes their property, increases their burdens, or impairs their rights.

1 Cases that cite this headnote

[18] **Action**

☞ Statutory rights of action

Litigant's ability to redress his injuries is irrelevant to the zone-of-interests analysis; the very point of the zone-of-interests doctrine is that not every injury traceable to the violation of a federal statute is remediable in the federal courts.

1 Cases that cite this headnote

[19] **Action**

☞ Statutory rights of action

Because the zone-of-interests doctrine presumes congressional intent to limit causes of action, Congress can expand a statute's zone of interests with language indicating that a cause of action extends to a broader range of claims.

Cases that cite this headnote

[20] **Federal Civil Procedure**

☞ In general; injury or interest

In re Peeples, 880 F.3d 1207 (2018)

65 Bankr.Ct.Dec. 33, Bankr. L. Rep. P 83,203

Broad statutory language does not necessarily expand the statute's zone of interests to Article III's limits. U.S. Const. art. 3.

Cases that cite this headnote

**[21] Bankruptcy**

☞ Judicial proceedings in general

Judgment creditor's claim for damages for purported willful stay violation by trustee of trust in which Chapter 7 debtor allegedly held an interest, against whom judgment creditor had brought state-court action in an attempt to collect the judgment debt, and in whose favor state court had awarded attorney fees, did not fall within the stay provision's "zone of interests," and so judgment creditor could not assert the claim; zone of interests of the section of the Bankruptcy Code providing for damages for an individual injured by any willful stay violation extends to debtors and creditors when they allege those types of harms against which the stay is meant to protect, which, for creditors, includes inequitable treatment, and trustee's alleged stay violation did not harm judgment creditor in his capacity as a creditor. 11 U.S.C.A. § 362(k).

1 Cases that cite this headnote

**[22] Bankruptcy**

☞ Damages and attorney fees

Claims for damages for automatic-stay violations are limited to those whose interests Congress intended to protect with the automatic stay. 11 U.S.C.A. § 362(k).

Cases that cite this headnote

**[23] Bankruptcy**

☞ Automatic Stay

Specific purposes of the automatic stay are to protect the debtor from collection efforts and to protect creditors from inequitable treatment. 11 U.S.C.A. § 362.

Cases that cite this headnote

**[24] Bankruptcy**

☞ Proceedings, Acts, or Persons Affected

When a creditor alleges an injury in some capacity other than as a creditor, the automatic stay's goal of ensuring equal creditor treatment is not implicated, and the creditor's claim does not fall within the stay's "zone of interests." 11 U.S.C.A. § 362.

1 Cases that cite this headnote

**\*1210 Appeal from the United States District Court for the District of Utah (D.C. No. 2:16-CV-00808-JNP)**

**Attorneys and Law Firms**

Adrian J. Lee, Holladay, Utah, pro se and for Co-Appellant.

Daniel K. Brough, Bennett Tueller Johnson & Deere, Salt Lake City, Utah (Brigman L. Harman, Bennett Tueller Johnson & Deere, Salt Lake City, Utah, with him on the brief) for Appellee.

Before LUCERO, BACHARACH, and MORITZ, Circuit Judges.

**Opinion**

MORITZ, Circuit Judge.

\*1211 Plaintiffs Adrian and Angela Lee<sup>1</sup> asked the bankruptcy court to declare that the automatic stay in Adam and Jennifer Peeples' bankruptcy case applies to a separate lawsuit Adrian Lee filed in state court against defendant Scott McCardle. The Lees also asserted that the automatic stay prevented McCardle from collecting attorney's fees levied against Adrian Lee in that state-court lawsuit. The Lees further sought damages against McCardle for willfully violating the automatic stay. The bankruptcy court found—and the district court agreed—that the automatic stay didn't apply to the state-court lawsuit. Thus, it granted summary judgment to McCardle. The Lees appeal, arguing that the district court erred in ruling that the automatic stay didn't apply. We don't reach this question; instead, we vacate the district court's judgment against Angela Lee because she lacks Article III standing to bring this lawsuit, and we affirm summary

**In re Peebles, 880 F.3d 1207 (2018)**

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judgment against Adrian Lee because his claims don't fall within the Bankruptcy Code's zone of interests.

## I

In 2012, the Lees obtained a default judgment against the Peebles for unpaid rent and waste. In 2013, they obtained a second default judgment against the Peebles for fraud. The Lees then sought to collect on those judgments by garnishing distributions that the Jack and Ruth McCardle Trust (the Trust) allegedly owed Adam Peebles. Trustee Scott McCardle responded that Adam Peebles was only an inconsequential beneficiary of the trust who wasn't owed any distributions. Adrian Lee then sued Scott McCardle in Utah state court, both individually and in Scott McCardle's capacity as trustee, essentially alleging that Scott McCardle's undue influence over Ruth McCardle prompted her to disinherit Adam Peebles in a memorandum amending the Trust. Thus, Lee asserted that the memorandum must be rescinded and that the Trust owed Adam Peebles overdue distributions dating back to Ruth McCardle's death in 2009. Lee sought to collect these distributions as Peebles' judgment creditor.

The state court dismissed the lawsuit because it determined Lee didn't have standing and, alternatively, the claims were time-barred. The state court further ordered Lee to pay McCardle attorney's fees and left the case open to determine those fees. The Peebles filed their bankruptcy petition while the state court was calculating fees. Lee then argued that the automatic stay triggered by the Peebles' bankruptcy petition covered his lawsuit against McCardle and moved to stay further proceedings. The state court denied the motion and entered judgment assessing \$41,889 in attorney's fees against Lee.

The Lees initiated this adversarial proceeding against McCardle in the Peebles' bankruptcy case a week before the state court entered final judgment. The Lees sought (1) a declaratory judgment to confirm that the automatic stay applied to the state-court lawsuit and (2) damages from McCardle for willfully violating the automatic stay. The Lees moved for partial summary judgment on the declaratory judgment and the issue of McCardle's liability for violating the automatic stay. But \*1212 they reserved the issue of damages for trial. McCardle filed a cross-motion for full summary judgment. The bankruptcy court held that the automatic stay didn't apply to the state-

court lawsuit because Lee had asserted claims against McCardle, not Adam Peebles. Thus, the bankruptcy court denied the Lees' motion and granted McCardle's.<sup>2</sup> The Lees appealed to the district court, which affirmed for substantially the same reasons the bankruptcy court provided in its order.

## II

[1] [2] [3] [4] When hearing an appeal from a district court's review of a bankruptcy-court order, "we independently review the bankruptcy court's decision, applying the same standard as the ... district court." *Jubber v. SMC Elec. Prods., Inc. (In re C.W. Min. Co.)*, 798 F.3d 983, 986 (10th Cir. 2015). We review bankruptcy-court orders granting summary judgment in adversarial proceedings de novo, *id.*, and affirm if "there is no genuine dispute as to any material fact and the movant is entitled to judgment as a matter of law." Fed. R. Civ. P. 56(a); *see also* Fed. R. Bankr. P. 7056 (applying Rule 56 to adversarial proceedings). The scope of the automatic stay is a question of law that we review de novo regardless of the case's posture. *Johnson v. Smith (In re Johnson)*, 575 F.3d 1079, 1082 (10th Cir. 2009). We also review jurisdictional questions de novo. *In re Special Grand Jury 89-2*, 450 F.3d 1159, 1170 (10th Cir. 2006).

## A

[5] [6] [7] Initially, we must address whether Angela Lee has Article III standing to bring this appeal. Article III standing is jurisdictional; thus, "where the record reveals a colorable standing issue, we have a 'duty to undertake an independent examination' (*sua sponte* if necessary) of that issue." *United States v. Ramos*, 695 F.3d 1035, 1046 (10th Cir. 2012) (quoting *Morgan v. McCotter*, 365 F.3d 882, 887 (10th Cir. 2004) ). Article III standing requires that a "plaintiff must have (1) suffered an injury in fact, (2) that is fairly traceable to the challenged conduct of the defendant, and (3) that is likely to be redressed by a favorable judicial decision." *Spokeo, Inc. v. Robins*, — U.S. —, 136 S.Ct. 1540, 1547, 194 L.Ed.2d 635 (2016). The plaintiff bears the burden of "demonstrat[ing] that these requirements are met" and must do so "before a federal court can review the merits of a case." *Petrella v. Brownback*, 697 F.3d 1285, 1293 (10th Cir. 2012).

In re Peeples, 880 F.3d 1207 (2018)

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[8] We discern no plausible basis for Angela Lee to assert Article III standing here. The Lees' alleged injury is the attorney's fees the state court assessed against Adrian Lee. But Adrian Lee was the sole plaintiff in the state-court lawsuit, and the state court entered judgment for attorney's fees against Adrian Lee alone. McCardle alluded to this issue in his response brief on appeal, but the Lees made no attempt in their reply brief to explain what injury in fact Angela Lee could have suffered. Nor did they address Angela Lee's standing at oral argument. Because the Lees fail to demonstrate Angela Lee's standing to bring this case, we vacate the judgment against her below and remand to the district court with directions to dismiss her claims. *See Colo. Outfitters Ass'n v. Hickenlooper*, 823 F.3d 537, 544 (10th Cir. 2016) (declining to consider arguments in favor of standing that the plaintiff failed to "adequately brief[ ]"); *id.* at 554–55 (vacating order granting summary judgment and remanding with directions to dismiss for \*1213 lack of jurisdiction where plaintiffs failed to establish Article III standing to bring claims).

B

[9] [10] Next, we address McCardle's assertion that Adrian Lee's claims fall outside the zone of interests protected by the automatic stay.<sup>3</sup> Although traditionally viewed as a prudential- or statutory-standing requirement, the zone-of-interests doctrine isn't actually a matter of standing at all; instead, it merely asks whether a particular federal cause of action "encompasses a particular plaintiff's claim." *Lexmark Int'l v. Static Control Components, Inc.*, — U.S. —, 134 S.Ct. 1377, 1387, 188 L.Ed.2d 392 (2014); *see also United States v. Wells*, 873 F.3d 1241, 1261 (10th Cir. 2017) ("[T]he question that courts have *misguidedly* used the term 'standing' to describe ... is really whether a particular litigant is a member of a class that Congress has authorized to sue ...."). To answer this question, "we presume that a statute ordinarily provides a cause of action 'only to plaintiffs whose interests fall within the zone of interests protected by the law invoked.'" *Bank of Am. Corp. v. City of Miami*, — U.S. —, 137 S.Ct. 1296, 1302, 197 L.Ed.2d 678 (2017) (quoting *Lexmark*, 134 S.Ct. at 1388); *see also Lexmark*, 134 S.Ct. at 1388 ("Congress is presumed to 'legislat[e] against the background of' the zone-of-interests limitation, 'which applies unless it is

expressly negated.'" (quoting *Bennett v. Spear*, 520 U.S. 154, 163, 117 S.Ct. 1154, 137 L.Ed.2d 281 (1997) ).

[11] [12] [13] [14] There's no single test to determine whether a cause of action falls within a statute's zone of interests; rather "the breadth of the zone of interests varies according to the provisions of law at issue." *Bennett*, 520 U.S. at 163, 117 S.Ct. 1154. Thus, in the context of the Administrative Procedures Act (APA), under which zone-of-interests issues often arise, the Supreme Court has "said that the test 'forecloses suit only when a plaintiff's "interests are so marginally related to or inconsistent with the purposes implicit in the statute that it cannot reasonably be assumed that" ' Congress authorized that plaintiff to sue." *Lexmark*, 134 S.Ct. at 1389 (quoting *Match-E-Be-Nash-She-Wish Band of Pottawatomi Indians v. Patchak*, 567 U.S. 209, 225, 132 S.Ct. 2199, 183 L.Ed.2d 211 (2012) ). But "what comes within the zone of interests of a statute for purposes of obtaining judicial review of administrative action under the 'generous review provisions' of the APA may not do so for other purposes." *Id.* (quoting *Bennett*, 520 U.S. at 163, 117 S.Ct. 1154). We must therefore "us[e] traditional tools of statutory interpretation" to decide whether a claim falls within a particular statute's zone of interests. *Id.* at 1387.

With this understanding of the zone-of-interests doctrine, we analyze whether Lee's claims fall within the Bankruptcy Code's zone of interests. Lee asserts two distinct claims: (1) a claim for a declaratory judgment pronouncing that 11 U.S.C. § 362(a) automatically stayed the state-court lawsuit and (2) a claim for damages under 11 U.S.C. § 362(k) for McCardle's willful violation of that automatic stay. We analyze these claims separately because these two subsections of § 362 don't necessarily share the same zone of interests.

\*1214 1

[15] [16] Section 362(a) imposes an automatic stay when a debtor files a bankruptcy petition. In relevant part, this stay prevents "the commencement or continuation ... of a judicial ... action or proceeding against the debtor ... or to recover a claim against the debtor that arose before the commencement of the case under [the Bankruptcy Code]." § 362(a)(1). Lee argues that the state-court lawsuit was an action "to recover a claim against" Adam Peeples that was thus barred by the automatic stay, and he seeks a

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declaratory judgment to that effect. But the only injury Lee alleges is the judgment for attorney's fees assessed against him. Before we reach the merits of Lee's argument, we address whether this injury is the type of injury that falls within § 362(a)'s zone of interests.

[17] We impose a “stringent” zone-of-interests requirement (although we've previously referred to it simply as a “standing requirement” instead) for appeals from bankruptcy-court orders. *Nintendo Co., Ltd. v. AlpeX Comput. Corp.* (*In re AlpeX Comput. Corp.*), 71 F.3d 353, 357 n.6 (10th Cir. 1995). Generally, appellants must show that “the order [appealed from] diminishes their property, increases their burdens, or impairs their rights.” *Lopez v. Behles* (*In re Am. Ready Mix, Inc.*), 14 F.3d 1497, 1500 (10th Cir. 1994) (alteration in original) (quoting *GMAC v. Dykes* (*In re Dykes*), 10 F.3d 184, 187 (3d Cir. 1993)). Although Lee arguably meets this general standard, our case law holds that the automatic stay's zone of interests is even more limited.

Specifically, in *Lopez*, we held that an unsecured creditor couldn't appeal an order lifting the automatic stay to allow a secured creditor to foreclose on the debtor's real property because the harms the creditor alleged didn't fall within § 362(a)'s zone of interests.<sup>4</sup> *Id.* at 1501. We explained that the creditor couldn't appeal the order because he didn't have a direct interest in the property at issue, even though he may have been harmed by any loss of value to the estate that could ultimately affect his payout. We expounded that “the automatic stay is for the sole benefit of the debtors' estate ... [and] it could subvert the [bankruptcy] trustee's powers to allow a creditor to appeal if the trustee chooses not to.” *Id.*; see also *Tilley v. Vucurevich* (*In re Pecan Groves of Ariz.*), 951 F.2d 242, 244 (9th Cir. 1991) (“[I]f the [bankruptcy] trustee does not seek to enforce the protections of the automatic stay, no other party may challenge acts purportedly in violation of the automatic stay.”).

The facts of this case present an even more compelling basis than did the facts of *Lopez* for concluding that the party challenging the automatic stay hasn't asserted a harm within § 362(a)'s zone of interests. Although Lee is a creditor, he hasn't alleged that he's been harmed in his capacity as a creditor. Clearly, McCardle's alleged automatic-stay violation doesn't impair any of Lee's claims against the Peebles' bankruptcy estate. When the Peebles' bankruptcy case concludes and their assets

are divided among their creditors, Lee will receive the exact same payout that he would have had the state-court lawsuit been stayed. Instead, Lee seeks to protect himself from having to pay attorney's fees assessed against him in a state-court lawsuit. Lee's goal thus falls outside the stay's zone of interests. Cf. \*1215 *Magnoni v. Globe Inv. & Loan Co., Inc.* (*In re Globe Inv. & Loan Co., Inc.*), 867 F.2d 556, 560 (9th Cir. 1989) (holding that automatic stay's zone of interests didn't extend to creditors whose injuries stemmed from their status as “aggrieved property owners,” not creditors).

[18] Moreover, Lee doesn't suggest that remedying his injury will benefit the bankruptcy estate. Instead, he responds that his declaratory-judgment claim must fall within the automatic stay's zone of interests because otherwise he has no redress for his injury (i.e. the state-court judgment). But this isn't the case: Lee's injury is the state court's assessment of attorney's fees against him and he may appeal that order in state court. In any event, Lee's ability to redress his injury is irrelevant to the zone-of-interests analysis. The very point of the zone-of-interests doctrine is that not every injury traceable to the violation of a federal statute is remediable in the federal courts. See *Clarke v. Sec. Indus. Ass'n*, 479 U.S. 388, 395–96, 107 S.Ct. 750, 93 L.Ed.2d 757 (1987) (describing zone-of-interests doctrine as limiting causes of action where Congress didn't “intend[ ] to allow suit by every person suffering injury in fact” from statutory violation). An injury in fact that is traceable to the defendant's actions is already a necessary condition for Article III standing. See *Spokeo*, 136 S.Ct. at 1547. If we accept Lee's argument, then there could never be a case in which a plaintiff meets Article III's standing requirements but fails the zone-of-interests test; the test for Article III standing would swallow the zone-of-interests doctrine. Cf. *Thompson v. N. Am. Stainless, LP*, 562 U.S. 170, 177, 131 S.Ct. 863, 178 L.Ed.2d 694 (2011) (construing Title VII's zone of interests “more narrowly than the outer boundaries of Article III”).

At oral argument, Lee further argued that he must necessarily have the power to enforce the automatic stay because otherwise no one could. This isn't true either; the bankruptcy trustee could have enforced the automatic stay if doing so were in the estate's interest. And the bankruptcy trustee's decision not to enforce the automatic stay precisely illustrates the zone-of-interests doctrine's application here: to the extent that the bankruptcy trustee concludes that enforcing the automatic stay

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wouldn't benefit the estate, doing so would further no congressional purpose. Lee certainly doesn't suggest that Congress created the automatic stay to allow creditors to avoid judgments for attorney's fees they incurred while attempting to collect their debts. Cf. *Magnoni*, 867 F.2d at 560 ("The appellants' cause of action under section 362 is a disingenuous attempt to use the Bankruptcy Code to their advantage."). We therefore conclude that § 362(a)'s zone of interests doesn't extend to Lee's attempt to avoid the attorney's fees the state court assessed against him. Accordingly, we agree that Lee's declaratory judgment claim must be dismissed.

2

[19] [20] Whether Lee's claim for damages falls within § 362(k)'s zone of interests is a slightly different question. The language of § 362(k) suggests a broader reach than § 362(a): it provides that "an *individual* injured by any willful violation of a stay provided by this section shall recover actual damages." § 362(k) (emphasis added). Because the zone-of-interests doctrine presumes congressional intent to limit causes of action, Congress can expand a statute's zone of interests with language indicating that a cause of action extends to a broader range of claims. See *Lexmark*, 134 S.Ct. at 1388. But broad language doesn't necessarily expand a statute's zone of interests to Article III's limits. For example, the Supreme Court interpreted the language "person aggrieved" in Title VII as incorporating the APA's zone-of-interests \*1216 test instead of expanding upon it. *Thompson*, 562 U.S. at 178, 131 S.Ct. 863. So even though anyone with Article III standing could conceivably be a "person aggrieved," the Court refused to assume that Congress intended Title VII's zone of interests to extend to those who are marginally harmed by workplace discrimination. See *id.* at 176-77, 131 S.Ct. 863.

[21] [22] We read "individual" in § 362(k) similarly. "[T]he nature of bankruptcy litigation ... almost always implicates the interests of persons who are not formally parties to the litigation." *Tilley*, 951 F.2d at 245. Congress couldn't possibly have intended for anyone who is marginally injured by an automatic-stay violation to sue for damages under § 362(k). Such claims are limited to those whose interests Congress intended to protect with the automatic stay. See *St. Paul Fire & Marine Ins. Co v. Labuzan*, 579 F.3d 533, 540 (5th Cir. 2009) ("If Congress

intended to abrogate the prudential standing requirement by enacting § 362(k), that intent is not expressed clearly.").

[23] [24] As we explained above, the automatic stay is for the benefit of the estate. But the term "individual" at least suggests that § 362(k) is meant for some party or parties other than the bankruptcy trustee.<sup>5</sup> The most logical conclusion is that § 362(k) creates a cause of action for debtors and creditors. As the Fifth Circuit explained, the automatic stay's specific purposes are to protect the debtor from collection efforts and to protect creditors from inequitable treatment. See *St. Paul Marine & Fire Ins.*, 579 F.3d at 540. So § 362(k)'s zone of interests extends to debtors and creditors when they allege those types of harms. But when a creditor alleges an injury in some capacity other than as a creditor, the automatic stay's goal of ensuring equal creditor treatment isn't implicated. See *id.* at 545 ("[T]he Labuzans, as pre-petition creditors of CTL, have standing to assert a claim against St. Paul ... [but] to the extent the Labuzans' claims are based on their status as *owners/equity holders* of CTL, § 362(k) cannot be invoked."); *In re Ampal-Am. Isr. Corp.*, 502 B.R. 361, 371 (Bankr. S.D.N.Y. 2013) ("In other words, the fact that someone is a pre-petition creditor is not a foot in the door that allows the creditor to recover damages for injuries suffered to its non-creditor interests.").

As explained above, Lee may be the Peeples' creditor, but McCardle's alleged automatic-stay violation didn't harm him in that capacity. Lee's claim for damages therefore falls outside of § 362(k)'s zone of interests. Accordingly, we agree that Lee's § 362(k) claim must be dismissed.

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The interests that led Congress to create the automatic stay simply aren't harmed when a state court assesses attorney's fees against a creditor. Because devoting further attention to Adrian Lee's claims wouldn't further congressional policy, those claims aren't within the automatic stay's zone of interests and therefore he may not assert them. We thus affirm the district court's judgment against Adrian Lee. But because Angela Lee hasn't established that she has Article III standing, we vacate the district court's judgment against her and remand with instructions to dismiss her claims for lack of jurisdiction.

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Footnotes

- 1 Adrian Lee is a barred attorney who is representing himself and Angela Lee, his wife, in this matter.
- 2 Only the order granting McCardle's motion—not the order denying the Lees' motion—is properly before us. See *Poolaw v. Marcantel*, 565 F.3d 721, 728 (10th Cir. 2009) (“Orders ... denying summary judgment are generally not final appealable orders ....”).
- 3 Neither the bankruptcy court nor the district court addressed this preliminary issue. But McCardle raised this issue to both courts below and does so again on appeal, so we choose to address it. See *Richison v. Ernest Grp., Inc.*, 634 F.3d 1123, 1130 (10th Cir. 2011) (explaining that “we may affirm on any basis supported by the record, even if it requires ruling on arguments not reached by the district court”).
- 4 In *Lopez* we incorrectly characterized this as a standing issue. See *Lopez*, 14 F.3d at 1501; *Lexmark*, 134 S.Ct. at 1387.
- 5 The Bankruptcy Code doesn't define “individual.” See 11 U.S.C. § 101.

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14 F.3d 1497  
 United States Court of Appeals,  
 Tenth Circuit.

In re AMERICAN READY MIX, INC., Debtor,  
 and  
 Albuquerque Sand & Gravel, Inc., d/b/  
 a American Sand & Gravel, Inc., Debtor.  
 Andrew Leo LOPEZ, Appellant,

v.

Daniel J. BEHLES, Trustee, Appellee.

In re AMERICAN READY MIX, INC., Debtor,  
 and  
 Albuquerque Sand & Gravel, Inc., d/b/  
 a American Sand & Gravel, Inc., Debtor.  
 Andrew Leo LOPEZ, Appellant,

v.

Daniel J. BEHLES, Trustee, Appellee.

Nos. 93-2042, 93-2141.

Feb. 2, 1994.

**Synopsis**

Professional employed by Chapter 7 estate sought to appeal from three separate orders of the Bankruptcy Court denying his motion for recusal of bankruptcy judge, lifting stay to allow mortgagee to proceed with foreclosure action, and granting application for professional fees. The United States District Court for the District of New Mexico, Juan G. Burciaga, Chief Judge, affirmed. On further appeal, the Court of Appeals, Tacha, Circuit Judge, held that: (1) bankruptcy judge's denial of motion to disqualify himself was not abuse of discretion; (2) professional did not have standing to appeal bankruptcy court order lifting stay to allow foreclosure action to proceed; and (3) professional failed to demonstrate that he had sufficiently direct and adverse pecuniary interest in bankruptcy court's order granting other professional's application for compensation to have standing to appeal from order.

Appeals dismissed; petition for writ of mandamus denied.

West Headnotes (20)

[1] **Federal Courts**

⇨ Determination of question of jurisdiction  
 Court of Appeals has independent duty to inquire into its jurisdiction over dispute, even though neither party contests it and parties are prepared to concede it.

27 Cases that cite this headnote

[2] **Bankruptcy**

⇨ Interlocutory orders; collateral order doctrine  
 Bankruptcy judge's order denying a motion to recuse himself was "interlocutory order," which was not immediately appealable.

14 Cases that cite this headnote

[3] **Bankruptcy**

⇨ Finality  
 Bankruptcy judge's orders are "final" and "appealable" when they dispose of particular adversary proceeding or discrete controversy pursued within broader framework cast by bankruptcy petition.

7 Cases that cite this headnote

[4] **Mandamus**

⇨ Specific acts  
 Mandamus is appropriate means of reviewing judge's refusal to disqualify himself.

1 Cases that cite this headnote

[5] **Bankruptcy**

⇨ Right of review and persons entitled; parties; waiver or estoppel  
 "Person aggrieved," such as will have standing to appeal from bankruptcy court's order, is person whose rights or interests are directly and adversely affected pecuniarily by order.

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23 Cases that cite this headnote

5 Cases that cite this headnote

[6] **Bankruptcy**

↔ Right of review and persons entitled; parties;waiver or estoppel

Litigant is "person aggrieved" by bankruptcy court's order, with standing to appeal therefrom, if order diminishes litigant's property, increases litigant's burdens, or impairs litigant's rights.

14 Cases that cite this headnote

[7] **Bankruptcy**

↔ Remand

If there is dispute in facts bearing on party's standing to appeal from bankruptcy court's order, issue of party's standing should be remanded to lower court; it is only when there is no dispute in relevant facts that circuit court may go ahead and decide issue.

15 Cases that cite this headnote

[8] **Judges**

↔ Bias and Prejudice

Bankruptcy judge did not have to disqualify himself based on his alleged bias, where only evidence of judge's bias against party was his judicial decisions against party.

2 Cases that cite this headnote

[9] **Bankruptcy**

↔ Discretion

Bankruptcy judge's denial of motion to recuse is reviewed for abuse of discretion.

5 Cases that cite this headnote

[10] **Judges**

↔ Determination of objections

Judge should recuse himself if reasonable person, knowing all of the relevant facts, would harbor doubts about judge's impartiality.

[11] **Judges**

↔ Determination of objections

Judge has as much of an obligation not to recuse himself when there is no occasion to do so as to recuse himself when grounds for recusal exists.

5 Cases that cite this headnote

[12] **Judges**

↔ Sufficiency of objection, affidavit, or motion

Judge should not recuse himself based on unsupported, irrational or highly tenuous speculation.

10 Cases that cite this headnote

[13] **Judges**

↔ Bias and Prejudice

Allegation of personal bias by judge must be based on extrajudicial source to constitute grounds for judge's recusal.

7 Cases that cite this headnote

[14] **Judges**

↔ Bias and Prejudice

**Judges**

↔ Statements and expressions of opinion by judge

Judge's adverse rulings alone are insufficient basis for disqualifying judge based on his alleged bias, as is evidence that judge criticized or was angry with party.

12 Cases that cite this headnote

[15] **Mandamus**

↔ Nature and existence of rights to be protected or enforced

Mandamus relief will lie only when petitioner demonstrates a clear and indisputable right to relief.

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Cases that cite this headnote

**[16] Bankruptcy**

☛ Right of review and persons entitled; parties;waiver or estoppel

Professional employed by estate did not have standing to appeal from bankruptcy court order lifting stay to permit mortgagee to foreclose on its mortgage, where professional had no interest in property subject to foreclosure action and had only an indirect interest in challenged order to the extent that disposition of estate assets presumably affected the eventual payment or nonpayment of his administrative claim; professional failed to demonstrate any "direct and adverse pecuniary interest" in order.

15 Cases that cite this headnote

**[17] Bankruptcy**

☛ Automatic Stay

Automatic stay is for sole benefit of debtor's estate.

3 Cases that cite this headnote

**[18] Bankruptcy**

☛ Right of review and persons entitled; parties;waiver or estoppel

Professional employed by Chapter 7 estate did not have standing to appeal from bankruptcy court order granting professional fees to other applicant.

6 Cases that cite this headnote

**[19] Bankruptcy**

☛ Right of review and persons entitled; parties;waiver or estoppel

Party could not be allowed to appeal from bankruptcy court's orders, merely because no party had objected to his standing to appeal.

2 Cases that cite this headnote

**[20] Federal Courts**

☛ Waiver, estoppel, and consent

Parties may not consent to jurisdiction of federal court, no matter how that consent is phrased.

Cases that cite this headnote

**Attorneys and Law Firms**

\*1499 Andrew Leo Lopez, pro se.

Karen A. Hasselstrom of Behles & Associates, Albuquerque, New Mexico, for Appellee in case No. 93-2042.

George Moore Moore of Behles & Associates, Albuquerque, New Mexico, for Appellee in case No. 93-2141.

Before TACHA and KELLY, Circuit Judges, and BROWN,\* District Judge.

**Opinion**

TACHA, Circuit Judge.

Appellant Andrew Leo Lopez, representing himself, appeals from three orders of the district court affirming three orders of the bankruptcy court. The parties addressed the two issues in No. 93-2042 in two sets of briefs, one set for each issue. To keep the issues separate, we will refer to them as "No. 93-2042A" and "No. 93-2042B." In No. 93-2042A, Mr. Lopez challenges a bankruptcy court order that denied his motion to recuse or disqualify the bankruptcy judge pursuant to Rule 5004 of the Bankruptcy Code and 28 U.S.C. § 455(a) and (b) (1). R., Doc. 1, attachment A. In No. 93-2042B, Mr. Lopez challenges a bankruptcy court order that lifted the automatic stay as to Val & Sons, Inc. and Valentin and Marjorie Trujillo, so that Val & Sons could foreclose on its mortgage on certain real property belonging to the American Ready Mix estate. *Id.*, attachment B. In No. 93-2141, Mr. Lopez challenges a bankruptcy court order that authorized the payment of fees to the accountant for the Chapter 7 trustee. Because we conclude that we lack jurisdiction over these appeals, we dismiss. Construing

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the appeal in No. 93-2042A as a petition for a writ of mandamus, we deny relief.<sup>1</sup>

JURISDICTION

[1] It is well-settled that this court has an independent duty to inquire into its jurisdiction over a dispute, even where neither party contests it and the parties are prepared to concede it. See *Bender v. Williamsport Area Sch. Dist.*, 475 U.S. 534, 541, 106 S.Ct. 1326, 1331, 89 L.Ed.2d 501 (1986). As the appellant, it was Mr. Lopez's duty to establish and include in each opening brief a statement of this court's jurisdiction to consider his appeals. Fed.R.App.P. 28(a)(2).

1. Finality—No. 93-2042A

[2] [3] [4] In No. 93-2042A, Mr. Lopez appeals from an order of the bankruptcy court denying his motion to recuse or disqualify the bankruptcy judge. An order denying a motion to recuse or disqualify a judge is interlocutory, not final, and is not immediately appealable. See *Alexander v. Primerica Holdings, Inc.*, 10 F.3d 155, 162 (3d Cir.1993)<sup>2</sup> (noting that most circuit courts recognize "necessity and propriety of interlocutory review of disqualification issues"). Mandamus is an appropriate means of reviewing a judge's refusal to disqualify him- or herself, however. *Id.*; see also *Frates v. Weinshienk*, 882 F.2d 1502, 1503-04 (10th Cir.1989), *cert. denied*, 494 U.S. 1004, 110 S.Ct. 1297, 108 L.Ed.2d 474 (1990). Even if we construe the appeal as a petition for mandamus, Mr. Lopez nevertheless has failed to demonstrate his entitlement to relief. A threshold question is whether Mr. Lopez has standing to challenge the bankruptcy judge's refusal to recuse himself. The question of standing is also common to the orders appealed from in Nos. 93-2042B and 93-2141.

\*1500 2. Standing

[5] [6] The Bankruptcy Code of 1978, 11 U.S.C. § 101 *et seq.*, does not contain an explicit grant or limitation on appellate standing. Relying on pre-Code law, however, a number of courts, including this one, *Holmes v. Silver Wings Aviation, Inc.*, 881 F.2d 939, 940

(10th Cir.1989), have adopted a standard that requires an appellant to show that he is a "person aggrieved" by the challenged bankruptcy court order. That is, only a person "whose rights or interests are directly and adversely affected pecuniarily by the decree or order of the bankruptcy court" may appeal. *Id.* at 940 (citing *Fondiller v. Robertson (In re Fondiller)*, 707 F.2d 441, 442-43 (9th Cir.1983) (internal quotations and other citations omitted). "Litigants are 'persons aggrieved' if the order [appealed from] diminishes their property, increases their burdens, or impairs their rights." *GMAC v. Dykes (In re Dykes)*, 10 F.3d 184, 187 (3d Cir. Nov. 30, 1993) (citing *Fondiller*, 707 F.2d at 442). The "person aggrieved" test is meant to be a limitation on appellate standing in order to avoid "endless appeals brought by a myriad of parties who are indirectly affected by every bankruptcy court order." *Holmes*, 881 F.2d at 940.

[7] If there is a dispute in the relevant facts, the issue of an appellant's standing should be remanded to the district court. *In re Dykes*, 10 F.3d at 187. If there is no dispute in the relevant facts, the circuit court may go ahead and decide the issue. *Id.* We conclude, as we explain below, that Mr. Lopez did not allege sufficient facts in No. 93-2042B, or No. 93-2141 either to raise a fact question for remand or to establish jurisdiction and, therefore, these appeals are dismissed for lack of standing.

Mr. Lopez asserts he has standing to appeal from all three bankruptcy court orders on the basis he is a creditor of the estates. The parties dispute whether Mr. Lopez is a creditor. Mr. Lopez, an accountant with a business degree, became, post-petition, a professional employee of the debtor companies pursuant to 11 U.S.C. § 327 and the approval of the bankruptcy court. Addendum to Appellant's Br. on Standing, Docs. 1 and 2. Because Mr. Lopez's claim against the estates is post-petition,<sup>3</sup> technically, he is not a creditor. See 11 U.S.C.A. § 101(10). However, whether or not Mr. Lopez is a creditor misses the point.

To have standing to appeal, Mr. Lopez must demonstrate he has a direct and adverse pecuniary interest in each order he challenges. See *International Trade Admin. v. Rensselaer Polytechnic Inst.*, 936 F.2d 744, 746-48 (2d Cir.1991) (holding that bank with secured interest in lease which was subject of bankruptcy court order had standing to challenge that order); *Brady v. Andrew (In re Commercial W. Fin. Corp.)*, 761 F.2d 1329, 1334-

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35 (9th Cir.1985) (holding that, where bankruptcy plan eliminated the interests of certain investors, the investors had standing to appeal from order confirming that plan); *Salomon v. Logan (In re International Envtl. Dynamics, Inc.)*, 718 F.2d 322, 326 (9th Cir.1983) (holding that claimant who sought part of limited funds had standing to appeal from order disposing of those funds); cf. *Pignato v. Dein Host, Inc. (In re Dein Host, Inc.)*, 835 F.2d 402, 404-07 (1st Cir.1987) (holding that, where direct injury caused by bankruptcy court order was to corporation, corporate officer who was harmed only indirectly as shareholder lacked standing to appeal).

[8] In No. 93-2042A, Mr. Lopez challenges a bankruptcy court order in which the judge refused to recuse. Mr. Lopez does not cite, nor have we found, any cases that clearly support his assertion of standing to challenge this order. Arguably, though, he can show a direct and adverse pecuniary interest in this order, because one effect of the bankruptcy judge's refusal to recuse was to leave in place an order converting the proceeding from Chapter 11 to Chapter 7, and the conversion effectively terminated Mr. Lopez's employment with the debtors. Assuming Mr. Lopez has standing, he has failed to demonstrate his entitlement to relief.

[9] [10] [11] [12] The denial of a motion to recuse is reviewed for an abuse of discretion. \*1501 *Hinman v. Rogers*, 831 F.2d 937, 938 (10th Cir.1987). Under § 455, a judge should recuse if "a reasonable person, knowing all the relevant facts, would harbor doubts about the judge's impartiality." *Id.* at 939. However, "factual allegations do not have to be taken as true," and "[t]here is as much obligation for a judge not to recuse when there is no occasion ... to do so as there is ... to [recuse] when there is." *Id.* "A judge should not recuse ... on unsupported, irrational, or highly tenuous speculation." *Id.*

[13] [14] Mr. Lopez asserts that the bankruptcy judge was biased against him because, at a hearing on the motion for conversion from Chapter 11 to Chapter 7, opposing counsel offered into evidence a letter from Mr. Lopez to the State of New Mexico in which Mr. Lopez accused the State of having caused the death of the debtors' chief accountant by accusing him of failing to file tax returns for the debtors. After reading the letter, Mr. Lopez says, the bankruptcy judge started ruling against him. Mr. Lopez adds that opposing counsel offered the offending letter again at a later hearing. Except that it is clear that the

judge's subsequent decisions were adverse to Mr. Lopez, however, Mr. Lopez's argument that the judge was biased is unsupported in fact. In addition, and as the district judge correctly pointed out, an allegation of personal bias must be based on an "extrajudicial source and result in an opinion on the merits on some basis other than what the judge learned from his participation in the case." *United States v. Grinnell Corp.*, 384 U.S. 563, 583, 86 S.Ct. 1698, 1710, 16 L.Ed.2d 778 (1966). Adverse rulings alone are insufficient grounds for disqualification, *Green v. Dorrell*, 969 F.2d 915, 919 (10th Cir.1992), cert. denied, 507 U.S. 940, 113 S.Ct. 1336, 122 L.Ed.2d 720 (1993), as is evidence that the judge criticized or was angry with a party, *United States v. Troxell*, 887 F.2d 830, 833-34 (7th Cir.1989). Therefore, the bankruptcy judge did not abuse his discretion by refusing to recuse himself.

[15] To obtain mandamus relief, Mr. Lopez must demonstrate a "clear and indisputable" right to relief. *Will v. United States*, 389 U.S. 90, 96, 88 S.Ct. 269, 274, 19 L.Ed.2d 305 (1967) (quoting *Bankers Life & Casualty Co. v. Holland*, 346 U.S. 379, 384, 74 S.Ct. 145, 148, 98 L.Ed. 106 (1953)). Because we conclude the bankruptcy judge did not abuse his discretion in refusing to recuse himself, it follows that Mr. Lopez cannot meet the higher mandamus standard.

[16] Mr. Lopez lacks standing to challenge the orders appealed from in Nos. 93-2042B and 93-2141. In No. 93-2042B, Mr. Lopez challenges a bankruptcy court order that lifted the automatic stay as to Val & Sons so that it could foreclose on its mortgage on the debtors' building. Although Mr. Lopez apparently has an indirect interest in the challenged order because any disposition of estate assets presumably affects the eventual payment or nonpayment of his administrative claim, Mr. Lopez asserts no interest in the building which was subject to foreclosure due to the bankruptcy court's order lifting the automatic stay. Therefore, he has failed to assert a direct and adverse pecuniary interest in the order appealed from in No. 93-2042B, and has failed to establish standing.

[17] It is also true that the automatic stay is for the sole benefit of the debtors' estate. *Tilley v. Vucurevich (In re Pecan Groves of Ariz.)*, 951 F.2d 242, 245 (9th Cir.1991). The trustee may challenge an order lifting the stay, but it could subvert the trustee's powers to allow a creditor to appeal if the trustee chooses not to. *Id.* Here, the trustee stipulated to lifting the stay in the first place.

*In re American Ready Mix, Inc.*, 14 F.3d 1497 (1994)

30 Collier Bankr.Cas.2d 984, 25 Bankr.Ct.Dec. 326, Bankr. L. Rep. P 75,754

[18] In No. 93-2141, Mr. Lopez appeals from an order granting fees to the Chapter 7 trustee's accountant. As indicated above, although Mr. Lopez apparently has an indirect interest in any order disposing of the debtors' funds, he asserts no direct interest in the actual funds distributed by the challenged order. *Cf. In re International Envtl. Dynamics, Inc.*, 718 F.2d at 326 (claimant sought portion of funds disposed of by challenged order). That is, if paying the Chapter 7 accountant means that Mr. Lopez will not get paid, or if *not* paying the Chapter 7 accountant means that Mr. Lopez *will* get paid, Mr. Lopez has failed to demonstrate how either is true. Therefore, Mr. Lopez \*1502 has failed to establish standing to appeal in No. 93-2141.

In addition, Mr. Lopez argues that he has standing to appeal pursuant to 11 U.S.C. § 1109(b). Through Bankr.R. 2018, § 1109(b) "expands the right to be heard [in a Chapter 11 proceeding] to a wider class than those who qualify under the 'person aggrieved' standard." *International Trade Admin.*, 936 F.2d at 747. Section 1109(b) says nothing about a party's standing to appeal. The cases cited by Mr. Lopez, because they do not concern standing to appeal, are unhelpful to his position.

[19] [20] Mr. Lopez also argues he should be allowed to intervene pursuant to Fed.R.Civ.P. 24(a)(2) because no party has objected to his intervention so far, or, in

the alternative, that he can intervene as a matter of right because the trustee and the debtor-in-possession are in collusion and have not adequately represented the creditors' interest. Parties may not consent to jurisdiction, however, no matter how that consent is phrased. *See Bender*, 475 U.S. at 541, 106 S.Ct. at 1331. Mr. Lopez's asserted right to intervene is insufficient; he still must have standing to appeal. *In re Pecan Groves*, 951 F.2d at 245.

To the extent Mr. Lopez attempts, in No. 93-2042A, to raise the issue of the magistrate judge's disqualification, he neither points out, nor have we found, where this issue was raised before the district court. Therefore, the issue is not properly before this court and we will not address it. *Dais-Naid, Inc. v. Phoenix Resource Cos. (In re Texas Int'l Corp.)*, 974 F.2d 1246, 1247 n. 3 (10th Cir.1992) (circuit court does not ordinarily consider issues raised for first time on appeal).

Appellant's motion to reject appellee's answer brief is DENIED.

These appeals are DISMISSED, and the petition for writ of mandamus is DENIED.

**All Citations**

14 F.3d 1497, 30 Collier Bankr.Cas.2d 984, 25 Bankr.Ct.Dec. 326, Bankr. L. Rep. P 75,754

**Footnotes**

- \* Honorable Wesley E. Brown, Senior District Judge, United States District Court for the District of Kansas, sitting by designation.
- 1 After examining the briefs and appellate record, this panel has determined unanimously that oral argument would not materially assist the determination of these appeals. *See* Fed.R.App.P. 34(a); 10th Cir.R. 34.1.9. The cases are therefore ordered submitted without oral argument.
- 2 In bankruptcy proceedings, an order is final and appealable when it disposes of a "particular adversary proceeding or discrete controversy pursued within the broader framework cast by the petition." *Cascade Energy & Metals Corp. v. Banks (In re Cascade Energy & Metals Corp.)*, 956 F.2d 935, 938-39 (10th Cir.1992) (quoting *Adelman v. Fourth Nat'l Bank & Trust Co. (In re Durability, Inc.)*, 893 F.2d 264, 266 (10th Cir.1990)).
- 3 Mr. Lopez apparently does have an administrative claim against the estates.

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Lexmark Intern., Inc. v. Static Control Components, Inc., 572 U.S. 118 (2014)

134 S.Ct. 1377, 188 L.Ed.2d 392, 82 USLW 4195, 2014-1 Trade Cases P 78,716...

134 S.Ct. 1377  
 Supreme Court of the United States  
 LEXMARK INTERNATIONAL, INC., Petitioner  
 v.  
 STATIC CONTROL COMPONENTS, INC.

No. 12-873.  
 |  
 Argued Dec. 3, 2013.  
 |  
 Decided March 25, 2014.

[3] injuries alleged by manufacturer fell within zone of interests protected by false advertising provision of Lanham Act; and

[4] manufacturer satisfied proximate causation requirement for coverage by Lanham Act's false advertising provision.

Affirmed.

**Synopsis**

**Background:** Toner cartridge supplier brought action against manufacturer of components necessary for remanufacture, by supplier's competitors, of supplier's cartridges, alleging violations of Copyright Act and Digital Millennium Copyright Act. Manufacturer counterclaimed, alleging false advertising in violation of Lanham Act. The United States District Court for the Eastern District of Kentucky granted supplier's motion to dismiss manufacturer's Lanham Act counterclaim. Manufacturer appealed. The Sixth Circuit Court of Appeals, Karen Nelson Moore, Circuit Judge, 697 F.3d 387, reversed. Certiorari was granted.

**Holdings:** The Supreme Court, Justice Scalia, held that:

[1] a court cannot limit a cause of action that Congress has created merely because "prudence" dictates, abrogating *Elk Grove Unified School Dist. v. Newdow*, 542 U.S. 1, 12, 124 S.Ct. 2301, 159 L.Ed.2d 98; *Allen v. Wright*, 468 U.S. 737, 751, 104 S.Ct. 3315, 82 L.Ed.2d 556 (1984);

[2] a direct application of the zone-of-interests test and the proximate-cause requirement supplies the relevant limits on who may sue for false advertising under the Lanham Act; abrogating *Conte Bros. Automotive, Inc. v. Quaker State-Slick 50, Inc.*, 165 F.3d 221; *Procter & Gamble Co. v. Amway Corp.*, 242 F.3d 539; *Gilbert/Robinson, Inc. v. Carrie Beverage-Missouri, Inc.*, 989 F.2d 985; *Phoenix of Broward, Inc. v. McDonald's Corp.*, 489 F.3d 1156; *L.S. Heath & Son, Inc. v. AT & T Information Systems, Inc.*, 9 F.3d 561; *Waits v. Frito-Lay, Inc.*, 978 F.2d 1093; *Stanfield v. Osborne Industries, Inc.*, 52 F.3d 867; *Famous Horse, Inc. v. 5th Avenue Photo Inc.*, 624 F.3d 106;

West Headnotes (31)

[1] **Antitrust and Trade Regulation**

☞ Representations, assertions, and descriptions in general

**Antitrust and Trade Regulation**

☞ Advertising, Marketing, and Promotion

**Antitrust and Trade Regulation**

☞ Origin, representations concerning

The Lanham Act provision governing civil actions for false designation of origin, false or misleading description of fact, or false or misleading representation of fact creates two distinct bases of liability: false association and false advertising. Lanham Act, § 43(a)(1)(A, B), 15 U.S.C.A. § 1125(a)(1)(A, B).

77 Cases that cite this headnote

[2] **Federal Civil Procedure**

☞ In general;injury or interest

From Article III's limitation of the judicial power to resolving "Cases" and "Controversies," and the separation-of-powers principles underlying that limitation, the Supreme Court has deduced a set of requirements that together make up the irreducible constitutional minimum of standing. U.S.C.A. Const. Art. 3, § 2, cl. 1.

30 Cases that cite this headnote

[3] **Federal Civil Procedure**

☞ In general;injury or interest

Lexmark Intern., Inc. v. Static Control Components, Inc., 572 U.S. 118 (2014)

134 S.Ct. 1377, 188 L.Ed.2d 392, 82 USLW 4195, 2014-1 Trade Cases P 78,716...

**Federal Civil Procedure**

↔ Causation;redressability

To have Article III standing, the plaintiff must have suffered or be imminently threatened with a concrete and particularized injury in fact that is fairly traceable to the challenged action of the defendant and likely to be redressed by a favorable judicial decision. U.S.C.A. Const. Art. 3, § 2, cl. 1.

217 Cases that cite this headnote

[4] **Antitrust and Trade Regulation**

↔ Persons protected and entitled to sue

Complaint filed by manufacturer of components necessary for remanufacture of toner cartridge supplier's cartridges, alleging lost sales and damage to its business reputation as result of supplier's alleged misrepresentations, sufficiently presented case or controversy, as required for manufacturer to have Article III standing to bring false advertising claim against supplier under Lanham Act. U.S.C.A. Const. Art. 3, § 2, cl. 1; Lanham Act, § 43(a)(1)(B), 15 U.S.C.A. § 1125(a)(1)(B).

14 Cases that cite this headnote

[5] **Federal Courts**

↔ Right to Decline Jurisdiction; Abstention

A federal court's obligation to hear and decide cases within its jurisdiction is virtually unflagging.

63 Cases that cite this headnote

[6] **Federal Civil Procedure**

↔ In general;injury or interest

Whether a plaintiff comes within the zone of interests protected by a statute is an issue that requires the Supreme Court to determine, using traditional tools of statutory interpretation, whether a legislatively conferred cause of action encompasses a particular plaintiff's claim.

150 Cases that cite this headnote

[7] **Federal Civil Procedure**

↔ In general;injury or interest

"Prudential standing" is a misnomer as applied to the zone-of-interests analysis, which asks whether this particular class of persons has a right to sue under this substantive statute.

88 Cases that cite this headnote

[8] **Federal Civil Procedure**

↔ Rights of third parties or public

**Federal Courts**

↔ Injury, harm, causation, and redress

Suits claiming only harm to the plaintiff's and every citizen's interest in proper application of the Constitution and laws, and seeking relief that no more directly and tangibly benefits him than it does the public at large, do not present constitutional cases or controversies, and are barred for constitutional reasons, not prudential ones.

7 Cases that cite this headnote

[9] **Action**

↔ Statutory rights of action

**Constitutional Law**

↔ Civil Remedies and Procedure

**Constitutional Law**

↔ Creation of rights of action

**Federal Civil Procedure**

↔ In general;injury or interest

Just as a court cannot apply its independent policy judgment to recognize a cause of action that Congress has denied, it cannot limit a cause of action that Congress has created merely because "prudence" dictates; abrogating *Elk Grove Unified School Dist. v. Newdow*, 542 U.S. 1, 124 S.Ct. 2301, 159 L.Ed.2d 98; *Allen v. Wright*, 468 U.S. 737, 104 S.Ct. 3315, 82 L.Ed.2d 556.

20 Cases that cite this headnote

Lexmark Intern., Inc. v. Static Control Components, Inc., 572 U.S. 118 (2014)

134 S.Ct. 1377, 188 L.Ed.2d 392, 82 USLW 4195, 2014-1 Trade Cases P 78,716...

**[10] Antitrust and Trade Regulation**

☞ Persons protected and entitled to sue

The Lanham Act provision authorizing suit by “any person who believes that he or she is likely to be damaged” by a defendant’s false advertising does not provide that an action is available to anyone who can satisfy the minimum requirements of Article III, given the unlikelihood that Congress meant to allow all factually injured plaintiffs to recover. U.S.C.A. Const. Art. 3, § 2, cl. 1; Lanham Act, § 43(a)(1), 15 U.S.C.A. § 1125(a)(1).

11 Cases that cite this headnote

**[11] Federal Civil Procedure**

☞ In general;injury or interest

Under the zone-of-interests test, the Supreme Court presumes that a statutory cause of action extends only to plaintiffs whose interests fall within the zone of interests protected by the law invoked.

208 Cases that cite this headnote

**[12] Federal Civil Procedure**

☞ In general;injury or interest

The zone-of-interests test for determining who is protected by a statute always applies to statutorily created causes of action and is never negated, but the analysis of certain statutes will show that they protect a more-than-usually expansive range of interests.

30 Cases that cite this headnote

**[13] Antitrust and Trade Regulation**

☞ Persons protected and entitled to sue

To come within the zone of interests in a suit for false advertising under the Lanham Act, a plaintiff must allege an injury to a commercial interest in reputation or sales. Lanham Act, § 43(a)(1)(B), 15 U.S.C.A. § 1125(a)(1)(B).

157 Cases that cite this headnote

**[14] Antitrust and Trade Regulation**

☞ Persons protected and entitled to sue

A consumer who is hoodwinked into purchasing a disappointing product may well have an injury-in-fact cognizable under Article III, but he cannot invoke the protection of the Lanham Act’s false advertising provision. U.S.C.A. Const. Art. 3, § 2, cl. 1; Lanham Act, § 43(a)(1)(B), 15 U.S.C.A. § 1125(a)(1)(B).

19 Cases that cite this headnote

**[15] Antitrust and Trade Regulation**

☞ Persons protected and entitled to sue

Under the zone-of-interests test, even a business misled by a supplier into purchasing an inferior product is, like consumers generally, not under the aegis of the Lanham Act’s false advertising provision. Lanham Act, § 43(a)(1)(B), 15 U.S.C.A. § 1125(a)(1)(B).

31 Cases that cite this headnote

**[16] Federal Civil Procedure**

☞ Causation;redressability

The Supreme Court generally presumes that a statutory cause of action is limited to plaintiffs whose injuries are proximately caused by violations of the statute.

25 Cases that cite this headnote

**[17] Federal Civil Procedure**

☞ Causation;redressability

**Federal Courts**

☞ Injury, harm, causation, and redress

The venerable common law principle, that in all cases of loss, the loss is to be attributed to the proximate cause, and not to any remote cause, reflects the reality that the judicial remedy cannot encompass every conceivable harm that can be traced to alleged wrongdoing.

7 Cases that cite this headnote

**[18] Federal Civil Procedure**

**Lexmark Intern., Inc. v. Static Control Components, Inc., 572 U.S. 118 (2014)**

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↔ Causation;redressability

**Federal Courts**

↔ Injury, harm, causation, and redress

Proximate-cause analysis for determining who is protected by a statute is controlled by the nature of the statutory cause of action; the question it presents is whether the harm alleged has a sufficiently close connection to the conduct the statute prohibits.

29 Cases that cite this headnote

**[19] Federal Civil Procedure**

↔ Causation;redressability

**Federal Courts**

↔ Injury, harm, causation, and redress

The proximate-cause requirement for protection by a statute generally bars suits for alleged harm that is too remote from the defendant's unlawful conduct; that is ordinarily the case if the harm is purely derivative of misfortunes visited upon a third person by the defendant's acts.

17 Cases that cite this headnote

**[20] Antitrust and Trade Regulation**

↔ Persons protected and entitled to sue

A plaintiff suing for false advertising under the Lanham Act ordinarily must show economic or reputational injury flowing directly from the deception wrought by the defendant's advertising, and that that occurs when deception of consumers causes them to withhold trade from the plaintiff; that showing is generally not made when the deception produces injuries to a fellow commercial actor that in turn affect the plaintiff. Lanham Act, § 43(a)(1)(B), 15 U.S.C.A. § 1125(a)(1)(B).

95 Cases that cite this headnote

**[21] Antitrust and Trade Regulation**

↔ Persons protected and entitled to sue

While a competitor who is forced out of business by a defendant's false advertising

generally will be able to sue under the Lanham Act for its losses, the same is not true of the competitor's landlord, its electric company, and other commercial parties who suffer merely as a result of the competitor's inability to meet its financial obligations. Lanham Act, § 43(a)(1)(B), 15 U.S.C.A. § 1125(a)(1)(B).

7 Cases that cite this headnote

**[22] Federal Civil Procedure**

↔ Causation;redressability

Proximate causation is not a requirement of Article III standing, which requires only that the plaintiff's injury be fairly traceable to the defendant's conduct. U.S.C.A. Const. Art. 3, § 2, cl. 1.

231 Cases that cite this headnote

**[23] Antitrust and Trade Regulation**

↔ Persons protected and entitled to sue

**Federal Courts**

↔ Trade or Business

Like the zone-of-interests test, proximate causation is an element of a cause of action for false advertising under the Lanham Act, and so is subject to the rule that the absence of a valid, as opposed to arguable, cause of action does not implicate subject-matter jurisdiction. Lanham Act, § 43(a)(1)(B), 15 U.S.C.A. § 1125(a)(1)(B).

67 Cases that cite this headnote

**[24] Antitrust and Trade Regulation**

↔ Pleading

Like any other element of a cause of action, proximate cause must be adequately alleged at the pleading stage in order for a case for false advertising under the Lanham Act to proceed. Lanham Act, § 43(a)(1)(B), 15 U.S.C.A. § 1125(a)(1)(B).

35 Cases that cite this headnote

**[25] Antitrust and Trade Regulation**

**Lexmark Intern., Inc. v. Static Control Components, Inc., 572 U.S. 118 (2014)**

134 S.Ct. 1377, 188 L.Ed.2d 392, 82 USLW 4195, 2014-1 Trade Cases P 78,716...

⚡ Pleading

If a plaintiff's allegations, taken as true, are insufficient to establish proximate causation, then a complaint for false advertising under the Lanham Act must be dismissed; if they are sufficient, then the plaintiff is entitled to an opportunity to prove them. Lanham Act, § 43(a)(1)(B), 15 U.S.C.A. § 1125(a)(1)(B).

2 Cases that cite this headnote

[26] **Antitrust and Trade Regulation**

⚡ Persons protected and entitled to sue

A direct application of the zone-of-interests test and the proximate-cause requirement supplies the relevant limits on who may sue for false advertising under the Lanham Act; abrogating *Conte Bros. Automotive, Inc. v. Quaker State-Slick 50, Inc.*, 165 F.3d 221; *Procter & Gamble Co. v. Amway Corp.*, 242 F.3d 539; *Gilbert/Robinson, Inc. v. Carrie Beverage-Missouri, Inc.*, 989 F.2d 985; *Phoenix of Broward, Inc. v. McDonald's Corp.*, 489 F.3d 1156; *L.S. Heath & Son, Inc. v. AT & T Information Systems, Inc.*, 9 F.3d 561; *Waits v. Frito-Lay, Inc.*, 978 F.2d 1093; *Stanfield v. Osborne Industries, Inc.*, 52 F.3d 867; *Famous Horse, Inc. v. 5th Avenue Photo Inc.*, 624 F.3d 106. Lanham Act, § 43(a)(1)(B), 15 U.S.C.A. § 1125(a)(1)(B).

2 Cases that cite this headnote

[27] **Antitrust and Trade Regulation**

⚡ Persons protected and entitled to sue

Injuries alleged in complaint by manufacturer of components necessary for remanufacture of supplier's toner cartridges, consisting of lost sales and damage to its business reputation as result of supplier's alleged misrepresentations, fell within zone of interests protected by false advertising provision of Lanham Act, since manufacturer was suing not as deceived consumer, but as person engaged in commerce within control of Congress. Lanham Act, §§ 43(a)(1)(B), 45, 15 U.S.C.A. §§ 1125(a)(1)(B), 1127.

9 Cases that cite this headnote

[28] **Antitrust and Trade Regulation**

⚡ Persons protected and entitled to sue

Manufacturer of components necessary for remanufacture of supplier's toner cartridges satisfied proximate causation requirement for coverage by Lanham Act's false advertising provision, in manufacturer's action against toner cartridge supplier, where manufacturer alleged that supplier disparaged its business and products by asserting that manufacturer's business was illegal, and further alleged that manufacturer designed, manufactured, and sold microchips that both were necessary for, and had no other use than, refurbishing supplier's toner cartridges, indicating that any false advertising that reduced remanufacturers' business necessarily injured manufacturer as well. Lanham Act, § 43(a)(1)(B), 15 U.S.C.A. § 1125(a)(1)(B).

2 Cases that cite this headnote

[29] **Antitrust and Trade Regulation**

⚡ Persons protected and entitled to sue

Although diversion of sales to a direct competitor may be the paradigmatic direct injury from false advertising, it is not the only type of injury cognizable under the Lanham Act's false advertising provision. Lanham Act, § 43(a)(1)(B), 15 U.S.C.A. § 1125(a)(1)(B).

75 Cases that cite this headnote

[30] **Antitrust and Trade Regulation**

⚡ Persons protected and entitled to sue

A defendant who seeks to promote his own interests by telling a known falsehood to or about the plaintiff or his product may be said to have proximately caused the plaintiff's harm, for purposes of the proximate causation requirement for coverage by the Lanham Act's false advertising provision. Lanham Act, § 43(a)(1)(B), 15 U.S.C.A. § 1125(a)(1)(B); Restatement (Second) of Torts § 870.

6 Cases that cite this headnote

[31] **Antitrust and Trade Regulation**

↔ Pleading

To invoke the Lanham Act's cause of action for false advertising, a plaintiff must plead and ultimately prove an injury to a commercial interest in sales or business reputation proximately caused by the defendant's misrepresentations. Lanham Act, § 43(a)(1)(B), 15 U.S.C.A. § 1125(a)(1)(B).

121 Cases that cite this headnote

**\*\*1381 Syllabus\***

Petitioner Lexmark sells the only style of toner cartridges that work with the company's laser printers, but "remanufacturers" acquire and refurbish used Lexmark cartridges to sell in competition with Lexmark's own new and refurbished ones. Lexmark's "Prebate" program gives customers a discount on new cartridges if they agree to return empty cartridges to the company. Each Prebate cartridge has a microchip that disables the empty cartridge unless Lexmark replaces the chip. Respondent Static Control, a maker and seller of components for the remanufacture of Lexmark cartridges, developed a microchip that mimicked Lexmark's. Lexmark sued for copyright infringement, but Static Control counterclaimed, alleging that Lexmark engaged in false or misleading advertising in violation of § 43(a) of the Lanham Act, 15 U.S.C. § 1125(a), and that its misrepresentations had caused Static Control lost sales and damage to its business reputation. The District Court held that Static Control lacked "prudential standing" to bring the Lanham Act claim, applying a multifactor balancing test the court attributed to *Associated Gen. Contractors of Cal., Inc. v. Carpenters*, 459 U.S. 519, 103 S.Ct. 897, 74 L.Ed.2d 723. In reversing, the Sixth Circuit relied on the Second Circuit's "reasonable interest" test.

*Held*: Static Control has adequately pleaded the elements of a Lanham Act cause of action for false advertising. Pp. 1385 – 1395.

(a) The question here is whether Static Control falls within the class of plaintiffs that Congress authorized to sue under § 1125(a). To decide that question, this Court must determine the provision's meaning, using traditional principles of statutory interpretation. It is misleading to label this a "prudential standing" question. Lexmark bases its "prudential **\*\*1382** standing" arguments on *Associated General Contractors*, but that case rested on statutory considerations: The Court sought to "ascertain," as a statutory-interpretation matter, the "scope of the private remedy created by" Congress in § 4 of the Clayton Act, and the "class of persons who [could] maintain a private damages action under" that legislatively conferred cause of action, 459 U.S., at 529, 532, 103 S.Ct. 897. And while this Court may have placed the "zone of interests" test that Static Control relies on under the "prudential" rubric in the past, see, e.g., *Elk Grove Unified School Dist. v. Newdow*, 542 U.S. 1, 12, 124 S.Ct. 2301, 159 L.Ed.2d 98, it does not belong there any more than *Associated General Contractors* does. Rather, whether a plaintiff comes within the zone of interests requires the Court to determine, using traditional statutory-interpretation tools, whether a legislatively conferred cause of action encompasses a particular plaintiff's claim. See, e.g., *Steel Co. v. Citizens for Better Environment*, 523 U.S. 83, 97, and n. 2, 118 S.Ct. 1003, 140 L.Ed.2d 210. Pp. 1385 – 1388.

(b) The § 1125(a) cause of action extends to plaintiffs who fall within the zone of interests protected by that statute and whose injury was proximately caused by a violation of that statute. Pp. 1388 – 1393.

(1) A statutory cause of action is presumed to extend only to plaintiffs whose interests "fall within the zone of interests protected by the law invoked." *Allen v. Wright*, 468 U.S. 737, 751, 104 S.Ct. 3315, 82 L.Ed.2d 556. "[T]he breadth of [that] zone ... varies according to the provisions of law at issue." *Bennett v. Spear*, 520 U.S. 154, 163, 117 S.Ct. 1154, 137 L.Ed.2d 281. The Lanham Act includes a detailed statement of its purposes, including, as relevant here, "protect[ing] persons engaged in [commerce within the control of Congress] against unfair competition," 15 U.S.C. § 1127; and "unfair competition" was understood at common law to be concerned with injuries to business reputation and present and future sales. Thus, to come within the zone of interests in a § 1125(a) false-advertising suit, a plaintiff must allege an injury to a commercial interest in reputation or sales. Pp. 1388 – 1390.

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(2) A statutory cause of action is also presumed to be limited to plaintiffs whose injuries are proximately caused by violations of the statute. See, e.g., *Holmes v. Securities Investor Protection Corporation*, 503 U.S. 258, 268–270, 112 S.Ct. 1311, 117 L.Ed.2d 532. This requirement generally bars suits for alleged harm that is “too remote” from the defendant’s unlawful conduct, such as when the harm is purely derivative of “misfortunes visited upon a third person by the defendant’s acts.” *Id.*, at 268–269, 112 S.Ct. 1311. In a sense, all commercial injuries from false advertising are derivative of those suffered by consumers deceived by the advertising. But since the Lanham Act authorizes suit only for commercial injuries, the intervening consumer-deception step is not fatal to the proximate-cause showing the statute requires. Cf. *Bridge v. Phoenix Bond & Indemnity Co.*, 553 U.S. 639, 656, 128 S.Ct. 2131, 170 L.Ed.2d 1012. Thus, a plaintiff suing under § 1125(a) ordinarily must show that its economic or reputational injury flows directly from the deception wrought by the defendant’s advertising; and that occurs when deception of consumers causes them to withhold trade from the plaintiff. Pp. 1390 – 1391.

(3) Direct application of the zone-of-interests test and the proximate-cause requirement supplies the relevant limits on who may sue under § 1125(a). These principles provide better guidance than the multifactor balancing test urged by Lexmark, the direct-competitor test, or the **\*\*1383** reasonable-interest test applied by the Sixth Circuit. Pp. 1391 – 1393.

(c) Under these principles, Static Control comes within the class of plaintiffs authorized to sue under § 1125(a). Its alleged injuries—lost sales and damage to its business reputation—fall within the zone of interests protected by the Act, and Static Control sufficiently alleged that its injuries were proximately caused by Lexmark’s misrepresentations. Pp. 1392 – 1395.

697 F.3d 387, affirmed.

SCALIA, J., delivered the opinion for a unanimous Court.

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**Opinion**

Justice SCALIA delivered the opinion of the Court.

**\*120** This case requires us to decide whether respondent, Static Control Components, Inc., may sue petitioner, Lexmark International, Inc., for false advertising under the Lanham Act, 15 U.S.C. § 1125(a).

I. Background

Lexmark manufactures and sells laser printers. It also sells toner cartridges for those printers (toner being the **\*121** powdery ink that laser printers use to create images on paper). Lexmark designs its printers to work only with its own style of cartridges, and it therefore dominates the market for cartridges compatible with its printers. That market, however, is not devoid of competitors. Other businesses, called “remanufacturers,” acquire used Lexmark toner cartridges, refurbish them, and sell them in competition with new and refurbished cartridges sold by Lexmark.

Lexmark would prefer that its customers return their empty cartridges to it for refurbishment and resale, rather than sell those cartridges to a remanufacturer. So Lexmark introduced what it called a “Prebate” program, which enabled customers to purchase new toner cartridges at a 20–percent discount if they would agree to return the cartridge to Lexmark once it was empty. Those terms were communicated to consumers through notices printed on the toner-cartridge boxes, which advised the consumer that opening the box would indicate assent to the terms—a

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practice commonly known as “shrinkwrap licensing,” see, e.g., *ProCD, Inc. v. Zeidenberg*, 86 F.3d 1447, 1449 (C.A.7 1996). To enforce the Prebate terms, Lexmark included a microchip in each Prebate cartridge that would disable the cartridge after it ran out of toner; for the cartridge to be used again, the microchip would have to be replaced by Lexmark.

**\*\*1384** Static Control is not itself a manufacturer or remanufacturer of toner cartridges. It is, rather, “the market leader [in] making and selling the components necessary to remanufacture Lexmark cartridges.” 697 F.3d 387, 396 (C.A.6 2012) (case below). In addition to supplying remanufacturers with toner and various replacement parts, Static Control developed a microchip that could mimic the microchip in Lexmark’s Prebate cartridges. By purchasing Static Control’s microchips and using them to replace the Lexmark microchip, remanufacturers were able to refurbish and resell used Prebate cartridges.

[1] **\*122** Lexmark did not take kindly to that development. In 2002, it sued Static Control, alleging that Static Control’s microchips violated both the Copyright Act of 1976, 17 U.S.C. § 101 *et seq.*, and the Digital Millennium Copyright Act, 17 U.S.C. § 1201 *et seq.* Static Control counterclaimed, alleging, among other things, violations of § 43(a) of the Lanham Act, 60 Stat. 441, codified at 15 U.S.C. § 1125(a). Section 1125 (a) provides:

“(1) Any person who, on or in connection with any goods or services, or any container for goods, uses in commerce any word, term, name, symbol, or device, or any combination thereof, or any false designation of origin, false or misleading description of fact, or false or misleading representation of fact, which—

“(A) is likely to cause confusion, or to cause mistake, or to deceive as to the affiliation, connection, or association of such person with another person, or as to the origin, sponsorship, or approval of his or her goods, services, or commercial activities by another person, or

“(B) in commercial advertising or promotion, misrepresents the nature, characteristics, qualities, or geographic origin of his or her or another person’s goods, services, or commercial activities,

“shall be liable in a civil action by any person who believes that he or she is or is likely to be damaged by such act.”

Section 1125(a) thus creates two distinct bases of liability: false association, § 1125(a)(1)(A), and false advertising, § 1125(a)(1)(B). See *Waits v. Frito-Lay, Inc.*, 978 F.2d 1093, 1108 (C.A.9 1992). Static Control alleged only false advertising.

As relevant to its Lanham Act claim, Static Control alleged two types of false or misleading conduct by Lexmark. First, it alleged that through its Prebate program Lexmark “purposefully misleads end-users” to believe that they are **\*123** legally bound by the Prebate terms and are thus required to return the Prebate-labeled cartridge to Lexmark after a single use. App. 31, ¶ 39. Second, it alleged that upon introducing the Prebate program, Lexmark “sent letters to most of the companies in the toner cartridge remanufacturing business” falsely advising those companies that it was illegal to sell refurbished Prebate cartridges and, in particular, that it was illegal to use Static Control’s products to refurbish those cartridges. *Id.*, at 29, ¶ 35. Static Control asserted that by those statements, Lexmark had materially misrepresented “the nature, characteristics, and qualities” of both its own products and Static Control’s products. *Id.*, at 43–44, ¶ 85. It further maintained that Lexmark’s misrepresentations had “proximately caused and [we]re likely to cause injury to [Static Control] by diverting sales from [Static Control] to Lexmark,” and had “substantially injured [its] business reputation” by “leading consumers and others in the trade to believe that [Static Control] is engaged in illegal conduct.” *Id.*, at 44, ¶ 88. Static Control sought trebledamages, **\*\*1385** attorney’s fees and costs, and injunctive relief.<sup>1</sup>

The District Court granted Lexmark’s motion to dismiss Static Control’s Lanham Act claim. It held that Static Control lacked “prudential standing” to bring that claim, App. to Pet. for Cert. 83, relying on a multifactor balancing test it attributed to *Associated Gen. Contractors of Cal., Inc. v. Carpenters*, 459 U.S. 519, 103 S.Ct. 897, 74 L.Ed.2d 723 (1983). The court emphasized that there were “more direct plaintiffs in the form of remanufacturers of Lexmark’s cartridges”; that Static Control’s injury was “remot[e]” because it was a mere “byproduct of the supposed manipulation of consumers’ relationships with remanufacturers”; and that Lexmark’s “alleged intent

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[was] to dry \*124 up spent cartridge supplies at the remanufacturing level, rather than at [Static Control]'s supply level, making remanufacturers Lexmark's alleged intended target." App. to Pet. for Cert. 83.

The Sixth Circuit reversed the dismissal of Static Control's Lanham Act claim. 697 F.3d, at 423. Taking the lay of the land, it identified three competing approaches to determining whether a plaintiff has standing to sue under the Lanham Act. It observed that the Third, Fifth, Eighth, and Eleventh Circuits all refer to "antitrust standing or the [Associated General Contractors] factors in deciding Lanham Act standing," as the District Court had done. *Id.*, at 410 (citing *Conte Bros. Automotive, Inc. v. Quaker State-Slick 50, Inc.*, 165 F.3d 221, 233-234 (C.A.3 1998); *Procter & Gamble Co. v. Amway Corp.*, 242 F.3d 539, 562-563 (C.A.5 2001); *Gilbert/Robinson, Inc. v. Carrie Beverage-Missouri, Inc.*, 989 F.2d 985, 990-991 (C.A.8 1993); *Phoenix of Broward, Inc. v. McDonald's Corp.*, 489 F.3d 1156, 1162-1164 (C.A.11 2007)). By contrast, "[t]he Seventh, Ninth, and Tenth [Circuits] use a categorical test, permitting Lanham Act suits only by an actual competitor." 697 F.3d, at 410 (citing *L.S. Heath & Son, Inc. v. AT & T Information Systems, Inc.*, 9 F.3d 561, 575 (C.A.7 1993); *Waits, supra*, at 1108-1109; *Stanfield v. Osborne Industries, Inc.*, 52 F.3d 867, 873 (C.A.10 1995)). And the Second Circuit applies a " 'reasonable interest' approach," under which a Lanham Act plaintiff "has standing if the claimant can demonstrate '(1) a reasonable interest to be protected against the alleged false advertising and (2) a reasonable basis for believing that the interest is likely to be damaged by the alleged false advertising.'" 697 F.3d, at 410 (quoting *Famous Horse, Inc. v. 5th Avenue Photo Inc.*, 624 F.3d 106, 113 (C.A.2 2010)). The Sixth Circuit applied the Second Circuit's reasonable-interest test and concluded that Static Control had standing because it "alleged a cognizable interest in its business reputation and sales to remanufacturers and sufficiently alleged that th[o]se interests were \*125 harmed by Lexmark's statements to the remanufacturers that Static Control was engaging in illegal conduct." 697 F.3d, at 411.

We granted certiorari to decide "the appropriate analytical framework for determining a party's standing to maintain an action for false advertising under the Lanham Act." Pet. for Cert. i; 569 U.S. —, 133 S.Ct. 2766, 186 L.Ed.2d 217 (2013).<sup>2</sup>

**\*\*1386 II. "Prudential Standing"**

The parties' briefs treat the question on which we granted certiorari as one of "prudential standing." Because we think that label misleading, we begin by clarifying the nature of the question at issue in this case.

[2] [3] [4] From Article III's limitation of the judicial power to resolving "Cases" and "Controversies," and the separation-of-powers principles underlying that limitation, we have deduced a set of requirements that together make up the "irreducible constitutional minimum of standing." *Lujan v. Defenders of Wildlife*, 504 U.S. 555, 560, 112 S.Ct. 2130, 119 L.Ed.2d 351 (1992). The plaintiff must have suffered or be imminently threatened with a concrete and particularized "injury in fact" that is fairly traceable to the challenged action of the defendant and likely to be redressed by a favorable judicial decision. *Ibid.* Lexmark does not deny that Static Control's allegations of lost sales and damage to its business reputation give it standing under Article III to press its false-advertising claim, and we are satisfied that they do.

[5] Although Static Control's claim thus presents a case or controversy that is properly within federal courts' Article III jurisdiction, Lexmark urges that we should decline to adjudicate Static Control's claim on grounds that are "prudential, \*126 " rather than constitutional. That request is in some tension with our recent reaffirmation of the principle that "a federal court's 'obligation' to hear and decide" cases within its jurisdiction "is 'virtually unflagging.'" *Sprint Communications, Inc. v. Jacobs*, 571 U.S. —, —, 134 S.Ct. 584, 591, 187 L.Ed.2d 505 (2013) (quoting *Colorado River Water Conservation Dist. v. United States*, 424 U.S. 800, 817, 96 S.Ct. 1236, 47 L.Ed.2d 483 (1976)). In recent decades, however, we have adverted to a "prudential" branch of standing, a doctrine not derived from Article III and "not exhaustively defined" but encompassing (we have said) at least three broad principles: " 'the general prohibition on a litigant's raising another person's legal rights, the rule barring adjudication of generalized grievances more appropriately addressed in the representative branches, and the requirement that a plaintiff's complaint fall within the zone of interests protected by the law invoked.'" *Elk Grove Unified School Dist. v. Newdow*, 542 U.S. 1, 12, 124 S.Ct. 2301, 159

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L.Ed.2d 98 (2004) (quoting *Allen v. Wright*, 468 U.S. 737, 751, 104 S.Ct. 3315, 82 L.Ed.2d 556 (1984)).

Lexmark bases its “prudential standing” arguments chiefly on *Associated General Contractors*, but we did not describe our analysis in that case in those terms. Rather, we sought to “ascertain,” as a matter of statutory interpretation, the “scope of the private remedy created by” Congress in § 4 of the Clayton Act, and the “class of persons who [could] maintain a private damages action under” that legislatively conferred cause of action. 459 U.S., at 529, 532, 103 S.Ct. 897. We held that the statute limited the class to plaintiffs whose injuries were proximately caused by a defendant’s antitrust violations. *Id.*, at 532–533, 103 S.Ct. 897. Later decisions confirm that *Associated General Contractors* rested on statutory, not “prudential,” considerations. See, e.g., *Holmes v. Securities Investor Protection Corporation*, 503 U.S. 258, 265–268, 112 S.Ct. 1311, 117 L.Ed.2d 532 (1992) (relying on *Associated General Contractors* in finding a proximate-cause requirement in the cause of action created by the Racketeer Influenced and Corrupt Organizations Act (RICO), 18 U.S.C. § 1964(c)); *Anza v. Ideal Steel Supply Corp.*, 547 U.S. 451, 456, 126 S.Ct. 1991, 164 L.Ed.2d 720 (2006) (affirming that *Holmes* “relied on a careful interpretation of § 1964(c)”). Lexmark’s arguments thus do not deserve the “prudential” label.

[6] [7] [8] Static Control, on the other hand, argues that we should measure its “prudential standing” by using the zone-of-interests test. Although we admittedly have placed that test under the “prudential” rubric in the past, see, e.g., *Elk Grove, supra*, at 12, 124 S.Ct. 2301, it does not belong there any more than *Associated General Contractors* does. Whether a plaintiff comes within “the ‘zone of interests’” is an issue that requires us to determine, using traditional tools of statutory interpretation, whether a legislatively conferred cause of action encompasses a particular plaintiff’s claim. See *Steel Co. v. Citizens for Better Environment*, 523 U.S. 83, 97, and n. 2, 118 S.Ct. 1003, 140 L.Ed.2d 210 (1998); *Clarke v. Securities Industry Assn.*, 479 U.S. 388, 394–395, 107 S.Ct. 750, 93 L.Ed.2d 757 (1987); *Holmes, supra*, at 288, 112 S.Ct. 1311 (SCALIA, J., concurring in judgment). As Judge Silberman of the D.C. Circuit recently observed, “‘prudential standing’ is a misnomer” as applied to the zone-of-interests analysis, which asks whether “this particular class of persons ha[s] a right to sue under

this substantive statute.” *Association of Battery Recyclers, Inc. v. EPA*, 716 F.3d 667, 675–676 (2013) (concurring opinion).<sup>3</sup>

[9] \*128 In sum, the question this case presents is whether Static Control falls within the class of plaintiffs whom Congress has authorized to sue under § 1125(a). In other words, we ask whether Static Control has a cause of action under the statute.<sup>4</sup> \*\*1388 That question requires us to determine the meaning of the congressionally enacted provision creating a cause of action. In doing so, we apply traditional principles of statutory interpretation. We do not ask whether in our judgment Congress *should* have authorized Static Control’s suit, but whether Congress in fact did so. Just as a court cannot apply its independent policy judgment to recognize a cause of action that Congress has denied, see *Alexander v. Sandoval*, 532 U.S. 275, 286–287, 121 S.Ct. 1511, 149 L.Ed.2d 517 (2001), it cannot limit a cause of action that Congress has created merely because “prudence” dictates.

## \*129 III. Static Control’s Right To Sue Under § 1125(a)

[10] Thus, this case presents a straightforward question of statutory interpretation: Does the cause of action in § 1125(a) extend to plaintiffs like Static Control? The statute authorizes suit by “any person who believes that he or she is likely to be damaged” by a defendant’s false advertising. § 1125(a)(1). Read literally, that broad language might suggest that an action is available to anyone who can satisfy the minimum requirements of Article III. No party makes that argument, however, and the “unlikelihood that Congress meant to allow all factually injured plaintiffs to recover persuades us that [§ 1125(a)] should not get such an expansive reading.” *Holmes*, 503 U.S., at 266, 112 S.Ct. 1311 (footnote omitted). We reach that conclusion in light of two relevant background principles already mentioned: zone of interests and proximate causality.

## A. Zone of Interests

[11] [12] First, we presume that a statutory cause of action extends only to plaintiffs whose interests “fall within the zone of interests protected by the law invoked.” *Allen*, 468 U.S., at 751, 104 S.Ct. 3315. The modern

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“zone of interests” formulation originated in *Association of Data Processing Service Organizations, Inc. v. Camp*, 397 U.S. 150, 90 S.Ct. 827, 25 L.Ed.2d 184 (1970), as a limitation on the cause of action for judicial review conferred by the Administrative Procedure Act (APA). We have since made clear, however, that it applies to all statutorily created causes of action; that it is a “requirement of general application”; and that Congress is presumed to “legislat[e] against the background of” the zone-of-interests limitation, “which applies unless it is expressly negated.” *Bennett v. Spear*, 520 U.S. 154, 163, 117 S.Ct. 1154, 137 L.Ed.2d 281 (1997); see also *Holmes, supra*, at 287–288, 112 S.Ct. 1311 (SCALIA, J., concurring in judgment). It is “perhaps more accurat[e],” though not very different as a practical matter, to say that the limitation *always* applies and is never negated, but that our analysis of certain statutes will show that they protect \*130 a more-than-usually “expan[sive]” range of interests. *Bennett, supra*, at 164, 117 S.Ct. 1154. The zone-of-interests test is therefore an appropriate tool for determining \*\*1389 who may invoke the cause of action in § 1125(a).<sup>5</sup>

We have said, in the APA context, that the test is not “‘especially demanding,’” *Match–E–Be–Nash–She–Wish Band of Pottawatomi Indians v. Patchak*, 567 U.S. —, —, 132 S.Ct. 2199, 2210, 183 L.Ed.2d 211 (2012). In that context we have often “conspicuously included the word ‘arguably’ in the test to indicate that the benefit of any doubt goes to the plaintiff,” and have said that the test “forecloses suit only when a plaintiff’s ‘interests are so marginally related to or inconsistent with the purposes implicit in the statute that it cannot reasonably be assumed that’ ” Congress authorized that plaintiff to sue. *Id.*, at —, 132 S.Ct., at 2210. That lenient approach is an appropriate means of preserving the flexibility of the APA’s omnibus judicial-review provision, which permits suit for violations of numerous statutes of varying character that do not themselves include causes of action for judicial review. “We have made clear, however, that the breadth of the zone of interests varies according to the provisions of law at issue, so that what comes within the zone of interests of a statute for purposes of obtaining judicial review of administrative action under the ‘generous review provisions’ of the APA may not do so for other purposes.” *Bennett, supra*, at 163, 117 S.Ct. 1154 (quoting \*131 *Clarke*, 479 U.S., at 400, n. 16, 107 S.Ct. 750, in turn quoting *Data Processing, supra*, at 156, 90 S.Ct. 827).

Identifying the interests protected by the Lanham Act, however, requires no guesswork, since the Act includes an “unusual, and extraordinarily helpful,” detailed statement of the statute’s purposes. *H.B. Halicki Productions v. United Artists Communications, Inc.*, 812 F.2d 1213, 1214 (C.A.9 1987). Section 45 of the Act, codified at 15 U.S.C. § 1127, provides:

“The intent of this chapter is to regulate commerce within the control of Congress by making actionable the deceptive and misleading use of marks in such commerce; to protect registered marks used in such commerce from interference by State, or territorial legislation; to protect persons engaged in such commerce against unfair competition; to prevent fraud and deception in such commerce by the use of reproductions, copies, counterfeits, or colorable imitations of registered marks; and to provide rights and remedies stipulated by treaties and conventions respecting trademarks, trade names, and unfair competition entered into between the United States and foreign nations.”

Most of the enumerated purposes are relevant to false-association cases; a typical false-advertising case will implicate only the Act’s goal of “protect [ing] persons engaged in [commerce within the control of Congress] against unfair competition.” Although “unfair competition” was a “plastic” concept at common law, *Ely–Norris Safe Co. v. Mosler Safe Co.*, 7 F.2d 603, 604 (C.A.2 1925) (L. Hand, J.), it was \*\*1390 understood to be concerned with injuries to business reputation and present and future sales. See Rogers, Book Review, 39 *Yale L.J.* 297, 299 (1929); see generally 3 Restatement of Torts, ch. 35, Introductory Note, pp. 536–537 (1938).

[13] [14] [15] We thus hold that to come within the zone of interests in a suit for false advertising under § 1125(a), a plaintiff must \*132 allege an injury to a commercial interest in reputation or sales. A consumer who is hoodwinked into purchasing a disappointing product may well have an injury-in-fact cognizable under

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Article III, but he cannot invoke the protection of the Lanham Act—a conclusion reached by every Circuit to consider the question. See *Colligan v. Activities Club of N. Y., Ltd.*, 442 F.2d 686, 691–692 (C.A.2 1971); *Serbin v. Ziebart Int'l Corp.*, 11 F.3d 1163, 1177 (C.A.3 1993); *Made in the USA Foundation v. Phillips Foods, Inc.*, 365 F.3d 278, 281 (C.A.4 2004); *Procter & Gamble Co.*, 242 F.3d, at 563–564; *Barrus v. Sylvania*, 55 F.3d 468, 470 (C.A.9 1995); *Phoenix of Broward*, 489 F.3d, at 1170. Even a business misled by a supplier into purchasing an inferior product is, like consumers generally, not under the Act's aegis.

## B. Proximate Cause

[16] [17] Second, we generally presume that a statutory cause of action is limited to plaintiffs whose injuries are proximately caused by violations of the statute. For centuries, it has been “a well established principle of [the common] law, that in all cases of loss, we are to attribute it to the proximate cause, and not to any remote cause.” *Waters v. Merchants' Louisville Ins. Co.*, 11 Pet. 213, 223, 9 L.Ed. 691 (1837); see *Holmes*, 503 U.S., at 287, 112 S.Ct. 1311 (SCALIA, J., concurring in judgment). That venerable principle reflects the reality that “the judicial remedy cannot encompass every conceivable harm that can be traced to alleged wrongdoing.” *Associated Gen. Contractors*, 459 U.S., at 536, 103 S.Ct. 897. Congress, we assume, is familiar with the common-law rule and does not mean to displace it *sub silentio*. We have thus construed federal causes of action in a variety of contexts to incorporate a requirement of proximate causation. See, e.g., *Dura Pharmaceuticals, Inc. v. Broudo*, 544 U.S. 336, 346, 125 S.Ct. 1627, 161 L.Ed.2d 577 (2005) (securities fraud); *Holmes, supra*, at 268–270, 112 S.Ct. 1311 (RICO); *Associated Gen. Contractors, supra*, at 529–535, 103 S.Ct. 897 (Clayton Act). No party disputes that it is proper to read § 1125(a) as containing such a requirement, its broad language notwithstanding.

[18] \*133 The proximate-cause inquiry is not easy to define, and over the years it has taken various forms; but courts have a great deal of experience applying it, and there is a wealth of precedent for them to draw upon in doing so. See *Exxon Co., U.S.A. v. Sofec, Inc.*, 517 U.S. 830, 838–839, 116 S.Ct. 1813, 135 L.Ed.2d 113 (1996); *Pacific Operators Offshore, LLP v. Valladolid*, 565 U.S. —, —, 132 S.Ct. 680, 692–693, 181 L.Ed.2d 675 (2012) (SCALIA, J., concurring in part and concurring in

judgment). Proximate-cause analysis is controlled by the nature of the statutory cause of action. The question it presents is whether the harm alleged has a sufficiently close connection to the conduct the statute prohibits.

[19] Put differently, the proximate-cause requirement generally bars suits for alleged harm that is “too remote” from the defendant's unlawful conduct. That is ordinarily the case if the harm is purely derivative of “misfortunes visited upon a third person by the defendant's acts.” *Holmes, supra*, at 268–269, 112 S.Ct. 1311; see, e.g., \*\*1391 *Hemi Group, LLC v. City of New York*, 559 U.S. 1, 10–11, 130 S.Ct. 983, 175 L.Ed.2d 943 (2010). In a sense, of course, all commercial injuries from false advertising are derivative of those suffered by consumers who are deceived by the advertising; but since the Lanham Act authorizes suit only for commercial injuries, the intervening step of consumer deception is not fatal to the showing of proximate causation required by the statute. See *Harold H. Huggins Realty, Inc. v. FNC, Inc.*, 634 F.3d 787, 800–801 (C.A.5 2011). That is consistent with our recognition that under common-law principles, a plaintiff can be directly injured by a misrepresentation even where “a third party, and not the plaintiff, ... relied on” it. *Bridge v. Phoenix Bond & Indemnity Co.*, 553 U.S. 639, 656, 128 S.Ct. 2131, 170 L.Ed.2d 1012 (2008).

[20] [21] [22] [23] [24] [25] We thus hold that a plaintiff suing under § 1125(a) ordinarily must show economic or reputational injury flowing directly from the deception wrought by the defendant's advertising; and that that occurs when deception of consumers causes them to withhold trade from the plaintiff. That showing is generally not made when the deception produces injuries to a fellow commercial actor that in turn affect the \*134 plaintiff. For example, while a competitor who is forced out of business by a defendant's false advertising generally will be able to sue for its losses, the same is not true of the competitor's landlord, its electric company, and other commercial parties who suffer merely as a result of the competitor's “inability to meet [its] financial obligations.” *Anza*, 547 U.S., at 458, 126 S.Ct. 1991.<sup>6</sup>

## C. Proposed Tests

[26] At oral argument, Lexmark agreed that the zone of interests and proximate causation supply the relevant background limitations on suit under § 1125(a). See Tr.

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of Oral Arg. 4–5, 11–12, 17–18. But it urges us to adopt, as the optimal formulation of those principles, a multifactor balancing test derived from *Associated General Contractors*. In the alternative, it asks that we adopt a categorical test permitting only direct competitors to sue for false advertising. And although neither party urges adoption of the “reasonable interest” test applied below, several *amici* do so. While none of those tests is wholly without merit, we decline to adopt any of them. We hold instead that a direct application of the zone-of-interests test and the proximate-cause requirement supplies the relevant limits on who may sue.

The balancing test Lexmark advocates was first articulated by the Third Circuit in *Conte Bros.* and later adopted \*135 by several other Circuits. *Conte Bros.* identified five relevant considerations:

“(1) The nature of the plaintiff’s alleged injury: Is the injury of a type that Congress sought to redress in providing a private remedy for violations of the [Lanham Act]?”

\*\*1392 “(2) The directness or indirectness of the asserted injury.

“(3) The proximity or remoteness of the party to the alleged injurious conduct.

“(4) The speculativeness of the damages claim.

“(5) The risk of duplicative damages or complexity in apportioning damages.” 165 F.3d, at 233 (citations and internal quotation marks omitted).

This approach reflects a commendable effort to give content to an otherwise nebulous inquiry, but we think it slightly off the mark. The first factor can be read as requiring that the plaintiff’s injury be within the relevant zone of interests and the second and third as requiring (somewhat redundantly) proximate causation; but it is not correct to treat those requirements, which must be met in every case, as mere factors to be weighed in a balance. And the fourth and fifth factors are themselves problematic. “[T]he difficulty that can arise when a court attempts to ascertain the damages caused by some remote action” is a “motivating principle” behind the proximate-cause requirement, *Anza, supra*, at 457–458, 126 S.Ct. 1991; but potential difficulty in ascertaining and apportioning damages is not, as *Conte Bros.* might suggest, an *independent* basis for denying standing where

it is adequately alleged that a defendant’s conduct has proximately injured an interest of the plaintiff’s that the statute protects. Even when a plaintiff cannot quantify its losses with sufficient certainty to recover damages, it may still be entitled to injunctive relief under § 1116(a) (assuming it can prove a likelihood of future injury) or disgorgement of the defendant’s ill-gotten \*136 profits under § 1117(a). See *TrafficSchool.com, Inc. v. Edriver Inc.*, 653 F.3d 820, 831 (C.A.9 2011); *Johnson & Johnson v. Carter–Wallace, Inc.*, 631 F.2d 186, 190 (C.A.2 1980). Finally, experience has shown that the *Conte Bros.* approach, like other open-ended balancing tests, can yield unpredictable and at times arbitrary results. See, e.g., Tushnet, *Running the Gamut from A to B: Federal Trademark and False Advertising Law*, 159 U. Pa. L.Rev. 1305, 1376–1379 (2011).

In contrast to the multifactor balancing approach, the direct-competitor test provides a bright-line rule; but it does so at the expense of distorting the statutory language. To be sure, a plaintiff who does not compete with the defendant will often have a harder time establishing proximate causation. But a rule categorically prohibiting all suits by noncompetitors would read too much into the Act’s reference to “unfair competition” in § 1127. By the time the Lanham Act was adopted, the common-law tort of unfair competition was understood not to be limited to actions between competitors. One leading authority in the field wrote that “there need be no competition in unfair competition,” just as “[t]here is no soda in soda water, no grapes in grape fruit, no bread in bread fruit, and a clothes horse is not a horse but is good enough to hang things on.” Rogers, 39 Yale L. J., at 299; accord, *Vogue Co. v. Thompson–Hudson Co.*, 300 F. 509, 512 (C.A.6 1924); 1 H. Nims, *The Law of Unfair Competition and Trade–Marks*, p. vi (4th ed. 1947); 2 *id.*, at 1194–1205. It is thus a mistake to infer that because the Lanham Act treats false advertising as a form of unfair competition, it can protect *only* the false-advertiser’s direct competitors.

Finally, there is the “reasonable interest” test applied by the Sixth Circuit in this case. As typically formulated, it requires a commercial plaintiff to “demonstrate ‘(1) a reasonable interest to be protected against the alleged false advertising and (2) a reasonable basis for believing \*\*1393 that the interest is likely to be damaged by the alleged false advertising.’ ” 697 F.3d, at 410 (quoting *Famous Horse*, 624 F.3d, at 113). \*137 A purely practical objection to the test is that it lends itself to widely

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divergent application. Indeed, its vague language can be understood as requiring only the bare minimum of Article III standing. The popularity of the multifactor balancing test reflects its appeal to courts tired of “grappl[ing] with defining” the “‘reasonable interest’” test “with greater precision.” *Conte Bros.*, 165 F.3d, at 231. The theoretical difficulties with the test are even more substantial: The relevant question is not whether the plaintiff’s interest is “reasonable,” but whether it is one the Lanham Act protects; and not whether there is a “reasonable basis” for the plaintiff’s claim of harm, but whether the harm alleged is proximately tied to the defendant’s conduct. In short, we think the principles set forth above will provide clearer and more accurate guidance than the “reasonable interest” test.

#### IV. Application

Applying those principles to Static Control’s false-advertising claim, we conclude that Static Control comes within the class of plaintiffs whom Congress authorized to sue under § 1125(a).

[27] To begin, Static Control’s alleged injuries—lost sales and damage to its business reputation—are injuries to precisely the sorts of commercial interests the Act protects. Static Control is suing not as a deceived consumer, but as a “perso[n] engaged in” “commerce within the control of Congress” whose position in the marketplace has been damaged by Lexmark’s false advertising. § 1127. There is no doubt that it is within the zone of interests protected by the statute.

[28] [29] Static Control also sufficiently alleged that its injuries were proximately caused by Lexmark’s misrepresentations. This case, it is true, does not present the “classic Lanham Act false-advertising claim” in which “‘one competitio[r] directly injur[es] another by making false statements about his own goods [or the competitor’s goods] and thus inducing customers to switch.’” \*138 *Harold H. Huggins Realty*, 634 F.3d, at 799, n. 24. But although diversion of sales to a direct competitor may be the paradigmatic direct injury from false advertising, it is not the only type of injury cognizable under § 1125(a). For at least two reasons, Static Control’s allegations satisfy the requirement of proximate causation.

[30] First, Static Control alleged that Lexmark disparaged its business and products by asserting that Static Control’s business was illegal. See 697 F.3d, at 411, n. 10 (noting allegation that Lexmark “directly target[ed] Static Control” when it “falsely advertised that Static Control infringed Lexmark’s patents”). When a defendant harms a plaintiff’s reputation by casting aspersions on its business, the plaintiff’s injury flows directly from the audience’s belief in the disparaging statements. Courts have therefore afforded relief under § 1125(a) not only where a defendant denigrates a plaintiff’s product by name, see, e.g., *McNeilab, Inc. v. American Home Prods. Corp.*, 848 F.2d 34, 38 (C.A.2 1988), but also where the defendant damages the product’s reputation by, for example, equating it with an inferior product, see, e.g., *Camel Hair and Cashmere Inst. of Am., Inc. v. Associated Dry Goods Corp.*, 799 F.2d 6, 7–8, 11–12 (C.A.1 1986); *PPX Enterprises, Inc. v. Audiofidelity, Inc.*, 746 F.2d 120, 122, 125 (C.A.2 1984). Traditional proximate-causation principles support those results: As we have observed, a defendant who “‘seeks to promote his own interests by telling a known falsehood to or about the plaintiff or his \*\*1394 product’” may be said to have proximately caused the plaintiff’s harm. *Bridge*, 553 U.S., at 657, 128 S.Ct. 2131 (quoting Restatement (Second) of Torts § 870, Comment *h* (1977); emphasis added in *Bridge* ).

The District Court emphasized that Lexmark and Static Control are not direct competitors. But when a party claims reputational injury from disparagement, competition is not required for proximate cause; and that is true even if the defendant’s aim was to harm its immediate competitors, and the plaintiff merely suffered collateral damage. Consider two rival carmakers who purchase airbags for their \*139 cars from different third-party manufacturers. If the first carmaker, hoping to divert sales from the second, falsely proclaims that the airbags used by the second carmaker are defective, both the second carmaker and its airbag supplier may suffer reputational injury, and their sales may decline as a result. In those circumstances, there is no reason to regard either party’s injury as derivative of the other’s; each is directly and independently harmed by the attack on its merchandise.

In addition, Static Control adequately alleged proximate causation by alleging that it designed, manufactured, and sold microchips that both (1) were necessary for, and (2) had no other use than, refurbishing Lexmark toner

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cartridges. See App. 13, ¶ 31; *id.*, at 37, ¶ 54.<sup>7</sup> It follows from that allegation that any false advertising that reduced the remanufacturers' business necessarily injured Static Control as well. Taking Static Control's assertions at face value, there is likely to be something very close to a 1:1 relationship between the number of refurbished Prebate cartridges sold (or not sold) by the remanufacturers and the number of Prebate microchips sold (or not sold) by Static Control. "Where the injury alleged is so integral an aspect of the [violation] alleged, there can be no question" that proximate cause is satisfied. *Blue Shield of Va. v. McCready*, 457 U.S. 465, 479, 102 S.Ct. 2540, 73 L.Ed.2d 149 (1982).

To be sure, on this view, the causal chain linking Static Control's injuries to consumer confusion is not direct, but includes the intervening link of injury to the remanufacturers. Static Control's allegations therefore might not support standing under a strict application of the " "general tendency" " not to stretch proximate causation " "beyond the first step." " *Holmes*, 503 U.S., at 271, 112 S.Ct. 1311. But the reason \*140 for that general tendency is that there ordinarily is a " discontinuity" between the injury to the direct victim and the injury to the indirect victim, so that the latter is not surely attributable to the former (and thus also to the defendant's conduct), but might instead have resulted from "any number of [other] reasons." *Anza*, 547 U.S., at 458-459, 126 S.Ct. 1991. That is not the case here. Static Control's allegations suggest that if the remanufacturers sold 10,000 fewer refurbished cartridges because of Lexmark's false advertising, then it would follow more or less automatically that Static

Control sold 10,000 fewer microchips for the same reason, without the need for any "speculative ... proceedings" or "intricate, uncertain inquiries." *Id.*, at 459-460, 126 S.Ct. 1991. In these relatively unique circumstances, the remanufacturers are not "more immediate victim[s]" than Static Control. *Bridge, supra*, at 658, 128 S.Ct. 2131.

\*\*1395 Although we conclude that Static Control has *alleged* an adequate basis to proceed under § 1125(a), it cannot obtain relief without *evidence* of injury proximately caused by Lexmark's alleged misrepresentations. We hold only that Static Control is entitled to a chance to prove its case.

\* \* \*

[31] To invoke the Lanham Act's cause of action for false advertising, a plaintiff must plead (and ultimately prove) an injury to a commercial interest in sales or business reputation proximately caused by the defendant's misrepresentations. Static Control has adequately pleaded both elements. The judgment of the Court of Appeals is affirmed.

*It is so ordered.*

**All Citations**

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**Footnotes**

- \* The syllabus constitutes no part of the opinion of the Court but has been prepared by the Reporter of Decisions for the convenience of the reader. See *United States v. Detroit Timber & Lumber Co.*, 200 U.S. 321, 337, 26 S.Ct. 282, 50 L.Ed. 499.
- 1 Lexmark contends that Static Control's allegations failed to describe "commercial advertising or promotion" within the meaning of 15 U.S.C. § 1125(a)(1)(B). That question is not before us, and we express no view on it. We assume without deciding that the communications alleged by Static Control qualify as commercial advertising or promotion.
- 2 Other aspects of the parties' sprawling litigation, including Lexmark's claims under federal copyright and patent law and Static Control's claims under federal antitrust and North Carolina unfair-competition law, are not before us. Our review pertains only to Static Control's Lanham Act claim.
- 3 The zone-of-interests test is not the only concept that we have previously classified as an aspect of "prudential standing" but for which, upon closer inspection, we have found that label inapt. Take, for example, our reluctance to entertain generalized grievances—*i.e.*, suits "claiming only harm to [the plaintiff's] and every citizen's interest in proper application of the Constitution and laws, and seeking relief that no more directly and tangibly benefits him than it does the public at large." *Lujan v. Defenders of Wildlife*, 504 U.S. 555, 573-574, 112 S.Ct. 2130, 119 L.Ed.2d 351 (1992). While we have at

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times grounded our reluctance to entertain such suits in the “counsels of prudence” (albeit counsels “close [ly] relat[ed] to the policies reflected in” Article III), *Valley Forge Christian College v. Americans United for Separation of Church and State, Inc.*, 454 U.S. 464, 475, 102 S.Ct. 752, 70 L.Ed.2d 700 (1982), we have since held that such suits do not present constitutional “cases” or “controversies.” See, e.g., *Lance v. Coffman*, 549 U.S. 437, 439, 127 S.Ct. 1194, 167 L.Ed.2d 29 (2007) (*per curiam*); *DaimlerChrysler Corp. v. Cuno*, 547 U.S. 332, 344–346, 126 S.Ct. 1854, 164 L.Ed.2d 589 (2006); *Defenders of Wildlife*, *supra*, at 573–574, 112 S.Ct. 2130. They are barred for constitutional reasons, not “prudential” ones. The limitations on third-party standing are harder to classify; we have observed that third-party standing is “closely related to the question whether a person in the litigant’s position will have a right of action on the claim,” *Department of Labor v. Triplett*, 494 U.S. 715, 721, n. \*\* , 110 S.Ct. 1428, 108 L.Ed.2d 701 (1990) (quoting *Warth v. Seldin*, 422 U.S. 490, 500, n. 12, 95 S.Ct. 2197, 45 L.Ed.2d 343 (1975)), but most of our cases have not framed the inquiry in that way. See, e.g., *Kowalski v. Tesmer*, 543 U.S. 125, 128–129, 125 S.Ct. 564, 160 L.Ed.2d 519 (2004) (suggesting it is an element of “prudential standing”). This case does not present any issue of third-party standing, and consideration of that doctrine’s proper place in the standing firmament can await another day.

- 4 We have on occasion referred to this inquiry as “statutory standing” and treated it as effectively jurisdictional. See, e.g., *Steel Co. v. Citizens for Better Environment*, 523 U.S. 83, 97, and n. 2, 118 S.Ct. 1003, 140 L.Ed.2d 210 (1998); cases cited *id.*, at 114–117, 118 S.Ct. 1003 (Stevens, J., concurring in judgment). That label is an improvement over the language of “prudential standing,” since it correctly places the focus on the statute. But it, too, is misleading, since “the absence of a valid (as opposed to arguable) cause of action does not implicate subject-matter jurisdiction, *i.e.*, the court’s statutory or constitutional power to adjudicate the case.” *Verizon Md. Inc. v. Public Serv. Comm’n of Md.*, 535 U.S. 635, 642–643, 122 S.Ct. 1753, 152 L.Ed.2d 871 (2002) (quoting *Steel Co.*, *supra*, at 89, 118 S.Ct. 1003); see also *Grocery Mfrs. Assn. v. EPA*, 693 F.3d 169, 183–185 (Kavanaugh, J., dissenting), and cases cited therein; Pathak, *Statutory Standing and the Tyranny of Labels*, 62 Okla. L.Rev. 89, 106 (2009).
- 5 Although we announced the modern zone-of-interests test in 1971, its roots lie in the common-law rule that a plaintiff may not recover under the law of negligence for injuries caused by violation of a statute unless the statute “is interpreted as designed to protect the class of persons in which the plaintiff is included, against the risk of the type of harm which has in fact occurred as a result of its violation.” W. Keeton, D. Dobbs, R. Keeton, & D. Owen, *Prosser and Keeton on Law of Torts* § 36, pp. 229–230 (5th ed. 1984); see cases cited *id.*, at 222–227; *Gorris v. Scott*, [1874] 9 L.R. Exch. 125 (Eng.). Statutory causes of action are regularly interpreted to incorporate standard common-law limitations on civil liability—the zone-of-interests test no less than the requirement of proximate causation, see Part III–B, *infra*.
- 6 Proximate causation is not a requirement of Article III standing, which requires only that the plaintiff’s injury be fairly traceable to the defendant’s conduct. Like the zone-of-interests test, see *supra*, at 1387 – 1388, and nn. 3–4, it is an element of the cause of action under the statute, and so is subject to the rule that “the absence of a valid (as opposed to arguable) cause of action does not implicate subject-matter jurisdiction.” *Steel Co.*, 523 U.S., at 89, 118 S.Ct. 1003. But like any other element of a cause of action, it must be adequately alleged at the pleading stage in order for the case to proceed. See *Ashcroft v. Iqbal*, 556 U.S. 662, 678–679, 129 S.Ct. 1937, 173 L.Ed.2d 868 (2009). If a plaintiff’s allegations, taken as true, are insufficient to establish proximate causation, then the complaint must be dismissed; if they are sufficient, then the plaintiff is entitled to an opportunity to prove them.
- 7 We understand this to be the thrust of both sides’ allegations concerning Static Control’s design and sale of specialized microchips for the specific purpose of enabling the remanufacture of Lexmark’s Prebate cartridges.

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**Not If But When:**

**Handling The Fifth Amendment At A Meeting of Creditors**

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**I. Introduction**

Common situations where a debtor is suspected of a white-collar crime involving property of the estate, or in which the debtor's records could help establish a criminal case against him, are matters where attorneys should be prepared on the nuances of the Fifth Amendment. There are also situations where Fifth Amendment issues can arise from a client's statements that you have no knowledge about it before he or she uttered them. The full disclosure requirements of the Bankruptcy Code and Rules may directly conflict with the debtor's Fifth Amendment right to remain silent. In such a situation, the debtor may have to decide whether earning the bankruptcy discharge is more important than avoiding the possibility of being convicted of a crime. Your client or witness may ask you what you advise. "Do-overs" in this important area can have severe repercussions.

**II. Some Fifth Amendment Basics**

The Constitution of the United States through the Fifth Amendment states that no person shall be...compelled in any criminal case to be a witness against himself." See U.S. CONST. amend V.

Although the Constitution states that the Fifth Amendment applies to criminal cases, the privilege may be claimed in civil proceedings, including bankruptcy proceedings unless he or she is granted immunity. See. In Re Jerry H. Mudd, 95 B.R. 426 (Bankr. N.D. Tex. 1989); In Re Susan Petr Hulon, 92 B.R. 670 (Bankr. N.D. Tex. 1988).

Only individuals are entitled to assert the privilege. The U.S. Supreme Court has held that neither corporations nor other artificial or "collective" entities (e.g., partnerships, labor unions) are protected by the privilege. See Hale v. Henkel, 201 U.S. 43, 26 S.Ct. 370, 50 L.Ed. 652 (1906), Bellis v. United States, 417 U.S. 85, 94 S.Ct. 2179, 40 L.Ed.2d 678 (1974). Accordingly, the Fifth Amendment protects the person asserting the privilege only from compelled self-

incrimination. *United States v. Doe*, 465 U.S. 605, 104 S.Ct. 1237, 79 L.Ed.2d 552 (1984);

*Fisher v. United States*, 425 U.S. 391, 96 S.Ct. 1569, 48 L.Ed.2d 39 (1976).

The Fifth Amendment privilege is a personal right and does not extend to documents held by third parties.) *See. In Re Blinder, Robinson & Co., Inc.*, 140 B.R. 790 (D. Colo. 1992), *In re Standard Fin. Management Corp.*, 77 B.R. 324, 327 (Bankr.D.Mass.1987).

A corporate officer cannot refuse to testify or produce corporate documents on the grounds that he may thereby incriminate the corporation." *In re Marine Power & Equip. Co.*, 67 B.R. 643, 649 (Bankr. W.D. Wash. 1986) (citing *Curio v. United States*, 354 U.S. 118 (1957); *Baltimore & Ohio R.R. Co. v. Interstate Commerce Comm'n*, 221 U.S. 612 (1911); *Hale v. Henkel*, 201 U.S. 43 (1906).

Moreover, "a representative of a corporation '[cannot] resist [a] subpoena for corporate documents on the ground that the act of production might tend to incriminate him.'" *See. In re Caucus Distribs.*, Inc., 106 B.R. 890, 896 (Bankr. E.D. Va. 1989) (alteration in original) (quoting *Braswell v. United States*, 487 U.S. 99 (1988)). See also *In re Toyota of Morristown, Inc.*, 120 B.R. 925, 927 (Bankr. E.D. Tenn. 1990) (stating that an officer or custodian of records of a corporation may not withhold production of business records "even if the production of the records would personally incriminate the officer or custodian") (citing *Braswell v. United States*, 487 U.S. 99 (1988); *Bellis v. United States*, 417 U.S. 85 (1974); *United States v. White*, 322 U.S. 694 (1944); *Wilson v. United States*, 221 U.S. 361 (1911); *In re Grand Jury Proceedings (Morganstein)*, 771 F.2d 145, 148 (6th Cir. 1985)). The contents of corporate business records are not privileged, *See Fisher v. United States*, 425 U.S. 391 (1976).

Corporate record custodians may not successfully resist a subpoena for such records on the grounds that the records will incriminate them. *Braswell v. United States*, 487 U.S. 99

(1988). While the defendant in a criminal proceeding has the absolute right to refuse to take the witness stand, "[i]n any other situation, the privilege [against self-incrimination] does not permit a person to avoid being sworn as a witness or being asked questions. Rather the person must listen to the questions and specifically invoke the privilege rather than answer the questions." *In re Hulon*, 92 B.R. 670, 675 (Bankr. N.D. Tex. 1988).

Individuals may exercise their right against self incrimination under the Fifth Amendment in any proceeding. See 11 U.S.C. § 344. A debtor who is not granted immunity under 11 U.S.C. § 344, may assert their Fifth Amendment privilege, may refuse to testify and then retain a right to a discharge in bankruptcy. *In re Salzman*, 61 B.R. 878 (Bankr. S.D.N.Y. 1986), *Turner v. Wlodarski (In re Minton Group, Inc.)*, 43 B.R. 705, 709 (Bankr.S.D.N.Y.1984).

However, a debtor risks dismissal of the bankruptcy case for failure to provide relevant information about the estate under a claim of Fifth Amendment protection. *In re Connelly*, 59 B.R. 421,448 (Bankr. N.D. Ill. 1986). The debtor may also face denial of a discharge under 11 U.S.C. § 727(a)(4)(d), (5), and (6). Likewise, considering the disclosure requirements of 11 U.S.C. § 1125, Fifth Amendment assertions pose an obstacle to confirming a plan of reorganization in an individual's chapter 11 case.

A debtor's asserting a fifth amendment assertion may not have it be used against him in a criminal prosecution. However, it can be used against him in a civil case. For example, a Bankruptcy court may draw adverse inferences from a debtor's invoking their Fifth Amendment privilege, where debtor refuses to testify in response to evidence offered against him in action to determine dischargeability of creditor's claim under 11 U.S.C. § 523. *See In re Salzman*, 61 B.R. 878 (Bankr. S.D.N.Y. 1986)

A debtor who voluntarily petitions a bankruptcy court for discharge of debts under bankruptcy does not forfeit his or her rights guaranteed by the United States Constitution. In order to obtain a discharge, the debtor must comply with certain requirements. He or she must attend a meeting of creditors and comply with court orders, including orders compelling examination by a trustee. A debtor has the right to invoke his or her Fifth Amendment privilege against self incrimination if certain criteria are met. There are three requirements for a proper assertion of the Fifth Amendment privilege: 1) a compelled disclosure 2) found to be testimonial 3) which is incriminating. *In Re Ronald A. Piperi*, 137 B.R. 644. The debtor bears the burden of proof in demonstrating that he or she has a reasonable cause to apprehend a real danger of incrimination. *Id.* The debtor also bears the burden of providing sworn justifications of each and every assertion of Fifth Amendment privilege. *Id.* A debtor, however, cannot simply make a blanket Fifth assertion, he or she must assert the Fifth to each and every question asked at the hearing. *In Re Susan Petr Hulon*, the Court held that the debtor improperly invoked her Fifth Amendment privilege against self-incrimination when she refused to take the oath and answer any questions on advice of counsel. *Hulon* at 671. The Court said that the proper way to invoke the Fifth Amendment was to take the oath and listen to each and every question asked by the trustee before specifically invoking her Fifth Amendment privilege by refusing to answer specific questions. *Id.*

A Debtor must be cautious, throughout the bankruptcy process, to avoid waiving the Fifth Amendment Privilege. *See. Donald Sheldon & Co., Inc.* 193 B.R. 152 (Bankr. S.D.N.Y. 1996) examining the criteria for waiver. When an individual answers a question or otherwise testifies without claiming the privilege, it is waived.

A debtor cannot rely on the privilege in place of evidence needed to satisfy an evidentiary burden. *In Re Wazeter*, 209 B.R. 222 (W.D. Mich. 1997); *See* also *Baxter v. Palmigiano*, 425 U.S. 308 (1976) (The prevailing rule is that the Fifth Amendment does not forbid adverse inferences against parties to civil actions when they refuse to testify in response to probative evidence offered against them.).

#### PROCEDURES AT A MEETING OF CREDITORS

When a debtor asserts the Fifth Amendment privilege at a 341 meeting, the trustee may be expected (1) to make a record as to the precise question asked to which the debtor asserts the Fifth Amendment; (2) to continue asking specific, and limited questions to develop the scope of the privileged area; (3) (optional) to offer an opinion as to whether the question appears to fall within the permissible scope of examination; and (4) at the conclusion of the meeting, to explain that a resolution from the U.S. Attorney and the Court may be required.

#### PROCEDURES AFTER A MEETING OF CREDITORS

When a debtor invokes the Fifth Amendment right to self-incrimination, the standing chapter 12 or 13 Trustee, the panel chapter 7 trustee, or the United States Trustee may report the matter to the U.S. Attorney for consideration of whether immunity may be granted. Case law shows examples where the debtor or debtor's attorney did the reporting. Pursuant to 18 U.S.C. §§ 6002 and 6003, if the U.S. Attorney grants immunity, the witness can be required to testify. *Hoffman v. United States*, 341 U.S. 479 (1951); *In Re Save More Foods, Inc.*, 96 B.R. 1 (D. D.C. 1989); *In Re Hulon*, 92 B.R. 670 (Bankr. N.D. Tex. 1988). Upon the U.S. Attorney's request, immunity may be granted only by order of the district court in which the case was filed. 11 U.S.C. § 6003. *See also* United States Trustee Manual, <http://www.usdoj.gov/ust>.

CRITERIA FOR WITNESS IMMUNITY

The U.S. Department of Justice Offices of the United States Attorneys have specific policies and procedures for seeking "use immunity" under Title 18 U.S.C. §§ 6001-6005....See the Criminal Resource Manual at §716 through §719, for an overview of the differences between the various types of immunity, including use immunity, derivative use immunity, transactional immunity and informal immunity. See 9-23.100 - Witness Immunity—Generally at <https://www.justice.gov/usam/usam-9-23000-witness-immunity#9-23.100>.

“9-23.210 - Decision to Request Immunity—The Public Interest

Section 6003(b) of Title 18, United States Code, authorizes a United States Attorney to request immunity when, in his/her judgment, the testimony or other information that is expected to be obtained from the witness "may be necessary to the public interest." Some of the factors that should be weighed in making this judgment include:

The importance of the investigation or prosecution to effective enforcement of the criminal laws;

The value of the person's testimony or information to the investigation or prosecution;

The likelihood of prompt and full compliance with a compulsion order, and the effectiveness of available sanctions if there is no such compliance;

The person's relative culpability in connection with the offense or offenses being investigated or prosecuted, and his or her criminal history;

The possibility of successfully prosecuting the person prior to compelling his or her testimony;

The likelihood of adverse collateral consequences to the person if he or she testifies under a compulsion order.

These factors are not intended to be all-inclusive or to require a particular decision in a particular case. They are, however, representative of the kinds of factors that should be considered when deciding whether to seek immunity.” *See* United States Department of Justice United States Attorneys Manual § 9-23.000 Witness Immunity at <https://www.justice.gov/usam/usam-9-23000-witness-immunity#9-23.100>.

**III. *Hypothetical: Mr. & Mrs. Will NotTell and The Disappearing Corvette***

Mr. Will NotTell and his wife Mrs. Will NotTell filed this Chapter 13 bankruptcy case on November 30, 2017. On February 7, 2018, at the First Meeting of Creditors, the Will NotTells appeared with her counsel, Troubled Teresa, at the meeting of creditors. Actually, Troubled Teresa, had filed a motion to allow her to withdraw as counsel for the debtors. The resistance date for the motion had not yet passed, and counsel felt compelled to appear with the co-debtor because she had not been formally allowed to withdraw at the time of the First Meeting of Creditors. Zachary Zealous, attorney for the creditor, ABC Federal Savings and Loan, had contacted the Chapter 13 Trustee prior to the meeting of creditors and had tipped her off that he wanted to ask a lot of questions.

ABC Federal Savings and Loan’s claim arose in the following context: Prior to bankruptcy, the debtors owned a 1967 Corvette. This car was modified from its original stock condition and equipped to participate in sanctioned off-road drag racing events. The debtors took out a loan from

ABC Federal Savings and Loan and put the car up as collateral. They defaulted on the loan. ABC Federal Savings and Loan demanded that the debtors return the car. Eventually, the debtors claim, they placed the subject vehicle in a storage unit, notified ABC Federal Savings and Loan of the location of the car, and have not seen the car since that time. The creditor sent a representative to the storage unit to retrieve the car. However, the representative discovered that the car put into storage was a 1982 Corvette of little value. Subsequently, in October of 2016, the debtors were seen to be in possession of, and racing, a car that matched the description of the 1967 Corvette in which ABC Federal Savings and Loan holds a lien. Mrs. Will Not Tell was the main testifier, and the meeting of creditors proceeded as follows:

**Chapter 13 Trustee:** Why didn't you list the 1967 Corvette on your schedules?

**Mrs. Will NotTell:** because it was not in our possession.

**Zachary Zealous:** When was the last time that the 1967 Corvette VIN number... was in your possession.

**Mrs. Will NotTell:** Let's see. It was probably September 17, 2015. It was at my step mother's house but I don't know her address. I haven't been at her house in 15 years. The car was originally placed in my name. It was a gift from my grandfather. He gave it to me, and then we put the title to the car in the name of my beauty shop. Then we had to put the title back into my name. That's because we got the loan from ABC Federal Savings and Loan. The loan officer insisted that the car be taken out of the name of the beauty shop and put back into my name.

**Zachary Zealous:** was the car ever put in your husband's name?

**Mrs. Will NotTell:** No. It was never put in my husband's name. He just raced the car. He had the racing license, but he never made any money with it. He got a couple of trophies once or twice. Maybe the title was put in my grandson's name for a while. No, that could not be, because it was

a minor, but my grandson also raced the car. Maybe it was put in his mother's name because my grandson John Doe was a minor. I don't remember.

**Zachary Zealous:** when did you last see the 1967 Corvette VIN number...?

**Mrs. Will NotTell:** when we left the car at the storage unit as ABC Federal Savings and Loan told us to do.

**Zachary Zealous:** At what location of the storage unit did you leave the car?

**Mr. Will Not Tell:** She pleads the Fifth.

**Mrs. Will NotTell:** I was talking to my criminal attorney before I came here and he said that you could not ask me these questions?

**Zachary Zealous:** Who is your attorney?

**Mrs. Will NotTell:** Perry Mason. I just spoke to him.

**Zachary Zealous:** When did you retain him?

**Mrs. Will NotTell:** I just spoke to him by phone and when I see him later this afternoon I'll give him a retainer and he said I didn't have to answer your questions. I'm not going to say any more. After a short recess with her counsel, Troubled Teresa, Mrs. Will NotTell who was still under oath started answering questions again.

**Zachary Zealous:** did you and your husband Mr. Will NotTell present for the Car Race of the Century in Kansas City, Missouri on November 15, 2017?

**Mrs. Will NotTell:** Yes, we were there.

**Zachary Zealous:** did your husband Mr. Will NotTell actually race?

**Mrs. Will NotTell:** Yes, he did.

**Zachary Zealous:** Who made all of the arrangements for racing in that event?

**Mrs. Will Not Tell:** I did. I always make the arrangements. My husband doesn't know anything about that. He just races the cars.

**Zachary Zealous:** was the Corvette that your husband raced at the Car Race of the Century in Kansas City, Missouri on November 15, 2017 the same 1967 Corvette VIN number... in which ABC Federal Savings and Loan held a lien?

**Mrs. Will Not Tell:** No, it was not.

**Zachary Zealous:** Do you know who owned the car that your husband was racing?

**Mrs. Will Not Tell:** No, I do not know the person specifically.

**Zachary Zealous:** Do you know the name of the owner of the car your husband drove?

**Mrs. Will Not Tell:** No, I do not.

**Zachary Zealous:** Do you know how to obtain the name and address of the owner of the car your husband was racing?

**Mrs. Will Not Tell:** I am not gonna say. I imagine I could find out.

**Zachary Zealous:** Do you know anyone who will know the name of the owner?

**Mrs. Will Not Tell:** Yes.

**Zachary Zealous:** Will you give me the names of the people or person who know the name of that individual?

**Mrs. Will Not Tell:** The Fifth. (the debtor then refused to answer any more questions).

#### CONCLUSION

In sum, achieving the goals of avoiding potential criminal prosecution against a debtor's duty of full disclosure is a balancing act that bankruptcy trustees and counsel for debtors and creditors should be prepared to address before a 341 hearing to ensure all procedures are sufficiently followed.

## ETHICAL ISSUES REGARDING ATTORNEY FEES<sup>1</sup>

**Eighth Circuit Affirms Order Requiring Attorney Who Advised Client to Omit Items on Schedules to Disgorge Fees and Pay Additional Sanctions, and Referring to District Court for Disciplinary Proceedings. *In re Clink*, 770 F.3d 719 (8th Cir. 2014)**

After the debtor's Chapter 7 case was closed, the United States Trustee moved to reopen it because she learned that the debtor had failed to disclose that she owned horses and that she had made a \$3,000 preferential transfer to her mother. The debtor explained that her attorney had advised her not to disclose these items. With regard to the preferential transfer, the debtor's attorney had told the debtor in an email that she should not send the check to her mother, but that if she did, she should "make sure it cannot be traced and stick with the story. It did not happen." The attorney in fact admitted he had told his client to lie about the payment.

Section 526(a)(2) provides that "a debt relief agency shall not . . . make any statement, or counsel or advise any assisted person . . . to make a statement in a document filed in a case or proceeding under this title, that is untrue or misleading, or that upon the exercise of reasonable care, should have been known by such agency to be untrue or misleading." The bankruptcy court held that the attorney violated this section with regard to the preferential payment.

With regard to the horses, the court also found that the attorney violated § 707(b)(4)(C), which provides that "[t]he signature of an attorney on a petition, pleading, or written motion shall constitute a certification that the attorney has (i) performed a reasonable investigation into the circumstances that gave rise to the petition, pleading, or written motion; and (ii) determined that the petition, pleading, or written motion (I) is well grounded in fact; and (II) is warranted by existing law or a good faith argument for the extension, modification, or reversal of existing law and does not constitute an abuse under paragraph (1)." Section 707(b)(4)(D) provides, "[t]he signature of an attorney on the petition shall constitute a certification that the attorney has no knowledge after an inquiry that the information in the schedules filed with such petition is incorrect."

Although the debtor did not specifically advise the attorney that she owned horses, he knew that she had previously owned them, but did not ask her whether she had sold them

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<sup>1</sup> Materials prepared by Erica M. Garrett, Law Clerk to Chief Judge Cynthia A. Norton, United States Bankruptcy Court for the Western District of Missouri.

or still had them. The court also found that the attorney had filed schedules which were materially different than the ones actually executed by the debtor.

Based on these violations, as well as violation of Rule 9011, the court ordered the attorney to disgorge the \$1,411 he had been paid, and to pay \$4,233 to the trustee, representing three times the amount of fees he charged the debtor. In addition, the court found that the attorney had violated several of the Missouri Rules of Professional Conduct and referred the attorney to the district court for further discipline.

The district court and the Eighth Circuit Court of Appeals affirmed the bankruptcy court's order.

**Eighth Circuit Affirms Contempt Sanctions Against Attorney Who Failed to Make a Sufficient Attempt to Turn Over Records in Violation of Court Order. *In re Reed*, 888 F.3d 930 (8th Cir. 2018)**

Attorneys James Robinson and Ross Briggs worked to Critique Services LLC, a bankruptcy-services business run by Beverly Holmes Diltz. In June 2014, the bankruptcy court suspended Robinson from practicing in that court. Briggs agreed to represent about a hundred of Robinson's clients who had cases pending in the district when Robinson was suspended. In late 2014, the bankruptcy court ordered Robinson to show cause why it should not order disgorgement of his attorney fees in some of those cases, and asked the trustees in the district to gather information regarding the fees. The trustees then sent a letter to Briggs, Robinson, and Critique looking for the information. Briggs responded, saying that he had received no fees for representing Robinson's clients, and had no documents from Robinson or Critique. This prompted a motion by the trustees to compel Robinson, Briggs, and Critique to turn over the information. At a hearing on the trustees' motion, Briggs agreed to help obtain the information and documents the court wanted. The court then ordered Robinson, Briggs, and Critique to turn over the information, noting that Briggs might need to seek the documents and information from third parties or to make inquiries with Robinson and Critique. When the information was not forthcoming, the bankruptcy court found that all three had failed to comply with the order compelling turnover and gave them seven days to either comply or file a brief why sanctions should not be imposed. Briggs did file such a brief, but the court issued an order to show cause against him why he should not be sanctioned. Months later, the court found Briggs in contempt of the turnover order, found that he "deliberately and with deceptive intent made misleading representations to the Court regarding the true nature of his relationship with the Critique Services Business and Diltz." The court suspended him from practice in that court for six months, ordered him to complete twelve

hours of CLE in professional ethics, and permanently prohibited him “from being financially involved with” Critique, Diltz, and Robinson.

The district court and Eighth Circuit affirmed. The Eighth Circuit rejected Briggs’ argument that under *Stern v. Marshall*, 564 U.S. 462 (2011), the bankruptcy court lacked constitutional authority to sanction him. The Eighth Circuit also disagreed with Briggs’ argument that the bankruptcy court’s attorney ethics investigation implicated only state law issues; rather, although the state’s professional responsibility rules were implicated, the turnover order was made under § 542(e) of the bankruptcy code. In addition, all of the orders were matters “arising in” a bankruptcy case. Moreover, the orders did not implicate a common law claim. The Eighth Circuit also affirmed the bankruptcy court’s factual findings that Briggs had made no real effort to comply with the order. Finally, although the court should have afforded Briggs a hearing about whether he made false or misleading representations to the court and erred in that regard, the error did not compel remand because Briggs’ contempt of the turnover order was a sufficient basis for sanctions.

**Eighth Circuit BAP Affirms Bankruptcy Court’s Order Disgorging Fees. *In re Miller Automotive Group Inc.*, 536 B.R. 828 (B.A.P. 8th Cir. 2015)**

An out-of-state attorney filed a Chapter 11 case on behalf of a corporate debtor, an automobile dealership, in the Western District of Missouri. Because the attorney was not admitted to practice in that district, he filed a motion to appear *pro hac vice* and an application to be employed as counsel, which the court approved over the United States Trustee’s objection. The attorney had misidentified the name of the debtor in the petition he filed. He also failed to obtain authority for the debtor to use cash collateral, and failed to retain a broker to attempt to sell the business. He was also unsuccessful in opposing motions for relief from stay by the primary lenders. On the debtor’s motion, the case was dismissed and the case closed.

The UST moved to reopen the case, seeking disgorgement of fees, a declaration that the attorney was entitled to no compensation, and denial of permission to appear *pro hac vice* in the district in the future. The bankruptcy court granted the UST’s motion for disgorgement, suspended the attorney indefinitely from appearing *pro hac vice*, and revoked his electronic filing privileges in the Western District of Missouri.

The BAP affirmed, holding that there was no requirement under § 350(b) or Rule 5010 for notice and hearing prior to reopening the case. It also rejected the attorney’s argument that, in order to reopen a case, a court must expressly retain jurisdiction when dismissing it. The BAP also affirmed the award of sanctions, saying that the record showed the attorney “not only failed to provide a benefit, but took actions that were

detrimental to the debtor and the estate.” Moreover, the BAP held that the attorney had caused the debtor to incur unnecessary legal fees from the very beginning of the case. Therefore, based on the attorney’s violations of “not only the Bankruptcy Code, Bankruptcy Rules, and Local Rules, but basic tenets of legal representation,” the sanctions imposed were supported by the record.

**Law Firm Which Filed Ill-Advised Case for Debtor Involved in Pending Criminal Case Ordered to Disgorge Fees. *In re Small*, 2018 WL 2938517 (Bankr. W.D. Mo. June 7, 2018)**

Law firm filed a Chapter 11 case for an individual. The petition was filed with a complete set of schedules and statements, including a Rule 2016 Disclosure of Compensation stating that the firm had accepted \$20,500 for legal services to be rendered in connection with the case and that the debtor had been the source of the funds. The Disclosure also stated that \$4,467.75 had been paid to the firm prepetition, and that the balance, \$16,032.25, remained in the firm’s trust account “to be paid according to Court requirements.” In contrast to that disclosure, the SOFA stated that the debtor had paid the firm an \$18,000 “retainer fee” plus \$2,500 for “costs and expenses.” The firm’s affidavit attached to the application for employment contained “yet another variation” of the fee arrangement and source of funds, stating that the firm had been paid a total of \$20,500, but saying \$16,000 of that amount was paid by the debtor, and \$4,500 was paid by the debtor’s business. It further disclosed that the firm had paid itself \$4,467.75 in fees for prepetition services.

The SOFA also disclosed that the debtor was a defendant in a federal criminal tax evasion proceeding, had entered a plea agreement, and that sentencing was pending.

The debtor had had a Chapter 13 case dismissed for failure to file a plan in the months prior to filing this case, and so he filed a motion to extend the stay. A bank holding liens on the debtor’s real estate objected to the extension. According to the court, the bank “set forth a devastating denouncement” of the debtor’s good faith in filing the Chapter 11 case, including that the previous Chapter 13 had been filed on the date of a scheduled foreclosure, there was no equity in the real estate, and that the debts significantly exceeded the Chapter 13 debt limits. In addition, after the Chapter 13 case had been dismissed, the debtor convinced the bank to forbear from recommencing the foreclosure but took no efforts to sell the property, and that the debtor filed this case on the very date set for the second foreclosure. In addition, the schedules showed that there were a total of \$2 million in liens (including the IRS’s lien) and the property was valued at only \$850,000. Finally, the schedules showed the debtor had net income of only \$1,450 per

month and monthly expenses of more than \$1,700 and no financial ability to fund a Chapter 11 plan.

At the UST's initial interview of the debtor, the attorney appearing on behalf of the firm admitted that no one had reviewed the criminal tax evasion case, read the plea agreement, consulted with the debtor's criminal counsel, or contacted either the IRS or the U.S. Attorney's office before filing the case, notwithstanding the fact that the firm knew about the criminal tax evasion case. The attorney told the UST at that interview that the debtor intended to dismiss the bankruptcy case.

Shortly after that interview, the debtor did move to dismiss the case (less than thirty days after it had been filed), stating that the firm had initially believed there was equity in the real estate to pay the IRS, but that it later became apparent that there was no equity and that the property could not be sold. Therefore, the firm conceded, there was "nothing for the Debtor to reorganize."

Thereafter, the debtor appeared at the § 341 meeting, at which the UST inquired about the source of the law firm's fee. The debtor testified that some of the fee had come from selling scrap metal, and some came from his mother and brother, contrary to what had been disclosed in the disclosures.

The IRS and the UST then filed motions to compel the firm to disgorge the fees paid to it. At the hearing on those motions, the attorney appearing for the firm said that the plan had been to convince the IRS to release its liens so the property could be sold, hopefully at a price which would have paid the IRS something. However, the firm's time records revealed that almost no investigation or due diligence had been done prepetition, including inquiring of the IRS whether that would be possible. Although the court expressed that it had initially been inclined to allow some of the fees, it could not do so because of the complete lack of due diligence. Significantly, the U.S. Attorney pointed out that the district court had expressly found that the debtor's Chapter 11 bankruptcy filing violated the terms of his plea agreement and that the debtor received an enhanced sentence as a result of the filing. Had any bankruptcy attorney "taken the few minutes needed to review the plea agreement and the criminal case, or to have called the Debtor's criminal counsel, the U.S. Attorney or the IRS, he would have realized immediately that filing any bankruptcy – but particularly an individual chapter 11 bankruptcy – was patently in bad faith, given the fiduciary duties chapter 11 imposes on a debtor on behalf of the creditors and the estate."

The court went on: "The time records speak for themselves: there was no attempt to seriously evaluate the feasibility of this debtor filing bankruptcy. Rather, this case smacks of a rush to get paid out of a substantial retainer, and to sort out any damage to the

Debtor, the creditors, or the estate later, by simply dismissing.” Based on this failure, and the inaccuracies in the disclosures, the court ordered full disgorgement.

**Attorney Sanctioned for Filing Bad Faith Bankruptcy Case. *In re Midland Properties II, LLC*, 2016 WL 3637708 (Bankr. D. Neb. June 29, 2016)**

Jerry J. Morgan, Sr., was the sole and managing member of Midland Properties, LLC, an entity which owned a number of rental properties in the Omaha area. Several banks held mortgages on the properties, including First State Bank, which was owed more than \$1 million. Morgan and Midland Properties filed Chapter 11 petitions in 2013 and the cases were jointly administered. A plan was confirmed in March 2015, under which First State Bank’s claims would be paid over a term of five years. Midland properties quickly defaulted on its plan payments to First State and it obtained relief from the stay on October 27, 2015. The debtors appealed that order, but did not obtain a stay pending appeal. The bank proceeded with the foreclosures and scheduled sales of the properties on April 6 and April 14, 2016. It also filed quiet title actions and obtained the appointment of receivers to collect rents.

While those foreclosure sales were pending, Morgan deeded the properties from Midland Properties, LLC to Midland Properties II, LLC (“MPII”), which was formed on February 8, 2016. The deeds had been executed on January 2, 2016, and recorded on February 29, 2016. MPII then filed a chapter 11 petition on April 4, 2014, a few days before the scheduled foreclosures.

Meanwhile, Morgan and his attorney proceeded with the appeal in the first (Midland Properties) bankruptcy case, as well as an adversary proceeding it had filed against First State in that case, “as if the Midland Properties plan was still viable and ongoing.” At the § 341 meeting in the MPII case on May 2, 2016, counsel for First State learned for the first time that MPII had acquired all of its properties from Midland Properties in exchange for a purported assumption of the secured debt. MPII did not assume Midland Properties’ unsecured debt, however.

First State quickly moved to dismiss the MPII case for bad faith, and the UST moved to dismiss the Midland Properties’ case, asserting that the transfer of the assets to MPII made it so there was no reasonable likelihood of rehabilitation. In addition, Midland Properties had failed to make plan payments and was being “grossly mismanaged.” The bankruptcy court granted both motions to dismiss on May 10.

Meanwhile, the appeal from the first case remained pending before the BAP, which did not learn until late April 2016 that Midland Properties had transferred all of its assets to MPII, and that MPII was now a debtor. It also then learned of the dismissal of the

underlying bankruptcy cases. The BAP found that the appeal had become moot on January 2 when Midland executed the quit claim deeds transferring the properties to MPII. Nevertheless, debtors' counsel briefed the appeal in February and March without notifying either the bank or the BAP about the transfers. The BAP found the appeal frivolous and sanctioned Midland, Morgan, and their attorney \$25,000.

Meanwhile, First State had also filed a motion for sanctions in the MPII case. The court issued sanctions against both Morgan and the attorney under Rule 9011. With regard to the attorney, the court pointed out that this attorney – the bankruptcy attorney – had not been involved in the formation of MPII or the transfers of the properties – another attorney had assisted Morgan with that. The court also noted that this attorney was a distinguished and well-regarded bankruptcy attorney. Nevertheless, the court found, given his excellent reputation in the community, the attorney's willingness to encourage and enable Morgan's gamesmanship with First State Bank and other creditors was "befuddling." Under all the circumstances, the court ordered the attorney to disgorge all fees he had received in connection with the MPII case, totaling \$17,000.

**Court Orders Disgorgement for Nondisclosures Concerning Fees. *In re Grabanski*, 578 B.R. 458 (Bankr. D. N.D. 2017)**

As the court described it, this case had "a long and complicated history," involving numerous delays and misrepresentations by the debtors. The case was ultimately dismissed with prejudice. A theme throughout the case, though, was a dispute between the debtors and creditors John and Dawn Keeley. The Keeleys had also been active in monitoring, and objecting to, the fees being charged by the debtors' attorney while the case was pending. After several rounds of litigation involving the amount of fees, the court ultimately awarded the attorney a final and total fee award of \$37,013.76.

Thereafter, the Keeleys began to suspect the attorney had been paid significantly more than that. At a show cause hearing, the evidence was that, despite having disclosed only receiving \$15,000, the attorney had received over \$205,000 from the debtors or their solely-owned partnerships. The attorney defended the fees, arguing that since the money came from non-debtor entities, he didn't have to disclose them. The court soundly rejected that argument, but denied the Keeleys' initial request for sanctions. It directed the attorney to fully disclose the fees. He filed a new disclosure, to which the Keeleys objected.

Again finding the disclosure inadequate, the court ordered the attorney to file an amended accounting along with his billing records and IOLTA trust account statements showing payments from the debtors or any of their entities. It also ordered the UST to take a position on the sufficiency, which it had not yet done. After the attorney filed the new

information, the UST took the position that the disclosure still violated six of his duties as counsel for the debtors in his disclosures. The UST requested that the fees be disgorged and that the attorney be sanctioned in the form of paying the Keeleys' attorney fees. The attorney vigorously opposed the request. After much more litigation over the matter, the court ultimately ordered disgorgement. The court rejected the attorney's argument that the court had lost jurisdiction when the bankruptcy case was dismissed, regardless of the length of time the case had been dismissed. The court found that the debtors' attorney failed to show that fee payments which he received during the pendency of the debtors' bankruptcy case, from companies wholly owned by the debtors, were not for services performed "in connection with" the debtors' bankruptcy case under § 329. Accordingly, and taking into account some fees he had already paid back through settlements and other litigation, the court ordered him to disgorge \$44,887.74.

**Bankruptcy Court Did Not Abuse its Discretion in Imposing Disgorgement Based on Attorney's Failure to Disclose Compensation Information. *In re Redding*, 263 B.R. 874 (B.A.P. 8th Cir. 2001).**

When the Chapter 13 debtors filed their case, their attorney filed a Rule 2016(b) statement disclosing that the debtors paid him \$3,000 for services relating to the case. He did not, however, comply with a local rule that required him to seek court approval for payment of fees in excess of \$1,000. After the case was converted to Chapter 11, his employment as counsel for the debtors-in-possession was approved by the court. During the pendency of the case, he billed the debtors and received payments in the additional sum of \$8,011.40, meaning that he had been paid a total of \$11,011.40 in the case. After the case was converted to Chapter 7, the newly-appointed trustee discovered the additional \$8,000 postpetition payment. Since this payment had not been disclosed, the trustee sought disgorgement. A month later, the attorney finally filed his amended Rule 2016 disclosure and filed an application for approval of his fees as required by local rule, in the sum of \$14,715 in fees and \$1,001.96 in expenses, for a total of \$15,716.97.

The court disapproved the fees and directed disgorgement. The attorney appealed. The BAP reversed and remanded, directing the court to analyze the fees under § 329 and issue further findings of fact on the reasons for the imposition of sanctions. On remand, the court found the amount of fees to be reasonable in amount but, based on the failure to disclose the payments, ordered that the attorney disgorge \$10,011.40 to the trustee. The court did not disallow the fees in their entirety, but instead provided for payment of the fees on a subordinated, nonpriority basis, since there was some indication that unsecured creditors were going to be paid in full. The attorney appealed again.

On the second appeal, the BAP affirmed. According to the BAP, the attorney had failed to comply with the disclosure requirements over the course of a year, and only finally “grudgingly” complied after the trustee sought disgorgement. While the sanction was concededly harsh, the BAP held that it was not an abuse of discretion. On a motion for rehearing, the BAP rejected the attorney’s argument that he should not be sanctioned because the court had not enforced the local rule previously. *In re Redding*, 265 B.R. 601 (B.A.P. 8th Cir. 2001).

**AMERICAN BANKRUPTCY INSTITUTE**

B2030 (Form 2030) (12/15)

**United States Bankruptcy Court**

District Of \_\_\_\_\_

**In re**

Case No. \_\_\_\_\_

**Debtor**

Chapter \_\_\_\_\_

**DISCLOSURE OF COMPENSATION OF ATTORNEY FOR DEBTOR**

- Pursuant to 11 U.S.C. § 329(a) and Fed. Bankr. P. 2016(b), I certify that I am the attorney for the above named debtor(s) and that compensation paid to me within one year before the filing of the petition in bankruptcy, or agreed to be paid to me, for services rendered or to be rendered on behalf of the debtor(s) in contemplation of or in connection with the bankruptcy case is as follows:

For legal services, I have agreed to accept ..... \$ \_\_\_\_\_

Prior to the filing of this statement I have received ..... \$ \_\_\_\_\_

Balance Due ..... \$ \_\_\_\_\_

- The source of the compensation paid to me was:

Debtor                       Other (specify)

- The source of compensation to be paid to me is:

Debtor                       Other (specify)

- I have not agreed to share the above-disclosed compensation with any other person unless they are members and associates of my law firm.

I have agreed to share the above-disclosed compensation with a other person or persons who are not members or associates of my law firm. A copy of the agreement, together with a list of the names of the people sharing in the compensation, is attached.

- In return for the above-disclosed fee, I have agreed to render legal service for all aspects of the bankruptcy case, including:
  - Analysis of the debtor's financial situation, and rendering advice to the debtor in determining whether to file a petition in bankruptcy;
  - Preparation and filing of any petition, schedules, statements of affairs and plan which may be required;
  - Representation of the debtor at the meeting of creditors and confirmation hearing, and any adjourned hearings thereof;

**2018 MIDWESTERN BANKRUPTCY INSTITUTE**

B2030 (Form 2030) (12/15)

- d. Representation of the debtor in adversary proceedings and other contested bankruptcy matters;
- e. [Other provisions as needed]

6. By agreement with the debtor(s), the above-disclosed fee does not include the following services:

<b>CERTIFICATION</b>	
I certify that the foregoing is a complete statement of any agreement or arrangement for payment to me for representation of the debtor(s) in this bankruptcy proceeding.	
_____ <i>Date</i>	_____ <i>Signature of Attorney</i>
	_____ <i>Name of law firm</i>

AMERICAN BANKRUPTCY INSTITUTE

B2030 (Form 2030) (12/15)

United States Bankruptcy Court
Western District of Missouri

In re [Redacted] Debtor(s) Case No. [Redacted] Chapter [Redacted]

DISCLOSURE OF COMPENSATION OF ATTORNEY FOR DEBTOR(S)

1. Pursuant to 11 U.S.C. § 329(a) and Fed. Bankr. P. 2016(b), I certify that I am the attorney for the above named debtor(s) and that compensation paid to me within one year before the filing of the petition in bankruptcy, or agreed to be paid to me, for services rendered or to be rendered on behalf of the debtor(s) in contemplation of or in connection with the bankruptcy case is as follows:

Table with 2 columns: Description of compensation and Amount. Rows include: For legal services, I have agreed to accept (\$ 10,000.00); Prior to the filing of this statement I have received (\$ 10,000.00); Balance Due (\$ 0.00).

2. \$ 275.00 of the filing fee has been paid.

3. The source of the compensation paid to me was: [Redacted]

4. The source of compensation to be paid to me is: [Redacted]

5. I have not agreed to share the above-disclosed compensation with any other person unless they are members and associates of my law firm.

I have agreed to share the above-disclosed compensation with a person or persons who are not members or associates of my law firm. A copy of the agreement, together with a list of the names of the people sharing in the compensation is attached.

6. In return for the above-disclosed fee, I have agreed to render legal service for all aspects of the bankruptcy case, including:

a. [Other provisions as needed] [Redacted]

7. By agreement with the debtor(s), the above-disclosed fee does not include the following service:

CERTIFICATION

I certify that the foregoing is a complete statement of any agreement or arrangement for payment to me for representation of the debtor(s) in this bankruptcy proceeding.

Date [Redacted]

Name of law firm [Redacted]

**2018 MIDWESTERN BANKRUPTCY INSTITUTE**

Debtor 1 [REDACTED] Case number (if known) [REDACTED]

or gambling?

- No
- Yes. Fill in the details.

<b>Describe the property you lost and how the loss occurred</b>	<b>Describe any insurance coverage for the loss</b> Include the amount that insurance has paid. List pending insurance claims on line 33 of <i>Schedule A/B: Property</i> .	<b>Date of your loss</b>	<b>Value of property lost</b>
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**Part 7: List Certain Payments or Transfers**

16. **Within 1 year before you filed for bankruptcy, did you or anyone else acting on your behalf pay or transfer any property to anyone you consulted about seeking bankruptcy or preparing a bankruptcy petition?**  
Include any attorneys, bankruptcy petition preparers, or credit counseling agencies for services required in your bankruptcy.

- No
- Yes. Fill in the details.

<b>Person Who Was Paid</b> Address Email or website address Person Who Made the Payment, if Not You	<b>Description and value of any property transferred</b>	<b>Date payment or transfer was made</b>	<b>Amount of payment</b>
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]

17. **Within 1 year before you filed for bankruptcy, did you or anyone else acting on your behalf pay or transfer any property to anyone who promised to help you deal with your creditors or to make payments to your creditors?**  
Do not include any payment or transfer that you listed on line 16.

- No
- Yes. Fill in the details.

<b>Person Who Was Paid</b> Address	<b>Description and value of any property transferred</b>	<b>Date payment or transfer was made</b>	<b>Amount of payment</b>
---------------------------------------	--	--	--------------------------

18. **Within 2 years before you filed for bankruptcy, did you sell, trade, or otherwise transfer any property to anyone, other than property transferred in the ordinary course of your business or financial affairs?**  
Include both outright transfers and transfers made as security (such as the granting of a security interest or mortgage on your property). Do not include gifts and transfers that you have already listed on this statement.

- No
- Yes. Fill in the details.

<b>Person Who Received Transfer</b> Address Person's relationship to you	<b>Description and value of property transferred</b>	<b>Describe any property or payments received or debts paid in exchange</b>	<b>Date transfer was made</b>
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]

NOTES FOR ROUND-TABLE PRESENTATION  
JUDGE CHARLES E. RENDLEN, III  
MWBI – OCTOBER 12, 2018

- Section 707(a) provides that a chapter 7 case may be dismissed “for cause”
- “Cause” is not statutorily defined, but § 707(a) provides three illustrative examples of “cause”: unreasonable delay, (2) nonpayment of fees, or (3) failure to timely file certain information.
- By the 90s, Circuit courts had begun considering whether bad faith could support dismissal under § 707(a)
- In 1991, the Sixth Circuit recognized that bad faith can support § 707(a) dismissal. *In re Zick*, 931 F.2d 1124, 1126-27 (6th Cir. 1991).
- Today, a majority of Circuits agree:
  - The Third Circuit permits § 707(a) dismissal for bad faith, instructing that courts “determine good faith only on an ad hoc basis and must decide whether the petitioner has abused the provisions, purpose, or spirit of bankruptcy law,” with the understanding that bad faith “should not [be] lightly infer[red].” *In re Tamecki*, 229 F.3d 205, 207 (3d Cir. 2000).
  - The Fifth Circuit recognizes that a debtor’s pre- and post-petition behavior can support § 707(a) dismissal for bad faith, even if other Code provisions arguably encompass the conduct. *In re Krueger*, 812 F.3d 365, 372 (5th Cir. 2016).
  - The Eleventh Circuit has held that bad faith may be “cause” under § 707(a), and applies a totality of the circumstances approach. *In re Piazza*, 719 F.3d 1253, 1271-72 (11th Cir. 2013)
  - And although the Second Circuit has not yet addressed the issue, a bankruptcy court in that Circuit has indicated that, if dismissal for bad faith is permitted, a “stringent standard” is proper. *In re Chovev*, 559 B.R. 339, 347 (Bank. E.D.N.Y. 2016).
- By contrast, the Ninth Circuit has held that, while “bad faith per se can properly constitute ‘cause’ for dismissal of a Chapter 11 or Chapter 13 petition,” as a general proposition, it cannot constitute “cause” for dismissal of a Chapter 7 petition under § 707(a). *In re Padilla*, 222 F.3d 1184, 1193 (9th Cir. 2000).
- The Eighth Circuit has held that, while some conduct giving rise to dismissal under § 707(a) can be characterized as bad faith, the inquiry is properly whether

the petition should be dismissed “for cause.” *In re Huckfeldt*, 39 F.3d 829, 832 (8th Cir. 1994).

- Recently, in *Janvey v. Romero*, 883 F.3d 406 (4th Cir. 2018), the Fourth Circuit joined the majority Circuits, reasoning that “the majority view is the sounder one, because it is the most helpful in preventing serious abuses of the bankruptcy process.”
- However, the court stressed that bad faith is reserved for cases of “real” misconduct—also echoing other majority-position Circuits.
- *Janvey* employed a totality of the circumstances approach and considered public policy concerns.
- Rejected *Janvey*’s argument that bad faith had been established because the debtor sought to discharge only a single debt. Bad faith cannot be established merely because the debtor has only one debt to discharge and it is not proper to “transform this single factor into a per se test for bad faith.”
- Called “groundless” *Janvey*’s argument that the debtor committed “blackmail” by raising the possibility of bankruptcy during settlement efforts.
- Rejected *Janvey*’s argument that the debtor had “too much money,” essentially complaining that the debtor was not forced to use exempt assets.

*Background:* In *Janvey*, the debtor had been a retired foreign service officer who founded a consulting business. When it came to light that Stanford Financial Group, one of the debtor’s clients, ran a Ponzi scheme, the debtor cuts ties with Stanford. However, the SEC sued Stanford in U.S. district court, and the receiver, Ralph Janvey, sued the debtor, seeking to recover for the Ponzi victims. Pre-trial, the debtor offered to settle, but Janvey rejected the offer and declined to counteroffer. While appealing the \$1.25 million judgment against him, the debtor again offered to settle—which Janvey rejected without counteroffering. After the debtor lost his appeal, he filed for chapter 7 relief. He had \$5.35 million in mostly exempt assets, and had debts of the \$1.25 million judgment and \$150,000.00 in legal bills. His monthly expenses exceeded his income by \$350.00, due to medical expenses for his disabled wife. Janvey moved to dismiss under § 707(a), alleging bad faith. The bankruptcy court held that, while bad faith may constitute § 707(a) “cause,” the debtor had not acted in bad faith.

**DISCHARGE OF STUDENT LOANS UNDER  
§ 523(A)(8) BASED ON UNDUE HARDSHIP:**

**(1) THE 10TH CIRCUIT APPLIES  
THE THREE-PART *BRUNNER* TEST**

**AND**

**(2) THE 8TH CIRCUIT APPLIES A  
TOTALITY- OF-THE-CIRCUMSTANCES TEST,**

*presented by*

**THE HONORABLE DALE L. SOMERS,  
UNITED STATES BANKRUPTCY JUDGE  
FOR THE DISTRICT OF KANSAS**

**MIDWESTERN BANKRUPTCY INSTITUTE**

October 11 & 12, 2018

## PART 1

Section 523(a)(8) creates an exception to the discharge for certain debts:

(8) unless excepting such debt from discharge under this paragraph would impose an undue hardship on the debtor and the debtor's dependents, for —

- (A) (i) an educational benefit overpayment or loan made, insured, or guaranteed by a governmental unit, or made under any program funded in whole or in part by a governmental unit or nonprofit institution; or
- (ii) an obligation to repay funds received as an educational benefit, scholarship, or stipend; or
- (B) any other educational loan that is a qualified education loan, as defined in section 221(d)(1) of the Internal Revenue Code of 1986, incurred by a debtor who is an individual.

“Undue hardship” is not defined in the Bankruptcy Code, and courts have struggled for years to determine what it means in the context of this provision. Ultimately, most of the federal courts of appeal, including the 10th Circuit, have applied the three-part test the 2d Circuit adopted in *Brunner v. New York State Higher Education Services Corp.*, 831 F.2d 395 (2d Cir. 1987), but the 8th Circuit applies a totality-of-the-circumstances test it first adopted in *Andrews v. South Dakota Student Loan Assistance Corp. (In re Andrews)*, 661 F.2d 702 (8th Cir. 1981). In general, both tests will require similar evidence and involve the consideration of similar facets of the debtor's circumstances, but they may lead to different results in some cases.

## PART 2

### A. 10th Circuit case law

1. *Educational Credit Management Corp. v. Polleys*, 356 F.3d 1302 (10th Cir. 2004)

This case concerned a 45-year-old single mother of a teenaged girl. She had obtained an accounting degree in 1993, but thereafter had little luck getting work in that field. After filing bankruptcy, the debtor filed an adversary proceeding in 1999 seeking to discharge her student loans under § 523(a)(8) on the basis of undue hardship. By the time of trial, she owed \$51,000 on the loans, and repayment would require \$420 per month for

20 years. From 1997 to 2000, the debtor's annual income ranged from \$3,000 to \$16,000. She and her daughter lived in a rental property her parents owned, and paid no rent or utilities. She qualified for food stamps and her income was below the federal poverty guidelines. The debtor was in good physical health, but suffered from a diagnosed psychological condition and took an antidepressant twice a day. The bankruptcy court granted a discharge of the student loans based on undue hardship and the district court affirmed.

The 10th Circuit first addressed the proper standard for determining undue hardship under § 523(a)(8), noting that many courts apply the three-part test *Brunner* test, but that the 8th Circuit applies the totality-of-the-circumstances test it adopted in *Andrews*. The Circuit said that the two tests would often consider similar information: "the debtor's current and prospective financial situation relative to the educational debt and the debtor's efforts at repayment." 356 F.3d at 1309. The Tenth Circuit decided to adopt the *Brunner* test. Under that test, the debtor must prove:

- (1) that the debtor cannot maintain, based on current income and expenses, a "minimal" standard of living for herself and her dependents if forced to repay the loans;
- (2) that additional circumstances exist indicating that this state of affairs is likely to persist for a significant portion of the repayment period of the student loans; and
- (3) that the debtor has made good faith efforts to repay the loans.

*Brunner*, 831 F.2d at 396. If the court finds against the debtor on any of the three parts, the student loan is not dischargeable. The 10th Circuit noted that many courts applying *Brunner* had denied discharge even under the most dire circumstances, 356 F.3d at 1308, and disagreed with such interpretations of the test. Instead, it said, "[T]he terms of the test must be applied such that debtors who truly cannot afford to repay their loans may have their loans discharged." *Id.* at 1309.

The 10th Circuit went on to apply the *Brunner* test to the factual findings made by the bankruptcy court, and concluded the debtor satisfied all three parts of the test. The creditor did not dispute that the debtor could not maintain a minimal standard of living while repaying her loans. The Circuit rejected the creditor's argument that a debtor must prove she has a medical disability to satisfy the second prong of the *Brunner* test, and concluded the bankruptcy court's findings about the debtor's emotional health established that her mental condition would interfere with her ability to earn a substantial income. Finally, the debtor's failure to make any payments on her loans did not establish a lack of good faith under the third prong of the test. Instead, the debtor had consolidated her loans, entered into deferral programs, and tried to negotiate with her lenders when they demanded payments. In addition, her good faith was shown by her efforts to minimize her current living expenses and maximize her personal and professional resources.

2. *Alderete v. Educational Credit Management Corp.*, 412 F.3d 1200 (10th Cir. 2005)

This case concerned a married, relatively young couple who sought to discharge about \$78,000 in student loans, which constituted over 98% of their total unsecured debts. The bankruptcy court had applied the *Brunner* test and determined the debtors failed to satisfy its second and third prongs, so it found they had not shown an undue hardship. Nevertheless, the court granted a partial discharge of their student loan debts. The 10th Circuit BAP ruled the court should have found an undue hardship, and affirmed the partial discharge on the ground the court would have had discretion to grant it if it had properly found an undue hardship. On further appeal, the 10th Circuit affirmed the bankruptcy court's finding of no undue hardship, but ruled the court could not grant a discharge of any part of the loans without finding an undue hardship.

The bankruptcy court had found that: the debtors were relatively young and had no health conditions affecting their ability to work; as their children reached the age of majority, their family budget would be less strained; their ability to earn better pay was not limited by their current circumstances; the debtors had made no real effort to look for better-paying or additional work; and the debtors did not face any circumstances — such as illness, recent disability, or an exceptionally large number of dependents — that would hamper their ability to repay the loans. The Circuit said these findings were not disputed on appeal, and they showed the second prong of the *Brunner* test was not met, based on “specific articulable facts” supporting that conclusion. The bankruptcy court said the third prong was not met because the debtors had made only minimal payments on their student loans, they had almost no debt other than the loans, and they had failed to consider other repayment options, such as the Income Contingent Repayment Plan, before they filed bankruptcy, and the Circuit agreed with this conclusion. However, because no undue hardship had been shown, the Circuit ruled the bankruptcy court had no power to grant a partial discharge of the student loans.

## PART 3

### A. 8th Circuit case law

1. *Andrews v. South Dakota Student Loan Assistance Corp. (In re Andrews)*, 661 F.2d 702 (8th Cir. 1981)

This case concerned a 36-year-old divorced woman who had no support obligations or dependents, and who worked as the director of a shelter for victims of domestic violence, earning \$10,000 per year under a two-year grant. Part of her job was to find new funding for the shelter. She had taken out a \$2,500 student loan in August 1978 and had completed two quarters of nursing training when she learned she had Hodgkin's Disease. She had received treatment and her disease was in remission when she filed bankruptcy in April 1980, although there was no assurance she would not suffer a relapse. She testified that she had group health insurance through her job and the

insurance contained no reservation for her disease, but the bankruptcy court did not mention this in its decision. The debtor was supposed to pay \$30 per month on her student loan, but she had made no payments. The bankruptcy court noted that the debtor's employment was not assured once the grant expired, that she was covered by social security, and that her total assets were worth substantially less than the balance owed on her student loan. The bankruptcy court granted a hardship discharge of the loan, and the creditor appealed.

The 8th Circuit reversed, finding that the record before the bankruptcy court was incomplete, and the court should have examined the debtor's necessary living expenses before deciding the undue hardship question. The Circuit quoted approvingly from a bankruptcy court opinion that said an undue hardship determination must be based on an examination of the facts and circumstances of the particular bankruptcy case, and resolve the question whether the debtor's estimated future income would enable the debtor to make some payment on the student loan without reducing the amount the debtor and his or her dependents need to maintain a minimal standard of living. With no information about the debtor's reasonable living expenses, her ability to pay \$30 per month on her student loan could not be decided. The Circuit added that on remand, the bankruptcy court could properly consider the debtor's disease, and her present employment status and employment prospects, particularly the funding of the shelter she was director of.

2. *Long v. Educational Credit Management Corp. (In re Long)*, 322 F.3d 549 (8th Cir. 2003)

In this case, the 8th Circuit clarified the standard for appellate courts to apply in reviewing a bankruptcy court's ruling about an undue hardship claim under § 523(a)(8). The Circuit declared that "undue hardship" is a question of law to be reviewed de novo based on the bankruptcy court's findings about the debtor's circumstances. The Circuit declined ECMC's request to adopt the *Brunner* test for undue hardship, instead reaffirming the totality-of-the-circumstances test it had adopted in *Andrews*. The Circuit also interpreted *Andrews* to require reviewing courts evaluating the totality of the circumstances to consider: "(1) the debtor's past, present, and reasonably reliable future financial resources; (2) a calculation of the debtor's and her dependent's reasonable necessary living expenses; and (3) any other relevant facts and circumstances surrounding each particular bankruptcy case." 322 F.3d at 554. But because the standard of review for appellate courts had been confused, the Circuit remanded the case to the BAP to apply the de novo standard of review to the legal determination whether excepting this debtor's student loans from her discharge would impose an undue hardship on her and her dependent.

3. *Reynolds v. Pennsylvania Higher Education Assistance Agency (In re Reynolds)*, 425 F.3d 526 (8th Cir. 2005)

This case concerned a woman who owed \$142,000 in student loans to five

different creditors, and suffered from anxiety and panic disorders, depression, and a persistent personality disorder. Stress caused by her student loan debts made it harder to sustain improvement in her depressive illness. She had obtained a law degree from the University of Michigan, but her mental condition made her unable to work as an attorney. When she filed bankruptcy, she was working as a secretary-receptionist at a roofing contractor, making about \$30,000 per year. Her husband was making about \$29,000 per year driving a school bus. Together, their income exceeded their monthly expenses by about \$700 per month. The debtor's monthly student loan payments would be about \$1,600 if amortized over 10 years or \$1,000 over 20 years. After the bankruptcy court found excepting the student loan debts from discharge would impose an undue hardship on the debtor, two of the creditors did not appeal. The debtor could consolidate the debts to the other three creditors under a program that would allow her to pay them over 30 years, with an initial payment of \$500. The bankruptcy court considered the medical evidence and concluded the best the debtor could do financially was to remain in the job she had, and might not be able to remain in that job due to her conditions. The court found the debtor had some ability to make payments on her student loans, but that ability was counter-balanced by the fact the existence of the debts was injurious to her fragile mental health. Under the circumstances, the court found the continued existence of the debts would impose an undue hardship on the debtor. All five creditors appealed, but the district court affirmed. Three of the creditors appealed to the 8th Circuit.

The Circuit rejected the creditors' argument that the bankruptcy court's finding that the debtor had the economic ability to repay her student loans should have ended the undue hardship inquiry, and the court should not have gone on to consider the effect the continued existence of the debts might have on her health. One judge dissented, arguing neither the Bankruptcy Code nor the Circuit's prior decisions permitted basing a finding of undue hardship on the circumstance that "her mental illness may make the mere condition of being in debt severely stressful." 425 F.3d at 536. Instead, the dissent contended her mental illness could only be considered to the extent it might reduce her reasonably reliable future financial resources and potentially increase her expenses.

4. *Educational Credit Management Corp. v. Jespersen*, 571 F.3d 775 (8th Cir. 2009)

This case concerned a 43-year-old law school graduate who owed over \$300,000 to one student loan creditor and over \$58,000 to another, which the bankruptcy court, affirmed by the district court, ruled were dischargeable based on undue hardship. The creditor owed the larger debt appealed to the 8th Circuit, and the Circuit produced a majority opinion, a concurring opinion, and a dissent.

The majority opinion declared that a number of the bankruptcy court's fact-findings were clearly erroneous. The debtor had "stipulated" that his gross monthly income of \$4,000 likely put him in the 33% combined federal and state income tax bracket, and the bankruptcy court used that percentage to find that his after-tax income was \$2,680 per month. The Circuit said that the debtor's "failure to make a good faith

estimate” of his tax rate arguably meant he had failed to prove undue hardship, but alternatively, a reasonable estimate of his tax rate would be 17.5%, making his monthly after-tax income \$3,300. The Circuit then declared the bankruptcy court’s estimate of the debtor’s monthly living expenses as \$2,857 was clearly erroneous because the court had used \$1,000 for housing instead of the \$500 he could pay to continue to live with his brother, saying “A debtor making a good faith effort to repay loans would continue to live with his brother to save money.” 571 F.3d at 780. The expenses estimate was also clearly erroneous because the debtor testified he had never made the full \$500 monthly payment he had been ordered to pay for his older son’s support, and he “does not owe child support” for his younger son, although he occasionally paid \$200 to \$400 to the mother and felt obliged to pay \$500. The Circuit determined the bankruptcy court’s finding that the debtor had no surplus to pay toward the student loans was clearly erroneous, and a reasonable estimate would instead be a surplus of \$900 per month. Then, the Circuit declared that the debtor’s age, good health, marketable skills, “lack of substantial obligations to dependents,” and lack of mental or physical impairments all weighed in favor of not granting an undue hardship discharge of his student loan debts. *Id.* at 780. Based on the record, the Circuit declared “the only reason [the debtor] has even a colorable claim of undue hardship is the sheer magnitude of his student loan debts,” and that should rarely be a determining factor. *Id.* When the size of the debts is the main basis for an undue hardship claim, the optional student loan repayment plans “become more relevant to a totality-of-the-circumstances undue hardship analysis.” *Id.* at 781. The creditor had submitted undisputed evidence that its loans were eligible for the Income Contingent Repayment Plan (ICRP), and based on the debtor’s adjusted gross income at the time of trial, the bankruptcy court had found his monthly payments would be \$629 for a family of one, \$572 for a family of two, and \$514 for a family of three, payments he could make from his \$900 monthly surplus. The Circuit also noted that under the ICRP, only 10 percent of unpaid interest can be capitalized, and any unpaid balance that is cancelled after 25 years will result in taxable income only if the debtor has assets exceeding the amount of debt that is cancelled. Based on this reasoning, the Circuit declared the debtor’s student loans were not discharged.

A second judge on the panel concurred in the judgment, but wrote separately to emphasize that whether a student loan debtor had enrolled in the ICRP remained merely a factor to consider in applying the totality-of-the-circumstances test. *Id.* at 783-86.

The third judge on the panel agreed with the second judge that ICRP eligibility was only a factor in deciding the undue hardship question, and emphasized that a debtor is not ineligible for an undue hardship discharge just because he or she is capable of making payments under the ICRP. *Id.* at 786. This judge dissented from the denial of this debtor’s hardship discharge, and the rejection of the bankruptcy court’s findings of fact and application of those facts to its § 523(a)(8) analysis. *Id.* at 786-91.

5. *Walker v. Sallie Mae Servicing Corp. (In re Walker)*, 650 F.3d 1227 (8th Cir. 2011)

This case concerned a woman who owed about \$300,000 in student loans when she sought to discharge them on the basis of undue hardship. She had obtained a Chapter 7 discharge in 2004, but did not seek a ruling under § 523(a)(8) until 2007. The debtor and her police officer husband had five children, one born in 1998, a set of twins born in 2000, and another set of twins born in 2001. The debtor had held some jobs until 2004, but thereafter stayed home to care for her children, especially the older twins, who had been diagnosed with autism in 2003. In 2008, the autistic twins were accepted into a state-funded program providing therapy for their autism and requiring the debtor to devote much of her time to helping the children with the program. In 2005, the debtor and her husband took out a home equity loan, much of which they spent to add a screened-in deck to their home, and in 2007, her husband bought a vehicle that required a monthly payment of \$850. In the dischargeability action the debtor brought in 2007, the parties agreed she qualified for the Income Contingent Repayment Plan and, based on her family's income and size at that time, would have a monthly payment of almost \$600 under the ICRP. The bankruptcy court granted a discharge of the debtor's student loans based on undue hardship, and the 8th Circuit BAP affirmed. On further appeal, the 8th Circuit also affirmed.

The Circuit first rejected the creditor's argument that the undue hardship determination should be based on the debtor's circumstances in 2004, ruling it was not clear error to consider the debtor's financial condition from 2004 through 2007. The creditor asserted that the bankruptcy court's calculation of the debtor's net income was wrong because it used incorrect income tax and payroll deductions and double-counted some deductions, but the Circuit determined the debtor and her family had a monthly deficit of \$650 even if all those disputed deductions were omitted from the calculation. The creditor complained about the family's purchases of the deck and the vehicle, but did not otherwise question their claimed expenses. The Circuit agreed with the BAP that the reality of the family's budget was that the debtor could not afford to make any payments on her student loans and still maintain a minimal standard of living, a circumstance that was likely to continue for many years.

## PART 4

### A. **The *Brunner* test, as interpreted by the 10th Circuit, and the 8th Circuit's totality-of-the-circumstances test may seldom lead to different results.**

1. In *Long*, the 8th Circuit said its totality-of-the-circumstances test for undue hardship is less restrictive than the *Brunner* test, and then said:

We are convinced that requiring our bankruptcy courts to adhere to the strict parameters of a particular test would

diminish the inherent discretion contained in § 523(a)(8). . . .

We believe that fairness and equity require each undue hardship case to be examined on the unique facts and circumstances that surround the particular bankruptcy.

322 F.3d at 554. The view that the *Brunner* test is too restrictive draws some support from decisions such as *In re Roberson*, 999 F.2d 1132, 1135-36 (7th Cir. 1993), in which the 7th Circuit adopted *Brunner*, but in discussing the second prong of its test, quoted approvingly from an opinion that said “the dischargeability of student loans should be based upon the certainty of hopelessness, not simply a present inability to fulfill financial commitment.” *Id.* at 1136 (quoting *In re Briscoe*, 16 B.R. 128, 131 (Bankr. S.D.N.Y. 1981).

2. In *Polleys*, the 10th Circuit suggested cases like *Roberson* had “constrained the three *Brunner* requirements to deny discharge under even the most dire circumstances.” 356 F.3d at 1308. The Circuit said it did not believe *Brunner* should be interpreted so restrictively. It went on to say that the 8th Circuit’s totality-of-the-circumstances test would not necessarily avoid the harshness of the *Brunner* analysis. *Id.* at 1309. The 10th Circuit complained the totality-of-the-circumstances test would tend to lead courts to generate ever-growing lists of factors that should be considered, and wind up providing little help in guiding the exercise of judicial discretion. *Id.* The Circuit said *Brunner* did not rule out considering all the facts and circumstances, and should be applied to allow debtors “who truly cannot afford to repay their loans” to have them discharged. The Circuit added that the good faith portion of the *Brunner* test “should consider whether the debtor is acting in good faith in seeking the discharge, or whether he is intentionally creating his hardship.” *Id.*
  3. So the 8th Circuit was concerned that the *Brunner* test would be applied too narrowly and too seldom allow student loans to be discharged, while the 10th Circuit was concerned the totality-of-the-circumstances test would provide too little guidance to courts required to decide the undue hardship question. Ultimately, especially with the 10th Circuit’s effort to avoid the harshness the *Brunner* test had sometimes produced in the past, there seems to be little reason to predict the two tests might produce different results in any specific case.
- B. The *Brunner* test may be softening since Congress eliminated the possibility of discharging student loans 7 years after the first payment on them became due.**
1. When *Brunner* was decided in 1987, student loans became routinely

dischargeable five years after they first became due.<sup>1</sup> In 1990, Congress increased that time period to seven years.<sup>2</sup> Then in 1998, Congress entirely eliminated the time-delay for dischargeability, leaving undue hardship as the only way to discharge student loan debts.<sup>3</sup> Early cases applying the *Brunner* test may well have been unlikely to find an undue hardship because they knew the debtors would only have had to wait five — and later seven — years, to discharge their student loans without showing undue hardship. At least to the extent they become aware of this history, courts applying *Brunner* since 1998 may be more open to finding an undue hardship because they know a debtor with substantial student loan debts no longer has any other way to obtain a fresh start through bankruptcy. This fact may well have informed the 10th Circuit’s assertion in *Polleys* that *Brunner* should be applied in such a way that debtors who cannot repay their student loans may have them discharged based on undue hardship.

2. The facts presented by the debtor in *Brunner* did not paint a sympathetic portrait of her circumstances. The 2d Circuit’s opinion included only a limited description of the facts, but the district court’s opinion revealed more of her circumstances.<sup>4</sup> The debtor had entered college in 1972, but her age was not specified. She obtained a bachelor’s degree in psychology in 1979 and a master’s in social work in 1982. Seven months after receiving her master’s degree, she filed bankruptcy and received a discharge of all her debts except \$9,000 in student loans. Two months later, when a nine-month post-graduation grace period suspending repayment of her student loans expired, she filed an adversary proceeding seeking to discharge them on the basis of undue hardship.

During the decade before the undue hardship hearing, the debtor’s greatest annual income was \$9,000. The only evidence of her expenses was that her rent was \$200 per month. At the time of the hearing, she was receiving monthly public assistance, including \$258 in cash, \$49 in food stamps, and Medicaid for health care, and had been receiving that assistance for four months. Her testimony was vague about her source of support before that. Two months before the hearing, she withdrew \$2,400 from her savings to buy a used car. When she filed bankruptcy, her student loans were 80% of her total debts.

The debtor testified that she had sent out many resumes looking for work in her chosen field but been unsuccessful, and that many of her classmates were likewise unable to find jobs. It was unclear how much she had tried to find work

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<sup>1</sup>See 4 *Collier on Bankruptcy*, ¶ 523.14[7] n. 63 (Richard Levin & Henry J. Sommers, eds.-in-chief, 16th ed. 2018).

<sup>2</sup>*Id.* at ¶ 523.14[7], p. 523-113.

<sup>3</sup>*Id.*

<sup>4</sup>*In re Brunner*, 46 B.R. 752, 756-58 (S.D.N.Y. 1985).

outside her field. She was seeing a therapist for treatment of anxiety and depression partly caused by her unemployment, but she testified she was capable of working. The district court rejected as clearly erroneous the bankruptcy court's finding that the debtor had a psychological impairment because nothing in the record showed her anxiety and depression impaired her ability to work. The district court said it appeared the debtor would be unlikely to find a job in her chosen field in the near future, but she was an apparently healthy, presumably intelligent, and well-educated woman. The evidence was "too thin" to find that her chances of finding any work at all were slim. The debtor had no dependents or any other extraordinary burdens that would impair her finding a job, or, once she found one, that would make it unlikely she could both support herself and pay off her student loans. The debtor's evidence showed only that at the time of the hearing, she was unable to both meet her minimal expenses and pay off her loans, not that this situation would extend for a significant period. In addition, the debtor had not demonstrated good faith in trying to pay off her loans. She filed for an undue hardship discharge within a month of the first payment due date, and had not requested a deferment, a remedy available to those who couldn't pay because of prolonged unemployment.

3. The amount of outstanding student loan debt in the United States tripled between 2006 and 2018, growing from \$500 billion to more than \$1.5 trillion.<sup>5</sup> Economists suggest this debt load is harming the national economy because many Americans are spending years paying off their student loans instead of buying homes, investing, or starting businesses.<sup>6</sup> With growing public recognition that student loan debt has become a major economic concern for the country, courts may be further influenced to apply both *Brunner* and the 8th Circuit's totality-of-the-circumstances test in a more forgiving manner in the future.

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<sup>5</sup>Prof. Robert M. Lawless, *Hardship Discharge: ABI Consumer Commission Weighs in on [Dep't of Education's Request for Information]*, Am. Bankr. Inst. J., June 2018, at 8.

<sup>6</sup>Andrew A. Sexton, Comment, "The Education Loan Bubble: How the Discharge Student Loans in Bankruptcy Act of 2017 and Legislation Alike Is the Only Answer to the Student Loan Crisis," 54 Cal. Western L. Rev. 323, 324–25 (2018).

LLC Issues in Bankruptcy

1. Authority to File

- a. Should a court dismiss a bankruptcy filing where the debtor failed to obtain required consent of other LPs?
  - i. The court will likely dismiss the filing. Courts typically do not want to overrule the owners of the entity outside of certain circumstances. See *In re Squire Court Partners LP*, 574 B.R. 701 (E.D. Ark. 2017)
  - ii. Distinguish cases where the court did not dismiss although the filing lacked unanimous consent
    1. *In re Intervention Energy Holdings, LLC*, 553 B.R. 258 (Bankr. D.Del 2016)
      - Creditor sought to block the debtor from filing bankruptcy
    2. *In re Lake Michigan Beach Pottawattamie Resort, LLC*, 547 B.R. 899 (Bankr. N.D. Ill. 2016)
      - Language in LLC's operating agreement was void as against public policy because where operating agreement also provided that lender, in exercising its veto rights as a "special member" would have no duty or obligation to give any consideration to any interest of or factors affecting the Company or Members. Under Michigan law, members of LLC have a duty to consider interest of the entity and not only their own interests.

2. Applicability of Stay to Member

- a. Generally, the members and managers of an LLC are not liable for the obligations of the entity.
- b. Courts generally recognize the distinction between a LLC's assets and the assets of members and have held that when one or the other files bankruptcy, the automatic stay does not include the assets of the other. See *In re Calhoun*, 312 B.R. 380 (Bankr. N.D. Iowa 2004). (In an individual member bankruptcy, LLCs in which the debtor had an interest would not be subject to or protected by the automatic stay.
- c. In *In re Resources Energy Technologies, LLC*, 419 B.R. 746 (Bankr. W.D. Ky. 2009), the court found that discovery orders against members of a debtor LLC did not violate the automatic stay

**3. Is the LLC Agreement an Executory Contract?**

- a. Discuss how courts differ on this
- b. *In re AllenTown*, 361 B.R. 422 (Bankr. E.D. Pa. 2007) and *In re Denman*, 513 B.R. 720 (Bankr. W.D. Tenn. 2014)

**4. Bankruptcy of a LLC Member**

- a. LLC members do not have an interest in a LLC's property, therefore a member's bankruptcy estate will consist of the member's economic rights in the LLC and the member's management rights in the LLC.
  - i. Distinction between economic and non-economic rights
- b. Scope of the Estate

**5. Individual Who Owns LLC Files for Bankruptcy and Debtor's Interest in the LLC**

- a. *In re McCormick*, 381 B.R. 594 (Bankr. S.D.N.Y. 2008)
- b. Discuss how automatic stay does not extend to the LLC's assets but does extend to the debtor's interest in the LLC

# Bankruptcy Law Letter

JULY 2018 | VOLUME 38 | ISSUE 7

## THE AUTOMATIC STAY UNDER § 362(a)(3)—ONE MORE TIME

By Eugene R. Wedoff

One of most significant issues in consumer bankruptcy currently in dispute is whether § 362(a)(3) of the Bankruptcy Code requires creditors to return to a debtor any collateral—most commonly automobiles—that they repossessed before the bankruptcy filing. In 1984, subsection (a)(3) was amended. Before the amendment, it only applied the automatic stay to “any act to obtain possession of property of the estate or of property from the estate,” and so only prevented creditors from seizing a debtor’s property during the bankruptcy case. The 1984 amendment expanded the provision by extending the stay to apply to any act “to exercise control over property of the estate.” Debtors used this amendment to argue that after the filing of a bankruptcy case, § 362(a)(3) not only prevented creditors from seizing the debtor’s property, but also prohibited them from continuing to hold whatever property they had seized earlier, since by retaining what was now estate property, they would be exercising control over it.

The initial response to this argument was a string of circuit court and BAP decisions agreeing with the debtors, establishing a majority rule that creditors were indeed stayed by § 362(a)(3) from continuing to hold estate property repossessed before a debtor’s bankruptcy filing and that they were required to return that property to a debtor otherwise entitled to it.<sup>1</sup> This string was unbroken until last year,<sup>2</sup> when the Tenth Circuit issued *WD Equipment v. Cowen*, holding § 362(a)(3) imposes no duty on creditors to return repossessed collateral.<sup>3</sup>

One notable aspect of the new circuit split is that *Cowen’s* rejection of the majority rule cites a *Bankruptcy Law Letter* written by Professor Ralph Brubaker in 2013.<sup>4</sup> With the issuance of *Cowen*, and a set of related questions about the automatic stay, another look at the issues raised in that *Law Letter* may be timely.

### THE MAJORITY RATIONALE

The majority interpretation of § 362(a)(3) is based on plain language. The Second Circuit’s decision made the point this way:

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[S]ection 362 forbids any act to . . . “exercise control” over the property of the estate. We need consult only an ordinary dictionary to confirm that a typical definition of “control” is: “To exercise authority over; direct; command.” Webster’s New World College Dictionary (4th ed. 2002). In light of that definition, we see no way to avoid the conclusion that, by keeping custody of the vehicle and refusing [the debtor] access to or use of it, [the secured creditor] was “exercising control” over the object in which the estate’s equitable interest lay, and its retention of the vehicle violated the stay.<sup>5</sup>

The decision found additional linguistic support in the nature of the 1984 amendment, pointing out that “obtaining possession” of estate property held by the debtor had already been stayed, so that

“exercising control” had to mean something more. “This significant textual enlargement is consonant with our understanding . . . that Congress intended to prevent creditors from retaining property of the debtor . . . without regard to what party was in possession of the property in question when the petition was filed.”<sup>6</sup>

## THE MINORITY RATIONALE

The 2013 *Law Letter* is probably the most complete statement challenging the majority interpretation of § 362(a)(3).<sup>7</sup> The *Law Letter* sets out four grounds for questioning the majority interpretation. Each of these grounds, however, can itself be questioned.

### 1. Upholding established law

The *Law Letter*’s initial argument is based on the Supreme Court’s *Dewsnup* rationale: that an established principle of bankruptcy law should not be interpreted as changed by an amendment unless the change is set out unambiguously or supported by legislative history.<sup>8</sup> This approach to statutory construction has been widely criticized, as even the Supreme Court has noted.<sup>9</sup> But applying the approach here is problematic in any event, since it is difficult to see the bankruptcy principle that is contradicted by interrupting a creditor’s exclusive possession of estate property. The *Letter* suggests that creditors were only required to return collateral to debtors after a court determined that their interests would be adequately protected: “adequate protection before turnover.”<sup>10</sup> But under the Bankruptcy Code, adequate protection was not automatically required. It always had to be requested.<sup>11</sup>

Before the 1984 expansion of § 362(a)(3), if a creditor was unwilling to return collateral, the debtor would have to seek a court order requiring turnover under § 542(a), and in response the creditor could request adequate protection under § 363(e). Only if the creditor made that request could it be said that adequate protection was a prerequisite for turnover.<sup>12</sup> The 1984 amendment, in prohibiting a creditor from retaining collateral sought by a debtor, did not change the secured creditor’s right to adequate protection under § 363(e), it only changed the party with possession of the prop-

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erty during the time that the court considered a creditor's request for protection.

That change can be seen as consistent with the general operation of the automatic stay. Before the 1984 amendment, the stay took away a creditor's nonbankruptcy right to repossess collateral when the debtor was in default under a secured loan; the debtor was allowed to keep collateral until the court determined, in ruling on a creditor's motion for relief from the stay, that there was a lack of adequate protection. The amendment resulted in the same status being applied to property that was repossessed before the bankruptcy. Rather than changing a fundamental bankruptcy policy, the amendment can be seen as extending the basic policy underlying the stay: that the debtor should be able to use all estate property until the creditor requests relief.

The majority decisions reflect this understanding, as set out in the Seventh Circuit's *Thompson* decision:

The primary goal of reorganization bankruptcy is to group all of the debtor's property together in his estate such that he may rehabilitate his credit and pay off his debts; this necessarily extends to all property, even property lawfully seized prepetition. See *Whiting Pools, Inc.*, 462 U.S. at 203-04, 103 S.Ct. 2309; see also *In re Yates*, 332 B.R. 1, 5 (10th Cir. BAP 2005) ("As a practical matter, there is little difference between a creditor who obtains property of the estate before bankruptcy is filed, or after bankruptcy is filed. The ultimate result is the same—the estate will be deprived of possession of that property. This is precisely the result § 362 seeks to avoid."). An asset actively used by a debtor serves a greater purpose to both the debtor and his creditors than an asset sitting idle on a creditor's lot.<sup>13</sup>

#### 2. The meaning of an "act to exercise control"

The *Law Letter* next suggests that the phrase "acts to exercise control over estate property" is in fact ambiguous—"extremely vague"—and cites in support the *Inslaw* decision of the D.C. Circuit.<sup>14</sup> But the ambiguity addressed by *Inslaw* was whether, by refusing to pay damages on a claim asserted by the debtor, a creditor was engaging in an exercise of control.<sup>15</sup> *Inslaw* found this application of § 362(a)(3) unsupported.<sup>16</sup> But this is not an indication of a difficulty in understanding the

meaning of exercising control over property; rather, the question was the nature of the property involved. An estate's cause of action is property of the estate; the recovery that a debtor hopes to obtain from the cause of action is not estate property. In *Citizens Bank v. Strumpf*, the Supreme Court made exactly this distinction in holding that a bank's temporary freeze on a depositor's account did not violate § 362(a)(3). The provision might have been violated, the Court said, if the bank had "exercised dominion over property" as it would have "if a bank account consisted of money belonging to the depositor and held by the bank."<sup>17</sup>

In fact, however, [a bank account] consists of nothing more or less than a promise to pay, from the bank to the depositor, and [the bank's] temporary refusal to pay was neither a taking of possession of [the debtor's] property nor an exercising of control over it, but merely a refusal to perform its promise.<sup>18</sup>

*Inslaw*, then, gives no basis for finding that § 362(a)(3) is ambiguous.

But even if there were some difficulty in measuring the full extent of exercising control over estate property, the question would remain: why is a creditor holding exclusive possession of estate property not exercising control over it? The *Law Letter* answers this question by quoting dicta in *Inslaw*: "The automatic stay, as its name suggests, serves as a restraint only on acts to gain possession or control over property of the estate," and suggests that § 362(a)(3) cannot apply if "a creditor does nothing and simply retains possession of property that the creditor already has in its possession."<sup>19</sup> The difficulty with this argument is apparent from the *Inslaw* quotation, which speaks of "gaining" rather than "exercising" control. While "gain" refers to a past achievement ("[t]o come into possession or use of; acquire"), "exercise,"—the statutory term—refers to ongoing activity ("[t]o put into play or operation, employ").<sup>20</sup> The plain meaning of exercising control in § 362(a)(3) applies to continuing exclusive possession of collateral.

The Tenth Circuit's *Cowen* decision not only accepts the limitation of § 362(a)(3) suggested in the *Law Letter* but adds another argument about the provision's meaning, asserting that because the word "act" means "doing something," § 362(c)(2) "stays entities from doing something to obtain pos-

session of or to exercise control over the estate's property" rather than "passively holding onto an asset," as the Seventh Circuit stated in *Thompson*.<sup>21</sup> But, of course, the creditors in each of the majority decisions did "do something"—they prevented the debtors from obtaining access to the collateral. Although each creditor's action was not new, it was an ongoing, continuing exercise of control, and so proscribed by the statutory language.

Moreover, if exercising control over estate property did not include maintaining exclusive possession of the property, there would be the question of what it does include. It cannot mean selling the property or otherwise using it to reduce the creditor's claim, since § 362(a)(6) separately stays any act "to collect, assess, or recover a claim against the debtor." The *Law Letter* suggests that if the nondebtor party to an executory contract terminates the contract of the estate, it will be exercising control over estate property, and cites a Ninth Circuit decision, *In re Computer Communications*, in support of that interpretation.<sup>22</sup> However, *Computer Communications* held that terminating the contract was an "act to obtain possession of property of the estate," not an act to exercise control.<sup>23</sup>

Finally, the *Law Letter* suggests that if someone not in possession of estate assets files a lawsuit that belongs to the estate, the filing could be seen as exercising control over an estate asset. Again, though, this is more likely to be seen as obtaining possession of the asset. And even if one or more of these hypothetical applications of exercising control were reasonable, it is difficult to imagine that they were a significant enough problem in 1984 that Congress would specially legislate to address them. The common meaning of exercising control over a piece of property—holding it to the exclusion of others—is not only the plain meaning of the amendment but is the only meaning addressing an issue significant enough to prompt legislation.

### 3. The meaning of "property of the estate"

The *Law Letter* continues its statutory construction by turning to the meaning of "property of the estate." It cites an article by Professor Thomas Plank arguing that when the Bankruptcy Code uses the term "property of the estate," it does not mean

"property" in the ordinary sense—individual items or pieces of property—but rather the particular property interests that the debtor holds at the time the bankruptcy case is filed.<sup>24</sup> With this understanding, the *Law Letter* reasons (1) that the "property of the estate"—over which a creditor may not exercise control under § 362(a)(3)—does not include the right of possession, since the debtor did not have that right at the time the case was filed and (2) that to bring that right into the estate, the debtor would have to obtain turnover under § 542(a).<sup>25</sup>

The difficulty with this argument is in its premise. Apart from the bankruptcy court decision in *Hall*, which cites the *Law Letter* extensively,<sup>26</sup> no judicial decision appears to accept Professor Plank's understanding of "property of the estate," and this understanding is inconsistent with the manner in which the Bankruptcy Code uses the term. One example of the difficulty is § 363(f), which allows the sale of property under § 363(b) and (c), free and clear of "any interest in such property of an entity other than the estate" if one of a set of conditions is met, including that the interest of the other party is in bona fide dispute.<sup>27</sup> Subsections (b) and (c) only provide for sales of "property of the estate," and so, at least in § 363, the Code uses that term to mean the entire property to which the debtor claims title, even if another party is in possession at the time of filing or holds a bona fide claim of interest adverse to the debtor. With this understanding of property of the estate, the debtor's entire property is similarly subject to the protection of § 362(a)(3).

### 4. The balance of harms

Finally, the *Law Letter* compares the different costs imposed on debtors and creditors under the conflicting interpretations of § 362(a)(3).<sup>28</sup> For creditors, it says, returning collateral on demand by a debtor, as required by the majority interpretation, will likely result in—

- (a) the complete loss of any possessory lien,
- (b) the risk of full loss of value in uninsured collateral through theft or accidental damage, and
- (c) the deprivation of compensation for the value

lost through depreciation or the expense of seeking an order granting adequate protection.

These costs would be removed under the minority interpretation because it requires the debtor to file a turnover proceeding to regain possession of collateral, and, if demanded by the creditor, the debtor would have to prove adequate protection before turnover was granted.

For debtors, the *Law Letter* acknowledges the cost imposed by the minority interpretation: they will be unable to use a vehicle (or other collateral) that may be needed for work, schooling, and health care until the court rules on turnover, and the period of deprivation may be a long one—the time needed to file and obtain emergency relief in the adversary proceeding mandated by Fed. R. Bankr. P. 7001(1) for turnover under § 522(a). The majority interpretation of § 352(a)(3), by allowing debtors to obtain immediate return of the collateral without a turnover proceeding, removes this cost.

Although this balance shows harm to parties under both interpretations, the *Law Letter* suggests that the greater harm is imposed by the majority interpretation:

A well-advised debtor . . . would *never* offer any adequate protection in demanding turnover and would *always* put the secured creditor to the burden of moving for stay relief/adequate protection before the bankruptcy court, or use the prospective burden of doing so as leverage in adequate protection negotiations, but only *after* securing turnover *without* providing any adequate protection, which (as we've seen) holds the (not unrealistic) prospect of entirely eviscerating the secured creditor's right to receive adequate protection.<sup>29</sup>

Accordingly—and consistent with its view of the difficulties it sees with the majority interpretation—the only recommendation that *Law Letter* makes for improving the law on return of collateral is a rule change that would allow debtors prompt access to turnover.<sup>30</sup>

The balance set out by the *Law Letter*, however, may need adjustment. Although its description of harm to debtors is accurate, its view of the harm to creditors appears to be overstated in each of the respects it discusses.

(a) *Possessory liens are not eliminated by § 362(a)(3).*

Possessory liens generally terminate when the creditor holding the lien loses possession of the collateral.<sup>31</sup> For this reason the *Law Letter* sees the majority interpretation of § 362(a)(3)—requiring creditors to give up the collateral they possess—as resulting in the loss of any possessory lien.<sup>32</sup> It criticizes the Eighth Circuit BAP's opinion in *In re WEB2B Payment Solutions, Inc.*, which deals with a possessory lien, for bending the majority rule by suggesting that a possessory lien holder could withhold surrender of the collateral “until the bankruptcy court is able to make a determination as to whether, and to what extent, the creditor is entitled to adequate protection.”<sup>33</sup> That suggestion, the *Law Letter* states, cannot be reconciled with the majority decisions, including the Eighth Circuit's opinion in *Knaus*, which allow for no exceptions to return of collateral under § 362(a)(3).<sup>34</sup>

But there are two problems with the idea that § 362(a)(3) would cause the loss of a possessory lien. The first is that, under the common law, a possessory lien only terminates when the creditor loses possession if the creditor gives up possession voluntarily. The Restatement of Security explains this in a comment:

The lien is a legal interest dependent upon possession. Where the lienor voluntarily gives up the possession, his lien, at least so far as it is a legal interest, is gone. The lienor . . . does not lose his legal interest if he is deprived without his consent of his possession either by the bailor [owner] or a third person. If the lienor's surrender of possession is voluntary but obtained by fraud, the lienor can recover the chattel unless third persons in the meantime have acquired interests. Where possession is taken without the consent of the lienor, even a bona fide purchaser is subject to the lien, provided the chattel is non-negotiable.<sup>35</sup>

Accordingly, a retention lien continues to apply to collateral even if a legal obligation required the creditor to return it.<sup>36</sup>

The *WEB2B* decision reflects this rule. The collateral in the case was cash of a Chapter 7 debtor that a creditor had received subject to a possessory lien. The trustee requested that the creditor turnover all of the cash. Under an agreement with the

trustee, and without any proceeding in the bankruptcy court, the creditor retained what it considered a sufficient amount of cash to satisfy its claims against the debtor and gave the balance to the trustee. Later, the retained collateral proved insufficient to cover these claims, and the creditor argued that the transferred collateral had been given to the trustee under compulsion, so that the possessory lien should continue to apply to it, citing the Supreme Court's *Whiting Pools* decision under § 542(a) to argue that the Bankruptcy Court should have determined what adequate protection would apply to the continuing lien. The BAP rejected this argument, holding that the transfer was voluntary, so that the possessory lien terminated when the collateral was transferred.<sup>37</sup> The BAP did suggest that the creditor could have requested a court determination of adequate protection before turning over the property, but this was plainly dicta. If payment to the trustee had actually been compelled, rather than voluntary, so that the possessory lien continued in place, the creditor would have been able to seek a ruling on adequate protection after the transfer. The BAP, however, had no reason to consider the effect of an involuntary transfer on possessory liens, whether made pursuant to § 362(a)(3) or any other provision of law; indeed, § 362(a)(3) is not mentioned in the decision.

The second problem with the *Law Letter's* treatment of possessory liens is that if nonbankruptcy law did result in termination of the lien after an involuntary transfer, an exception to the automatic stay—§ 362(b)(3)—would prevent § 362(a)(3) from going into effect, and the creditor would not be required to give up possession. This exception to the stay was explained in a decision of the Ninth Circuit BAP, *Hayden v. Wells*.<sup>38</sup> In that case, Chapter 13 debtors relied on § 362(a)(3) to obtain the return of their vehicle from a company with a possessory lien for its services in towing and storing the automobile. The BAP held that the § 363(b) stay exception required denial of the debtors' request, and explained the exception's effect:

[I]f state law provides that a creditor's security interest is superior to the rights of any entity obtaining its interest in the property prior to the date the creditor takes action to maintain or continue perfection

of its lien, the creditor's post-petition act to maintain or continue perfection of the lien does not violate the automatic stay. *Boggan v. Hoff Ford, Inc.* (In re Boggan), 251 B.R. 95, 99 (9th Cir. BAP 2000) (holding that automobile dealership that retained possession of debtor's automobile as security for repayment of unpaid repair bill pursuant to Idaho law did not violate automatic stay).<sup>39</sup>

A recent decision by the Bankruptcy Court for the Northern District of Illinois, *In re Avila*, cited *Hayden* in holding that § 362(b)(3) permits the City of Chicago to retain vehicles impounded for traffic violations because return of the vehicle under § 362(a)(3) would terminate the City's possessory lien for the impounding; the Seventh Circuit's *Thompson* decision was held inapplicable because of the § 363(b)(3) stay exception.<sup>40</sup> No appeal was taken from this order, but other judges in the Northern District of Illinois have disagreed with its holding, one ruling that the municipal ordinance granting the City's lien exceeds the City's police power,<sup>41</sup> and the other ruling that § 363(b)(3) "applies only to 'acts' taken by creditors" and "passive possession of a debtor's property for the purposes of maintaining possession does not constitute an 'act.'"<sup>42</sup> These decisions have been appealed, and the appeals are pending in the district court.

But the *Hayden* and *Avila* decisions can be questioned on grounds other than those set out in the Chicago appeals. If applicable nonbankruptcy would not result in termination of a possessory lien after the lienholder was compelled to surrender possession, then there would be no need for the lienholder to retain possession in order to maintain or continue perfection of its lien, and the stay exception would not apply. The possessory lien would be given no different treatment than a purchase money lien. But in determining the effect of § 362(a)(2) on possessory liens, it is plain that regardless of whether the lien remains effective under the common law or under the § 362(b)(3) stay exception, the creditor does not lose its lien.

(b) *Transfers of uninsured vehicles may be prevented by annulment of the automatic stay.*

It is also unlikely that § 362(a)(3) will require creditors to return uninsured vehicles to debtors. In addition to allowing a creditor to seek termination or modification of the automatic stay for a lack

of adequate protection, § 362(d)(1) allows the stay to be annulled. Annulment has been consistently understood as retroactively terminating the stay, and so validating whatever action would otherwise have been a stay violation.<sup>43</sup> Although there is a lack of consistency in the language used by the courts discussing the grounds for stay annulment, there is general agreement that a balancing of the interests of the parties is required.<sup>44</sup> Among the factors that have generally been considered in this balancing are the good faith of the debtor in seeking enforcement of the stay and the harm to the creditor if the stay is enforced.<sup>45</sup> Courts may also grant annulment “if grounds for relief from the stay existed and a motion, if filed, would likely have been granted prior to the automatic stay violation [and] if failure to grant retroactive relief would cause unnecessary expense to the creditor.”<sup>46</sup>

Under this precedent, if a creditor that had repossessed an uninsured car was faced with a demand by a Chapter 13 debtor to return the car under § 362(a)(2), the creditor could refuse until the debtor obtained insurance, and if the debtor sought to hold the creditor in violation of the automatic stay, the creditor could file a motion for annulment of the stay and almost certainly prevail.<sup>47</sup> By attempting to obtain use of a vehicle without insurance, the debtor would be acting in bad faith; if the creditor had been able to present a motion for stay relief, it would have been granted; and the harm to the creditor if the stay were enforced would be the potential loss of the full value of its security interest.<sup>48</sup>

Of course, the creditor would still have to incur the expense of seeking stay annulment if the debtor charged the creditor with a stay violation. But since the courts would routinely grant such annulment motions, the debtor would have little reason to seek enforcement of § 362(a)(3); the cost of drafting and presenting the motion for stay enforcement would be wasted.

(c) *Chapter 13 provides substantial protection against declines in the value of collateral, without the need for creditor action.*

The remaining harm that the *Law Letter* sees imposed by the majority interpretation of § 362(a)(3) is the loss of value in a repossessed ve-

hicle that would occur while the debtor uses the vehicle without having to provide adequate protection that could have been ordered by the court, without a motion by the creditor, if the debtor had been required to seek a turnover under § 524(a). In Chapter 13, however, adequate protection is automatically required of any debtor holding collateral from the outset of the case; no creditor action is required. Section 1326(a)(1)(C) requires adequate protection payments to the secured creditor, unless the court orders otherwise, commencing no later than 30 days after the case is filed. It is unlikely that if debtors were required to file adversaries seeking turnover, the courts would order more in adequate protection than such payments. And to comply with the payment requirement would be grounds for stay relief and even dismissal of the case.<sup>49</sup>

All of this suggests that the balance of harms resulting from the two interpretations of § 362(a)(3) is different from that set out in the 2013 *Law Letter*. While the minority interpretation does indeed impose substantial costs on debtors unable to use their vehicles, the majority interpretation does not impose costs on creditors to the extent that the *Law Letter* suggests.

## POTENTIAL RESOLUTION OF THE CIRCUIT CONFLICT

Because the *Cowen* case was remanded for further proceedings (which could involve the imposition of sanctions on the creditors) there is no possibility, at least immediately, of Supreme Court review. The *Cowen* interpretation of § 362(a), however, might be subject to fuller consideration by the Tenth Circuit itself. In a Chapter 7 case in the District of Kansas, *Davis v. Tyson Prepared Foods*, an issue arose that the bankruptcy judge found similar to the question in *Cowen*.<sup>50</sup> In *Davis*, a worker was injured on the job and sought workers compensation benefits, but after filing a bankruptcy case, also filed a state court complaint against the company that supplied the item that caused her injury and obtained a judgment against that supplier. Under Kansas law, the employer was subrogated to the worker’s right to recover from the supplier to the extent of the employer’s work-

ers compensation payments to her, and a lien supporting this subrogation attaches to the judgment against the supplier.<sup>51</sup>

Does the attachment of this lien violate the automatic stay? If so, the estate would be entitled to the judgment, and the trustee has so argued. The bankruptcy court, however, held that the lien did not violate the automatic stay, because though the lien attached postpetition, it did so automatically, with no “act” violating the stay. The Tenth Circuit has granted direct review of this decision, and a decision applying *Cowen* is likely, but whatever decision is reached by the panel, a petition for en banc review or certiorari, challenging *Cowen*, seems likely.

## CONCLUSION

Because of the large number of Chapter 13 cases in which an automobile of the debtor has been repossessed, the question whether the automatic stay requires return of vehicle will remain an important one. As set out in the 2013 *Law Letter* and in this one, it is also a complicated one.

## ENDNOTES:

<sup>1</sup>See *In re Knaus*, 889 F.2d 773, 775, 19 Bankr. Ct. Dec. (CRR) 1691, Bankr. L. Rep. (CCH) P 73117 (8th Cir. 1989); *In re Del Mission Ltd.*, 98 F.3d 1147, 1151-52, 29 Bankr. Ct. Dec. (CRR) 1155, 36 Collier Bankr. Cas. 2d (MB) 1658, Bankr. L. Rep. (CCH) P 77176, 36 Fed. R. Serv. 3d 512 (9th Cir. 1996) (expressly adopting the reasoning of *In re Abrams*, 127 B.R. 239, 241-43, 21 Bankr. Ct. Dec. (CRR) 1283, 25 Collier Bankr. Cas. 2d (MB) 15, Bankr. L. Rep. (CCH) P 74023 (B.A.P. 9th Cir. 1991), holding that failure to return a repossessed car after receiving notice of the debtor’s bankruptcy violated § 362(a)(3)); *Thompson v. General Motors Acceptance Corp., LLC*, 566 F.3d 699, 703, 61 Collier Bankr. Cas. 2d (MB) 1611, Bankr. L. Rep. (CCH) P 81490 (7th Cir. 2009); and *In re Weber*, 719 F.3d 72, 81, 69 Collier Bankr. Cas. 2d (MB) 1168, Bankr. L. Rep. (CCH) P 82484 (2d Cir. 2013). Accord, *In re Yates*, 332 B.R. 1, 54 Collier Bankr. Cas. 2d (MB) 1901, 8 A.L.R. Fed. 2d 837 (B.A.P. 10th Cir. 2005) (abrogated by, *In re Cowen*, 849 F.3d 943, 63 Bankr. Ct. Dec. (CRR) 211, 77 Collier Bankr. Cas. 2d (MB) 438 (10th Cir. 2017)); *In re Sharon*, 234 B.R. 676, 1999 FED App. 0009P (B.A.P. 6th Cir. 1999); *In re Carrigg*, 216 B.R. 303, 31 Bankr. Ct. Dec. (CRR) 1324, Bankr. L. Rep. (CCH) P 77657 (B.A.P. 1st Cir. 1998). See also *In re Rozier*, 348 F.3d 1305 (11th

Cir. 2003), certified question answered, 278 Ga. 52, 597 S.E.2d 367, 54 U.C.C. Rep. Serv. 2d 31 (2004), and *In re Rozier*, 376 F.3d 1323, 1324, Bankr. L. Rep. (CCH) P 80137 (11th Cir. 2004) (requiring return of collateral obtained prepetition as long as the collateral remained estate property after repossession).

Because § 362(a)(3) applies only to estate property, however, these decisions do not require return of collateral to debtors who are not entitled to possess estate property—including all Chapter 7 debtors. Any right to receive repossessed property in Chapter 7 cases would belong to the trustee. *In re Perry*, 540 B.R. 710, 725 (Bankr. C.D. Cal. 2015), aff’d in part, rev’d in part, 2017 WL 1276075 (C.D. Cal. 2017) (“If a creditor fails to turn over the debtor’s property, the [Chapter 7] debtor cannot bring actions under § 362(a)(3) prior to the debtor’s exemption in the assets being perfected, because such actions may only be brought by the trustee. After the exemption reverts the property in the debtor, the debtor cannot bring a § 362(a)(3) action because the asset is then no longer property of the estate.”). In this *Law Letter*, “debtor” is used to mean a debtor entitled to possession of estate property.

<sup>2</sup>The only arguably inconsistent circuit decision issued before 2017 is *U.S. v. Inslaw, Inc.*, 932 F.2d 1467, 21 Bankr. Ct. Dec. (CRR) 1077, Bankr. L. Rep. (CCH) P 74056, 37 Cont. Cas. Fed. (CCH) P 76104 (D.C. Cir. 1991), which held that a creditor—the United States Department of Justice—was not required to return to the debtor computer programming material whose ownership was in dispute, reasoning that a party claiming ownership of property could not be required to surrender the property to a debtor with a competing ownership claim before the ownership dispute was adjudicated. In that context, the court stated both that “it is difficult to believe that Congress intended a [stay] violation whenever someone already in possession of property mistakenly refuses to capitulate to a bankrupt’s assertion of rights in that property” and that the stay “serves as a restraint only on acts to gain possession or control over property of the estate,” rather than “creat[ing] an affirmative duty to remedy past acts of fraud or bias or harassment.” *Id.* at 1473-74. *Inslaw* did not consider whether § 362(a)(3) requires the return of collateral when the debtor’s ownership of the property is undisputed, and indeed cites *Knaus*, the leading case so holding, for the rule that “turnover of property admitted to belong to the debtor is required.” 932 F.2d at 1472.

<sup>3</sup>*In re Cowen*, 849 F.3d 943, 63 Bankr. Ct. Dec. (CRR) 211, 77 Collier Bankr. Cas. 2d (MB) 438 (10th Cir. 2017). The facts in *Cowen* make it a somewhat unattractive case for upsetting the rule requiring repossessed collateral to be returned to debtors. The vehicle involved in the case was a truck that a Chapter 13 debtor used in his business

and was subject to a purchase money security interest held by another individual, Bert Dring. The circuit court opinion explains how the truck came to be repossessed:

Mr. Dring lured Mr. Cowen under false pretenses to his place of business to repossess the Kenworth [truck]. Mr. Dring asked Mr. Cowen, who had brought along his young son, to leave the keys in the ignition, engine running, and to step out of the truck. As Mr. Cowen exited the vehicle, Mr. Dring jumped in, grabbed the keys, and declared the truck “repossessed.” When Mr. Cowen asked what was going on, Mr. Dring told him to take his son and leave—immediately. A group of five men gathered around Mr. Dring while he brandished a can of mace above his head and threatened to use it if Mr. Cowen did not leave. Mr. Cowen pushed his young son behind him to protect him, and the two left the lot on foot.

Id. at 945. After Cowen filed a Chapter 13 bankruptcy case, Dring objected to any bankruptcy treatment of the truck. The decision explains:

Mr. Dring claimed that he sold the Kenworth sometime prior to the bankruptcy filing. (Initially, he claimed he had sold the Kenworth to an unknown Mexican national for cash in an undocumented sale just days before Mr. Cowen filed for bankruptcy. Later, Mr. Dring produced bill of sale, purporting to show that he sold the Kenworth to a Mr. Garcia for \$16,000 in cash on August 4 [two days before the bankruptcy filing].

Id. at 946. The bankruptcy court found that Dring (and a relative involved in the repossession of another of Cowen’s trucks) had probably forged documents, given perjured testimony, and coached witnesses during a hearing on the adversary proceeding that Cowen brought to enforce the automatic stay. Id.

<sup>4</sup>Cowen, 849 F.3d at 949-50, quoting Ralph Brubaker, Turnover, Adequate Protection, and the Automatic Stay (Parts I and II): Who Is “Exercising Control” Over What?, 33 Bankr. L. Letter Nos. 8-9 (Sept. & Aug. 2013).

<sup>5</sup>Weber v. SEFCU (In re Weber), 719 F.3d at 79. See also, Thompson, 566 F.3d at 702 (making the same point, citing a different dictionary).

<sup>6</sup>Weber v. SEFCU (In re Weber), 719 F.3d at 80.

<sup>7</sup>The 2013 *Law Letter* gives a much fuller set of reasons than *Cowen* does for rejecting the majority interpretation. For a judicial decision discussing these reasons and extensively citing the *Law Letter*, see In re Hall, 502 B.R. 650, 59 Bankr. Ct. Dec. (CRR) 6 (Bankr. D. D.C. 2014).

<sup>8</sup>Brubaker, 33 Bankr. L. Letter No. 9 at 8-9, citing *Dewsnup v. Timm*, 502 U.S. 410, 419, 112 S. Ct. 773, 116 L. Ed. 2d 903, 22 Bankr. Ct. Dec. (CRR) 750, 25 Collier Bankr. Cas. 2d (MB) 1297, Bankr. L. Rep. (CCH) P 74361A (1992).

<sup>9</sup>See *Bank of America, N.A. v. Caulkett*, 135 S.

Ct. 1995, n.1, 192 L. Ed. 2d 52, 61 Bankr. Ct. Dec. (CRR) 31, 73 C.B.C. 1485, Bankr. L. Rep. (CCH) P 82807 (2015):

From its inception, *Dewsnup v. Timm*, 502 U.S. 410, 112 S. Ct. 773, 116 L. Ed. 2d 903 (1992), has been the target of criticism. See, e.g., id., at 420-436, 112 S. Ct. 773 (Scalia, J., dissenting); In re Woolsey, 696 F.3d 1266, 1273-1274, 1278 (CA10 2012); In re Dever, 164 B. R. 132, 138, 145 (Bkrcty. Ct. CD Cal. 1994); Carlson, Bifurcation of Undersecured Claims in Bankruptcy, 70 Am. Bankr. L. J. 1, 12-20 (1996); Ponoroff & Knippenberg, The Immovable Object Versus the Irresistible Force: Re-thinking the Relationship Between Secured Credit and Bankruptcy Policy, 95 Mich. L. Rev. 2234, 2305-2307 (1997); see also *Bank of America Nat. Trust and Sav. Assn. v. 203 North LaSalle Street Partnership*, 526 U.S. 434, 463, 119 S. Ct. 1411, 143 L. Ed. 2d 607, and n. 3 (1999) (Thomas, J., concurring in judgment) (collecting cases and observing that “[t]he methodological confusion created by *Dewsnup* has enshrouded both the Courts of Appeals and . . . Bankruptcy Courts”).

<sup>10</sup>Brubaker, 33 Bankr. L. Letter No. 9 at 2.

<sup>11</sup>See 11 U.S.C.A. § 363(e), providing for adequate protection “on request of an entity that has an interest in [estate] property”; *U.S. v. Whiting Pools, Inc.*, 1983-2 C.B. 239, 462 U.S. 198, 204, 103 S. Ct. 2309, 2313, 76 L. Ed. 2d 515, 10 Bankr. Ct. Dec. (CRR) 705, 8 Collier Bankr. Cas. 2d (MB) 710, Bankr. L. Rep. (CCH) P 69207, 83-1 U.S. Tax Cas. (CCH) P 9394, 52 A.F.T.R.2d 83-5121 (1983) (“At the secured creditor’s insistence, the bankruptcy court must place such limits or conditions . . . as are necessary to protect the creditor.”).

<sup>12</sup>See In re R. Purbeck & Associates, Ltd., 12 B.R. 406, 408 (Bankr. D. Conn. 1981) (“[A] secured creditor may insist upon adequate protection as a condition precedent to the turnover of property since the property may not be used, sold or leased under section 363 without it.”).

<sup>13</sup>Thompson, 566 F.3d at 702.

<sup>14</sup>Brubaker, 33 Bankr. L. Letter No. 9 at 3, citing *Inslaw*, 932 F.2d at 1474. The clarity of the 1984 amendment to § 362(a)(3) is a critical question under the *Dewsnup* approach to statutory construction. There is no relevant legislative history for the 1984 amendment to § 362(a)(3), but *Dewsnup* recognizes that this cannot defeat the effect of clear statutory language. See *Dewsnup*, 502 U.S. at 419-20, 112 S. Ct. at 779 (“Of course, where the language is unambiguous, silence in the legislative history cannot be controlling.”).

<sup>15</sup>*Inslaw*, 932 F.2d at 1472 (defining the “property” at issue as the debtor’s “intangible trade secret rights” and the asserted “exercise of control” as the use of these rights contrary to the parties’ contract).

<sup>16</sup>*Inslaw*, 932 F.2d at 1472 (“Whenever a party against whom the bankrupt holds a cause of action

(or other intangible property right) acted in accord with his view of the dispute rather than that of the debtor-in-possession or bankruptcy trustee, he would risk a determination by a bankruptcy court that he had 'exercised control' over intangible rights (property) of the estate.")

<sup>17</sup>*Citizens Bank of Maryland v. Strumpf*, 516 U.S. 16, 21, 116 S. Ct. 286, 290, 133 L. Ed. 2d 258, 28 Bankr. Ct. Dec. (CRR) 97, 33 Collier Bankr. Cas. 2d (MB) 869, Bankr. L. Rep. (CCH) P 76666A (1995).

<sup>18</sup>*Strumpf*, 516 U.S. 16, 21, 116 S. Ct. 286, 290 (1995).

<sup>19</sup>Brubaker, 33 Bankr. L. Letter No. 9 at 3, quoting *Inslaw*, 932 F.2d at 1474.

<sup>20</sup>*American Heritage College Dictionary* 556, 479 (3d ed. 1997)

<sup>21</sup>*Cowen*, 849 F.3d at 949, quoting *New Oxford American Dictionary* 15 (3d ed. 2010) and *Thompson*, 566 F.3d at 703.

<sup>22</sup>Brubaker, 33 Bankr. L. Letter No. 9 at 4, citing *In re Computer Communications, Inc.*, 824 F.2d 725, 16 Bankr. Ct. Dec. (CRR) 615, 17 Collier Bankr. Cas. 2d (MB) 556, Bankr. L. Rep. (CCH) P 71933 (9th Cir. 1987).

<sup>23</sup>*Computer Communications*, 824 F.2d at 728.

<sup>24</sup>Brubaker, 33 Bankr. L. Letter No. 9 at 4-5, citing *Thomas E. Plank, The Outer Boundaries of the Bankruptcy Estate*, 47 *Emory L.J.* 1194, 1209, 1213 (1998).

<sup>25</sup>Brubaker, 33 Bankr. L. Letter No. 9 at 5.

<sup>26</sup>*Hall*, 502 B.R. at 667.

<sup>27</sup>*Precision Industries, Inc. v. Qualitech Steel SBQ, LLC*, 327 F.3d 537, 544, 41 Bankr. Ct. Dec. (CRR) 65, 49 Collier Bankr. Cas. 2d (MB) 1765, Bankr. L. Rep. (CCH) P 78836 (7th Cir. 2003) summarizes the operation of § 362(f) this way:

Section 363 generally provides for the use, sale, or lease of property belonging to the bankruptcy estate. [S]ubsections (b) and (c) permit the trustee of a bankruptcy estate to sell estate property either within the normal course of a debtor's business (in which case the sale may take place without prior notice and a hearing) or outside the normal course of business (in which case . . . notice and hearing are mandatory). Subsection (f) makes clear that the property, under specified conditions, may be sold unencumbered of interests held by others . . . .

<sup>28</sup>Brubaker, 33 Bankr. L. Letter No. 9 at 6-9.

<sup>29</sup>Brubaker, 33 Bankr. L. Letter No. 9 at 7-8.

<sup>30</sup>Brubaker, 33 Bankr. L. Letter No. 9 at 9.

<sup>31</sup>*In re Borden*, 361 B.R. 489, 494, 62 U.C.C. Rep. Serv. 2d 158 (B.A.P. 8th Cir. 2007) ("[P]ossession is generally required for a possessory lien.")

<sup>32</sup>Brubaker, 33 Bankr. L. Letter No. 9 at 6-7.

<sup>33</sup>*In re WEB2B Payment Solutions, Inc.*, 488 B.R. 387, 393, 57 Bankr. Ct. Dec. (CRR) 202, Bankr. L. Rep. (CCH) P 82449 (B.A.P. 8th Cir. 2013).

<sup>34</sup>Brubaker, 33 Bankr. L. Letter No. 9 at 8.

<sup>35</sup>Restatement of Security § 80 cmt. c (1941). Among the decisions applying this common law rule is *Finch v. Miller*, 531 P.2d 892, 893 (Or. 1975)(en banc) (holding that a possessory lien was not lost by the debtors' removing the collateral from the creditor's possession without the creditor's consent).

<sup>36</sup>*See Gangloff Industries, Inc. v. Generic Financing and Leasing, Corp.*, 907 N.E.2d 1059, 69 U.C.C. Rep. Serv. 2d 113 (Ind. Ct. App. 2009) (holding that a possessory lien continued in effect after the secured creditor had given up possession of the collateral pursuant to an erroneous court order).

<sup>37</sup>*WEB2B*, 488 B.R. at 393.

<sup>38</sup>*In re Hayden*, 308 B.R. 428, 51 Collier Bankr. Cas. 2d (MB) 1688, Bankr. L. Rep. (CCH) P 80084 (B.A.P. 9th Cir. 2004).

<sup>39</sup>*Hayden*, 308 B.R. at 432.

<sup>40</sup>*In re Avila*, 566 B.R. 558, 560, 77 Collier Bankr. Cas. 2d (MB) 709 (Bankr. N.D. Ill. 2017).

<sup>41</sup>*In re Howard*, 584 B.R. 252 (Bankr. N.D. Ill. 2018).

<sup>42</sup>*In re Fulton*, 2018 WL 2392854 (Bankr. N.D. Ill. 2018), opinion amended and superseded, 2018 WL 2570109 (Bankr. N.D. Ill. 2018)

<sup>43</sup>*See, e.g., In re Siciliano*, 13 F.3d 748, 751, 30 Collier Bankr. Cas. 2d (MB) 667, Bankr. L. Rep. (CCH) P 75656 (3d Cir. 1994) *In re Schwartz*, 954 F.2d 569, 573, 22 Bankr. Ct. Dec. (CRR) 845, 26 Collier Bankr. Cas. 2d (MB) 649, Bankr. L. Rep. (CCH) P 74539, 92-1 U.S. Tax Cas. (CCH) P 50069, 69 A.F.T.R.2d 92-548 (9th Cir. 1992); *Sikes v. Global Marine, Inc.*, 881 F.2d 176, 178-79, 19 Bankr. Ct. Dec. (CRR) 1224, Bankr. L. Rep. (CCH) P 73061 (5th Cir. 1989) (rejected by, *In re Servico, Inc.*, 144 B.R. 933, 23 Bankr. Ct. Dec. (CRR) 687, 27 Collier Bankr. Cas. 2d (MB) 1239, Bankr. L. Rep. (CCH) P 74936 (Bankr. S.D. Fla. 1992)); *In re Albany Partners, Ltd.*, 749 F.2d 670, 675, 12 Bankr. Ct. Dec. (CRR) 787, 12 Collier Bankr. Cas. 2d (MB) 244, Bankr. L. Rep. (CCH) P 70184 (11th Cir. 1984) (rejected by, *In re Victoria Ltd. Partnership*, 187 B.R. 54, 27 Bankr. Ct. Dec. (CRR) 1210, Bankr. L. Rep. (CCH) P 76666 (Bankr. D. Mass. 1995)).

<sup>44</sup>*See In re Myers*, 491 F.3d 120, 129, 48 Bankr. Ct. Dec. (CRR) 133, Bankr. L. Rep. (CCH) P 80962 (3d Cir. 2007) ("Even those cases that have subscribed to a narrow conception of the power to retroactively annul the stay have affirmed that balancing the equities is the appropriate test.")

<sup>45</sup>*See In re National Environmental Waste Corp.*, 129 F.3d 1052, 1055, 31 Bankr. Ct. Dec. (CRR) 876, Bankr. L. Rep. (CCH) P 77541 (9th Cir. 1997); *Easley v. Pettibone Michigan Corp.*, 990 F.2d

905, 911, 28 Collier Bankr. Cas. 2d (MB) 1002 (6th Cir. 1993).

<sup>46</sup>In re Stockwell, 262 B.R. 275, 281, 37 Bankr. Ct. Dec. (CRR) 244 (Bankr. D. Vt. 2001).

<sup>47</sup>The Bankruptcy Court for the District of New Jersey appears to have had a practice that informally came to this result without requiring the filing of a motion to annul the stay. See In re Denby-Peterson, 576 B.R. 66, 81, 93 U.C.C. Rep. Serv. 2d 1367 (Bankr. D. N.J. 2017) (“For at least the last 20 years . . . the practice in this district has been that a creditor holding a car repossessed prepetition may request proof of insurance naming it as loss payee prior to turnover without violating the stay. But once proof of insurance has been produced, the creditor violates the stay by not returning the car.”). The court questioned the basis for this practice and suggested that the minority interpretation of § 362(a)(3) is preferable, at least if there is a dispute about the debtor’s ownership of the vehicle, but that for personal property free of liens, the creditor may violate the automatic stay by failing to return the property to the debtor on request. *Id.* at 82-83.

<sup>48</sup>One court has treated the lack of vehicle insurance as grounds for automatically annulling the

automatic stay. The Bankruptcy Court for the Western District of Missouri has adopted a local rule, Rule 4070-1, prohibiting a debtor from operating an uninsured vehicle and giving the secured creditor, after notice to the debtor and an opportunity to obtain insurance, the right to repossess the vehicle without seeking relief from the automatic stay. When this rule was challenged, the court found that it was supported by annulment under § 362(d)(2). In re Suggs, 354 B.R. 903, 912 (Bankr. W.D. Mo. 2006), rev’d and remanded, 377 B.R. 198 (B.A.P. 8th Cir. 2007) (The Court . . . essentially annuls the automatic stay and retroactively validates the repossession. A rule authorizing the creditor’s action and the entry of such an order is therefore not inconsistent with § 362.”).

<sup>49</sup>See In re Hicks, 2011 WL 2414419 (Bankr. N.D. Ala. 2011).

<sup>50</sup>In re Garcia, 2017 WL 2951439 (Bankr. D. Kan. 2017).

<sup>51</sup>K.S.A. § 44-504.

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