AMERICAN BANKRUPTCY INSTITUTE

2019 Midwestern Bankruptcy Institute

Case Law Updates from the Bench

Hon. Brian T. Fenimore
U.S. Bankruptcy Court (W.D. Mo.); Kansas City

Hon. Terrence L. Michael
U.S. Bankruptcy Court (N.D. Okla.); Tulsa

Hon. Kathleen H. Sanberg
U.S. Bankruptcy Court (D. Minn.); Minneapolis

Hon. Kathy A. Surratt-States
U.S. Bankruptcy Court (E.D. Mo.); St. Louis

2019

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Case Law Update

Hon. Brian T. Fenimore
United States Bankruptcy Court
Western District of Missouri

Hon. Terrence L. Michael
United States Bankruptcy Court
Northern District of Oklahoma

Hon. Kathleen H. Sanberg
United States Bankruptcy Court
District of Minnesota

Hon. Kathy A. Surratt-States
United States Bankruptcy Court
Eastern District of Missouri

Matthew Mason
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2019 Midwestern Bankruptcy Institute
Case Law Update

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I. Supreme Court Cases

A. *Mission Prod. Holdings, Inc. v. Tempnology, LLC*, 139 S.Ct. 1652 (2019)

A Chapter 11 debtor's rejection of an executory trademark licensing agreement does not deprive a licensee of its right to use the trademark. The debtor, an exercise clothing and accessory manufacturer, entered into a licensing agreement with a distributor. The agreement gave the distributor the exclusive right to distribute the debtor's products and a non-exclusive license to use the debtor's trademarks. Prior to the expiration of the contract, the debtor filed a Chapter 11 bankruptcy petition and rejected the licensing agreement under 11 U.S.C. § 365(a). The bankruptcy court approved the proposed rejection and held the debtor's rejection revoked the licensee's right to use the trademark. The First Circuit Bankruptcy Appellate Panel reversed, holding the licensee could continue to use the trademark. The First Circuit Court of Appeals reversed the Bankruptcy Appellate Panel and reinstated the bankruptcy court's decision.

Justice Kagan delivered the Court's majority opinion. The Court first determined it had a live controversy before it because the distributor brought a claim for money damages arising from its inability to use the trademarks. If it had used the trademark, the distributor would have violated a "crystal-clear ruling and courted yet more legal trouble to preserve its claim."

After determining the Court had a live controversy before it, the Court's analysis principally focused on the plain language of §§ 365(a) and (g). The debtor argued its rejection constituted rescission of the agreement. The Court disagreed, citing the language of § 365(g), providing that "rejection constitutes a breach of [an executory] contract." Because the Bankruptcy Code does not specifically define breach, the Court considered its meaning under contract law, which provides that breach does not terminate a contract, and the counterparty retains the rights it negotiated in the agreement. The Court noted this interpretation was also consistent with the Bankruptcy Code's "stringent limitations on 'avoidance' actions."

Additionally, the Court rejected the debtor's trademark-law-specific argument that a trademark licensor's continuing duty to monitor and exercise quality control of the use of its trademark should mean a trademark licensing agreement allows the debtor to rescind the agreement. Acknowledging no applicable exception to §§ 365(a) and (g) exists, the Court rejected the debtor's argument that "distinctive features of trademarks should persuade [the Court] to adopt a construction of [§] 365 that will govern not just trademark agreements, but pretty nearly every executory contract." The trademark-specific problems the debtor cited, if applied to all executory contracts "would allow the tail to wag the Doberman."

B. *Obduskey v. McCarthy & Holthus LLP*, 139 S.Ct. 1029 (2019)

A law firm hired to conduct a nonjudicial foreclosure is not a "debt collector" subject to the main provisions of the Fair Debt Collection Practices Act (FDCPA). A mortgage loan servicer hired a law firm to carry out a nonjudicial foreclosure on a Colorado home. After the law firm sent the homeowner a letter about the impending foreclosure, the homeowner sent the law firm a letter, disputing the amount of the debt and asking the law firm to cease all collection efforts until the law firm provided the homeowner verification of the debt. The law firm did not send the requested verification and proceeded with the nonjudicial foreclosure.

The homeowner sued the law firm, alleging the law firm failed to comply with FDCPA's verification procedure. The district court dismissed the homeowner's complaint, holding that the law firm was not a debt collector under the FDCPA, which the Tenth Circuit affirmed.

The Supreme Court agreed. The homeowner argued the law firm fell under the general definition of a "debt collector" under the FDCPA, which includes, "any person . . . in any business the principal purpose of which is the collection of any debts, or who regularly collects or attempts to collect, directly or indirectly, debts." The Court reasoned that security-interest enforcers, like the law firm, do not fall within the general definition of debt collectors because they are specifically listed as debt collectors for only a limited purpose under § 1692f(6) of the FDCPA.

The Court rejected the homeowner's argument that the limited definition only applied to security-interest enforcers of personal property (a.k.a. "repo men") because the limited-purpose definition used broad language and did not specifically mention the enforcement of security interests in personal property. The Court also surmised that Congress "may have well chosen to treat security-interest enforcers different to avoid conflicts with state nonjudicial foreclosure schemes" to allow nonjudicial foreclosures to occur as state laws permit. Last, the Court rejected the homeowner's argument that the sending of notices was conduct beyond security-interest enforcement because Colorado nonjudicial foreclosure law required the law firm to send the notices prior to foreclosure.

The Court's decision resolves a circuit split, siding with the Ninth and Tenth Circuits and reversing contrary decisions from the Third, Fourth, and Sixth Circuits.

C. *Henry Schein, Inc. v. Archer & White Sales, Inc.*, 139 S.Ct. 524 (2019)

Courts lack authority to override contractual arbitrability provisions even if they determine the underlying dispute is not arbitrable." A dental equipment distributor sued a manufacturer, seeking money damages and injunctive relief and alleging the manufacturer violated federal and Texas antitrust law. The parties' contract provided for arbitration of disputes arising under or related to the agreement, including arbitrability determinations.

The manufacturer filed a motion to compel arbitration. The district court denied the motion because it determined the manufacturer's argument for arbitration was wholly groundless. The Fifth Circuit Court of Appeals affirmed.

A unanimous Supreme Court held that the wholly groundless exception is inconsistent with the Federal Arbitration Act and Supreme Court precedent. Because the Federal Arbitration Act allows parties to delegate threshold questions of arbitrability to arbitrators and because the Act itself does not contain wholly groundless exception, courts do not have the authority to sidestep a valid arbitration agreement. The Court declined to express a view on whether the contract at issue actually delegated the arbitrability question to an arbitrator and remanded that issue back to Fifth Circuit.

Takeaway: this decision very well may open the door to arbitrators—not bankruptcy judges—deciding whether litigation over core matters must be resolved through arbitration rather than litigation in bankruptcy courts.

D. *Taggart v. Lorenzen*, 139 S.Ct. 1795 (June 3, 2019)

This case required the Supreme Court to articulate the standard courts should apply in determining whether to hold a creditor in civil contempt for violating the discharge injunction. The Chapter 7 debtor sought civil contempt sanctions against his former business partners and their attorney for attempting to collect post-petition attorneys' fees stemming from prepetition litigation. The bankruptcy court awarded civil contempt sanctions under a standard akin to strict liability, permitting civil contempt sanctions when a creditor was aware of discharge injunction and intended the actions that violated it. The Ninth Circuit Bankruptcy Appellate Panel reversed, holding a creditor's good faith belief that the discharge injunction did not bar its conduct precluded civil contempt sanctions, even if the creditor's belief was objectively unreasonable. The Ninth Circuit Court of Appeals affirmed under the "good faith belief" test.

The Supreme Court rejected both the bankruptcy court's and Ninth Circuit's tests. Explaining, "[w]hen a statutory term is 'obviously transplanted form another legal source' it 'brings the old soil with it,'" the Court applied nonbankruptcy civil contempt principles to the issue before it. Under nonbankruptcy law, "civil contempt should not be resorted to where there is [a] fair ground of doubt as to the wrongfulness of the defendant's conduct," but may be appropriate if an alleged contemnor (1) acts in bad faith or (2) acts with an objectively unreasonable good faith belief that he or she was complying with a court order.

The Court held that the correct test is whether "there is *no fair ground of doubt* as to whether the order barred the creditor's conduct. In other words, civil contempt may be appropriate if there is no objectively reasonable basis for concluding that the creditor's conduct might be lawful." In bankruptcy, "civil contempt therefore may be appropriate when the creditor violates a discharge order based on an objectively unreasonable understanding of the discharge order or the statutes that govern its

scope." The Court vacated the Ninth Circuit's decision and remanded for further proceedings consistent with its determination.

II. Eighth Circuit & Eighth Circuit Bankruptcy Appellate Panel Cases

Procedure & Case Administration – 8th Circuit

A. *Fulmer, II v. Fifth Third Equip. Fin. Co. (In re Veg Liquidation, Inc.)*, 931 F.3d 730 (8th Cir. 2019)

Bankruptcy Judge: Ben Barry

Appellant, the Chapter 7 trustee, brought suit against several parties involved in the sale of the Chapter 11 debtor's assets under § 363. The bankruptcy court dismissed the trustee's claims on two grounds: 1) the claims were impermissible collateral attacks on an earlier court order approving the sale; or 2) the claims were without merit. The bankruptcy court found that the trustee did not plead a plausible claim of fraud on the court, for collusion among bidders under § 363(n), or for post-judgment relief from the sale order under Rule 60(b). The trustee's other claims were barred by the finality of the order approving the asset sale. The bankruptcy court also denied the trustee's motion for leave to file a second amended complaint as futile. The BAP affirmed.

The Eighth Circuit affirmed, finding that the trustee's claims amounted to an impermissible collateral attack on the asset sale order. (In the asset sale order, the bankruptcy court had found that all of the assets were subject to a competitive and good faith bidding process and had gone to the highest bidder.) The Eighth Circuit also found that the trustee's "fraud on the court" claim fell short of meeting the claim's narrow and demanding standard. "Few, if any, of the alleged facts involve[d] conduct directed at the [bankruptcy] court in the sale proceeding." Finally, the Eighth Circuit held that the bankruptcy and district courts did not err in concluding that the trustee's proposed amendment would have been futile.

B. *Holmes-Diltz v. Sosne (In re Allen)*, 772 F. App'x 405 (8th Cir. 2019)

Bankruptcy Judge: Kathy Surratt-States

Appeal from the district court's dismissal of an interlocutory appeal from of a bankruptcy court order denying the appellant's motion for a jury trial. Appellant also requested mandamus relief. The Eighth Circuit found it lacked jurisdiction under 28 U.S.C. § 158(d)(1) to hear the appeal as there had not yet been a final judgment in

the underlying bankruptcy case. Appellant's mandamus request was denied as she failed to show entitlement to such extraordinary relief.

C. *Sears v. Sears (In re AFY, Inc.)*, 902 F.3d 884 (8th Cir. 2018)

Bankruptcy Judge: Thomas Saladino

The current shareholders of a Chapter 7 corporate debtor sought to bring various state court claims against the debtor's former shareholders. As a threshold matter, the Eighth Circuit affirmed the bankruptcy court's subject matter jurisdiction finding, at a minimum, "related to jurisdiction." Procedurally, the BAP had dismissed the shareholders' claims pursuant to the shareholder standing rule. The Eighth Circuit affirmed, finding that the current shareholders only alleged injuries that were derivate of the corporate debtor. The shareholders failed to demonstrate that they were owed a special duty or suffered a type of injury separate and distinct from those suffered by other shareholders generally.

Procedure & Case Administration – BAP

D. *Raynor v. Walker (In re Raynor)*, 602 B.R. 703 (B.A.P. 8th Cir. 2019)

Bankruptcy Judge: Thomas Saladino

The Chapter 7 debtor appealed the bankruptcy court's orders dismissing his adversary proceeding and denying his post-dismissal motion to vacate. The bankruptcy court found that it had already addressed the merits of the debtor's claims relating to a loan obligation incurred in 2008 several times over the years, including in previous adversary proceedings. The bankruptcy court dismissed the debtor's third adversary proceeding with prejudice, finding that it was a collateral attack on the final orders of the bankruptcy court in a previous adversary and an attempt to collaterally attack a Nebraska state court ruling in violation of the *Rooker-Feldman* doctrine. The bankruptcy court then denied the debtor's post-dismissal motion as it repeated the same arguments made in the motion to dismiss. The BAP upheld the bankruptcy court's orders based on principles of both collateral estoppel and *res judicata*.

E. *Abel v. Queen (In re Queen)*, 602 B.R. 60 (B.A.P. 8th Cir. 2019)

Bankruptcy Judge: Charles Rendlen, III

Creditors brought an adversary proceeding against the Chapter 7 debtors to determine the dischargeability of a debt arising from a state court default judgment in the creditors' favor. The lone issue to be decided by the bankruptcy court at summary judgment was whether the creditors' claims were dischargeable under § 523(a)(4) for fraud or defalcation while serving in a fiduciary capacity, embezzlement, or larceny. The creditors appealed the bankruptcy court's summary judgment order in favor of the debtors, which found that the state court judgment was only a default judgment and did not become final prior to the debtors filing for Chapter 7 relief. The BAP viewed the creditors' appeal as being premised on the bankruptcy court's alleged error in not giving preclusive effect to the state court judgment. The record, however, demonstrated that the creditors had abandoned this claim at summary judgment. An earlier motion for summary judgment raising the claim had been withdrawn and was not renewed by the motion that was the subject of the appealed order. Thus, the issue of preclusion was not before the bankruptcy court and it afforded no basis for the creditors' appeal.

F. *Marshall v. McCarty (In re Marshall)*, 596 B.R. 366 (B.A.P. 8th Cir. 2019) (on appeal)

Bankruptcy Judge: Richard Taylor

The bankruptcy court dismissed a Chapter 13 case due to the debtor's failure to comply with the Bankruptcy Code's credit counseling requirement under 11 U.S.C. § 109(h) and imposed a 180-day bar to refiling. The debtor appealed both the dismissal order and the 180-day bar. On appeal, the BAP held that the bankruptcy court had not abused its discretion in dismissing the case and imposing the bar to refiling. Although the debtor's petition indicated she had received credit counseling within 180 days of filing her petition, the debtor was unable to provide any proof that she actually received any such counseling. The BAP found the 180- day bar appropriate given the debtor's frequent history of filing for Chapter 13 relief to save her home from foreclosure.

G. *Curran v. Moon (In re Curran)*, 595 B.R. 272 (B.A.P. 8th Cir. 2019)

Bankruptcy Judge: Cynthia Norton

Debtor's application to waive the Chapter 7 filing fee was denied and bankruptcy court ordered the debtor to pay the fee in four equal installments. The debtor moved to voluntarily dismiss her case, following the bankruptcy court's order

sustaining the trustee's objection to certain exemptions and imposing sanctions against the debtor in a separate adversary proceeding for the pre-petition transfer of real property. The bankruptcy court denied the debtor's motion to dismiss.

Debtor timely made two installment payments but failed to make the third. A standard order was entered to show cause as to why the case should not be dismissed. The trustee then filed a response requesting that automatic dismissal be denied. The bankruptcy court vacated the order to show cause and indefinitely extended the deadline to pay the third and final installments pending the trustee's filing of a final report or report of no distribution. Debtor asked the bankruptcy court to reconsider its order, which was construed as a motion under Rule 60(b). The BAP found no error or abuse of discretion in the bankruptcy court's order denying the debtor's motion for reconsideration.

H. *Marshall v. Deutsche Bank Nat'l Trust Co. (In re Marshall)*, 595 B.R. 269 (B.A.P. 8th Cir. 2019)

Bankruptcy Judge: Richard Taylor

The BAP held that a debtor's appeal from the bankruptcy court's order granting a creditor's motion for relief from the automatic stay was moot. Although the debtor timely filed a notice of appeal, she did not obtain a stay of the order pending appeal. The underlying bankruptcy case was subsequently dismissed, the real property was sold to the creditor at the foreclosure sale, and the debtor was later evicted from the property. The BAP found that since it could not provide any effective relief to the debtor, the issues raised on appeal were moot.

I. *Frakes v. Arch Coal, Inc. (In re Arch Coal, Inc.)*, 592 B.R. 853 (B.A.P. 8th Cir. 2018)

Bankruptcy Judge: Charles Rendlen, III

Creditors appealed the bankruptcy court's order denying their amended motion for determination that the confirmation order did not bar them from filing and prosecuting a proposed state court action. The BAP dismissed the appeal as premature, finding that the bankruptcy judge's order was not a final order.

Here, the creditors requested that the bankruptcy court enter an order authorizing them to file and prosecute to completion a state court complaint because, among other reasons, the claims were excepted from discharge. The bankruptcy court denied this request on the basis that the action for a declaratory judgment on the issue of dischargeability should have been timely brought in an adversary proceeding. The BAP held that the bankruptcy court's order was not final because it never reached the merits of the requested declaratory judgment, and the parties and the bankruptcy court therefore had "more to do than simply execute the court's order." The panel held that, for this reason, it had no jurisdiction to review the order. It also

held that there was no basis for granting the creditors leave to appeal because nothing in the record suggested that an immediate appeal would materially advance the termination of litigation.

J. *Lariat Cos., Inc. v. Wigley (In re Wigley)*, 592 B.R. 339 (B.A.P. 8th Cir. 2018)

Bankruptcy Judge: William Fisher

Creditor brought a motion for rehearing and, in the alternative, a motion for stay of mandate. The BAP found that it had applied the undisputed facts to the issues presented and had not strayed from the issues briefed by the parties, as alleged by the creditor. With respect to the creditor's alternative motion, the BAP found that the creditor did not demonstrate a fair prospect of prevailing on the merits, irreparable harm in absence of a stay, or that the balance of equities warranted the imposition of a stay.

K. *AY McDonald Indus., Inc. v. McDonald (In re McDonald)*, 590 B.R. 506 (B.A.P. 8th Cir. 2018)

Bankruptcy Judge: Thad Collins

Creditor appealed the bankruptcy court's order denying its request for injunctive and declaratory relief as to the irrevocable nature of a pre-petition power of attorney executed in its favor by the Chapter 7 debtor. The power of attorney allowed the creditor to access distributions from spendthrift trusts which were excluded from the bankruptcy estate. The BAP determined that the bankruptcy court lacked subject matter jurisdiction to entertain the creditor's claims for declaratory and injunctive relief. The creditor's claims for declaratory and injunctive relief as to the power of attorney were not core proceedings, nor were they "related to" the bankruptcy case, as the outcome of the creditor's claims could have no conceivable effect on the debtor or the estate. The BAP exercised jurisdiction for the sole purpose of correcting the matter and vacated the portion of the bankruptcy court's decision concerning declaratory and injunctive relief.

Exemptions – 8th Circuit

L. *CRP Holdings A-1, LLC v. O'Sullivan (In re O'Sullivan)*, 914 F.3d 1162 (8th Cir. 2019)

Bankruptcy Judge: Cynthia Norton

Creditor appealed the BAP's CRP order affirming the bankruptcy court's order that it has unenforceable judicial lien against the real property of the debtor and avoiding the lien pursuant to § 522(f)(1). This case was before the circuit for the second time after remand with instructions to the bankruptcy court to find whether the creditor had a judicial lien properly subject to avoidance under § 522(f)(1). The bankruptcy court explained that "lien" is defined in § 101 and supplants any state law definition of a lien. The bankruptcy court held that the creditor possessed an unenforceable judicial lien against the debtor's property and granted the debtor's motion to avoid the lien.

The only contested issues on appeal were whether a judicial lien existed and, if so, whether the lien affixed to the debtor's interest in the property. The Eighth Circuit followed other circuits in holding that where a judgment gives rise to unenforceable lien, a debtor may move to avoid that lien under § 522. But when a judgment fails to give rise to any judicial lien, § 522 is superfluous and without application. It held further that when the creditor filed its notice of foreign judgment, it created a lien on any real estate owned by the debtor in that county. Under Missouri law, however, a judgment filed against only one spouse could not constitute a lien on the tenancy by the entireties property. Creditor's recording of foreign judgment created a cloud on title and fastened an existing but presently unenforceable lien on the property. As such, the Eighth Circuit held that § 522(f)(1) could be used to avoid the lien.

M. *Hanson v. Seaver (In re Hanson)*, 903 F.3d 793 (8th Cir. 2018)

Bankruptcy Judge: Michael Ridgway

A Chapter 7 debtor was not entitled to claim a Minnesota state-law exemption in a property tax refund as allegedly being in the nature of "government assistance based on need." Subdivision 14 of Minnesota's exemption statute—§ 550.37—delineates a non-exhaustive list of examples of government assistance based on need, such as supplemental social security income, medical assistance, and food support. The Eighth Circuit held that, under Minnesota law, in order for government benefits paid to a debtor to be exempt from the claims of creditors as "government assistance based on need," the benefits must aim to provide basic necessities to the needy. The examples provided in the Minnesota statue clearly aimed to serve the basic needs of low income, disabled, or elderly individuals.

In examining the text of Minnesota's Property Tax Refund Act, the Eighth Circuit found that the Minnesota Legislature did not intend for the property tax refund to constitute government assistance based on need. In so ruling, the Eighth Circuit distinguished its decision in *In re Hardy*, 787 F.3d 1189 (2015), in which it had held that the federal "additional child tax credit" (ACTC) qualifies as an exempt "public assistance benefit" under Missouri law.

Exemptions – BAP

N. *Lerbakken v. Sieloff & Assocs., PA, (In re Lerbakken)*, 590 B.R. 895 (B.A.P. 8th Cir. 2018)

Bankruptcy Judge: Robert Kressel

Chapter 7 debtor appealed the bankruptcy court's order that funds he received from his ex-wife through a stipulated property settlement in a dissolution of marriage order, which included one-half of his ex-wife's 401K and an entire IRA account, were not exempt "retirement funds" under § 522(D)(12). The Bankruptcy Code provides an exemption for retirement funds held in an account exempt from taxation under enumerated provisions of the Internal Revenue Code. The BAP determined that the issue on appeal was a question of law and reviewed the court's order *de novo*.

The BAP also decided that because retirement funds are "sums of money set aside for the day an individual stops working," the "exemption is limited to individuals who created and contribute funds into the retirement account." While the debtor's ex-wife had saved funds in the accounts for the parties' joint retirement, any interest the debtor held in the accounts resulted from nothing more than a property settlement. In affirming the bankruptcy judge's order, the BAP also rejected the idea that the debtor's intended use of the funds should be considered, holding that the courts are only required to look to the objective criteria: the legal characteristics of the account in which the funds are held.

O. *Rucker v. Belew* (*In re Belew*), 588 B.R. 875 (B.A.P. 8th Cir. 2018)

Bankruptcy Judge: Ben Barry

The trustee appealed the bankruptcy court's order overruling an objection to the debtor's second amended claim of exemption. The trustee argued that the claim of exemption should be disallowed because the debtor filed in bad faith and the claim was prejudicial to the debtor's creditors. Relying on the Supreme Court's decision in *Law v. Siegel*, 571 U.S. 415 (2014), the bankruptcy court held that federal law provides no authority for bankruptcy courts to deny an exemption on a ground that is not specified in the Bankruptcy Code.

Addressing a matter of first impression, the BAP agreed. The BAP reviewed the bankruptcy judge's interpretation and application of *Law v. Siegel de novo*. It

held that in *Law*, Justice Scalia, writing for a unanimous court, clearly stated that the Bankruptcy Code gives no power to the bankruptcy court to disallow an exemption based on the debtor's fraudulent concealment of an asset. Further, the BAP found that even though Justice Scalia's statement on this matter was *dicta*, it was an important and unambiguous statement of the law and should be enforced. The BAP acknowledged its unenviable position of having to determine whether the bankruptcy court was bound by *dicta* in *Law* or by the Eighth Circuit's holding in *In re Kaelin*, 308 F.3d 885 (2002), which provided that "a bankruptcy court may consider a debtor's bad faith and any prejudice to the debtor's creditors in determining whether to allow a debtor to amend his claim of exemptions," but concluded that *Kaelin* had been abrogated by *Law*.

Claims – Eighth Circuit

P. *Paddock, LLC v. Bennett (In re Bennett)*, 917 F.3d 676 (8th Cir. 2019)

Bankruptcy Judge: Thad Collins

Creditor with a secured claim in the debtors' manufactured home objected to the debtors' proposed Chapter 13 plan. The creditor argued that the plan violated § 1322(b)(2)'s anti- modification provision, which prevents a debtor from modifying the rights of a creditor with a security interest in real property that is used as the debtor's principal residence. The bankruptcy court found that the manner in which the manufactured home was attached to the leased realty on which it sat did not indicate an intent to make it a permanent accession to the property under Iowa law. The manufactured home, following removal of its wheels, had been placed on pier pads and concrete blocks and surrounded by a plastic skirt. Moreover, it could be removed, by reattaching its wheels, without significantly damaging the realty. The BAP affirmed the bankruptcy court's order overruling the creditor's objection.

A divided Eighth Circuit affirmed, finding that the bankruptcy court's determination that the manufactured home did not meet Iowa's fixture test was not clearly erroneous. A dissenting judge opined that, while the majority opinion set forth the correct test under Iowa law to determine whether personal property has become a fixture, and thus, real property, it misapplied that test and came to the wrong conclusion.

Q. *Oetting v. Sosne (In re Green Jacobson, PC)*, 911 F.3d 924 (8th Cir. 2018)

Bankruptcy Judge: Charles Rendlen, III

The bankruptcy court entered an order sustaining an objection to a proof of claim filed by a member of a class of unsecured creditors in the Chapter 7 case of the

law firm which had acted as lead counsel for the class. The unsecured claim totaled over $10.5 million. The class member appealed, and the trustee then moved to dismiss the appeal. The district court granted the motion to dismiss the appeal and later denied the class member's motion for reconsideration.

On appeal, the Eighth Circuit found that the negligent supervision component of the class member's proof of claim had to be disallowed as unenforceable on statute of limitation grounds. This component of the claim arose, at the latest, more than five years prior to the petition date and outside the "lookback" period of Missouri's five-year statute of limitations.

Claims – BAP

R. *SMC Holdings, LLC v. McCann (In re McCann)*, 601 B.R. 813 (B.A.P. 8th Cir. 2019)

Bankruptcy Judge: Robert Kressel

Creditor brought an adversary proceeding against the debtor to except its debt from discharge under § 523(a)(2)(A). At trial, the debtor presented no defense. At the end of trial, the debtor's counsel made an oral motion for judgment on partial findings on the grounds that the creditor was not the real party-in-interest. Debtor asserted that the creditor did not have immediate access to the amount of funds necessary to fund a contribution to the debtor's business in exchange for an ownership. As a result, another entity under common ownership with the creditor made the transfer to the debtor. Debtor argued that because of this, the entity under common ownership was the proper party to assert this claim against him. The bankruptcy court denied the debtor's motion and entered judgment in favor of the creditor.

On appeal, the BAP found that the bankruptcy court's determination that the creditor was the real party-in-interest was not clearly erroneous. The transfer was reflected on the companies' books as a loan from the entity under common ownership to the creditor, and the parties' term sheet specifically stated that should the agreement not be executed, the money would be returned to the creditor, not the other entity. The record showed that the entity under common ownership was only acting on the creditor's behalf and that the creditor was the real party-in-interest. Thus, the creditor was the proper party holding the claim against the debtor.

S. *Lariat Cos., Inc. v. Wigley (In re Wigley)*, 593 B.R. 327 (B.A.P. 8th Cir. 2018)

Bankruptcy Judge: William Fisher

Judgment creditor had obtained two pre-petition state-court judgments in connection with its lease of commercial property to a company formed by the Chapter

11 debtor's spouse. The first judgment was against the spouse and his company for damages under the lease and the spouse's guaranty thereof. The second judgment was against both debtor and spouse for violation of the Minnesota Uniform Fraudulent Transfer Act. Creditor filed a proof of claim seeking sums allegedly due under the fraudulent transfer judgment. Debtor subsequently objected to the claim, arguing that it should be disallowed because the spouse had satisfied her obligations to the judgment creditor in the spouse's earlier bankruptcy case. The bankruptcy court denied the objection and allowed the claim in a reduced amount.

As a matter of apparent first impression, the BAP held that because the creditor's claim against the debtor's spouse was paid in full it was unenforceable against the debtor. Debtor was neither a party to nor a guarantor of the lease, which was the subject of the first pre-petition judgment. Debtor's liability arose solely under the state fraudulent transfer act. The act did not create a new claim but, instead, required a predicate claim, which was the first judgment against the spouse and on the spouse's guaranty of the commercial lease. Creditor's rights flowing from the first judgment were extinguished in the spouse's bankruptcy when the bankruptcy court capped the spouse's liability under the judgment and the spouse then paid the capped amount plus interest. Because the predicate claim was satisfied, the judgment creditor no longer had a claim against the debtor.

Automatic Stay – BAP

T. *Edwards v. City of Ferguson (In re Edwards)*, 601 B.R. 660 (B.A.P. 8th Cir. 2019)

Bankruptcy Judge: Kathy Surratt-States

Chapter 13 debtor brought an adversary proceeding against the City of Ferguson for an alleged violation of the automatic stay in relation to a parking ticket and resulting arrest warrant for failure to pay the fine. Debtor argued that the City violated the stay by not releasing the arrest warrant and failing to issue a compliance letter which would reinstate the debtor's driver's license. The bankruptcy court granted the City's motion for summary judgment and denied the debtor's motion.

On appeal, the BAP found that although recall of the warrant might have been the safest way to ensure that she was not arrested in violation of the automatic stay, recalling the warrant was not something which the City had to do to avoid violating the stay. It was enough that the city took no action to enforce the arrest warrant or to compel payment of the fine post-petition. The BAP also agreed that the City was under no obligation to issue a letter of compliance for the unpaid fine which had not yet been discharged in bankruptcy.

Avoidance – 8th Circuit

U. *Stoebner v. Opportunity Fin., LLC*, 909 F.3d 219 (8th Cir. 2018)

Bankruptcy Judge: Gregory Kishel

The Chapter 7 trustee brought this adversary seeking to avoid over $250 million in pre-petition payments made to the defendants by an entity in the personal enterprise structure of Thomas J. Petters, the orchestrator of the massive Petters' Ponzi scheme. The complaint alleged that two of the Polaroid debtors are the successors in interest to the Petters' entity at issue in the adversary. The bankruptcy court dismissed the complaint on two grounds. First, that the trustee lacked standing as he failed to identify any creditor of the debtors at issue that would have an allowable claim against the debtors. Second, on the merits through application of Minnesota Supreme Court precedent holding that a "Ponzi-scheme presumption" could not be used to establish the three elements of a claim under the Minnesota Uniformat Fraudulent Transfer Act—fraudulent intent, insolvency, and lack of reasonably equivalent value. The district court affirmed on appeal.

The Eighth Circuit affirmed on the merits, finding that loan repayments to a lender from a separate company affiliated with the Ponzi scheme's operator were not made with fraudulent intent as required under Minnesota law. The fact that the entity received infusions of money from the Ponzi scheme alone did not give rise to the presumption that it was financially distressed within the meaning of the Minnesota Uniform Fraudulent Transfer Act. The Eighth Circuit reasoned that legitimate business transactions were financed with capital from the lender, and the loans were repaid through the proceeds of legitimate transactions. Having affirmed on the merits, the Eighth Circuit did not address the issue of standing.

Avoidance – BAP

V. *Kunkel v. CUSB Bank (In re Clement)*, 604 B.R. 352 (B.A.P. 8th Cir. 2019)

Bankruptcy Judge: Michael Ridgway

In this case, the BAP permitted a Chapter 11 trustee to avoid an unenforceable mortgage under Minnesota law. The debtor owned real property jointly with a third party. Prepetition, the debtor divorced his ex-wife, and she conveyed her marital interest in the property to him via a "Summary Real Estate Disposition of Judgment" (the judgment). The judgment required the ex-wife to execute a quit claim deed in favor of debtor, but also stated "a Summary Real Estate Disposition Judgment shall be sufficient to transfer legal interest and title of th[e] property to [the Debtor]." Later, the ex-wife executed a quit claim deed purportedly conveying the real property from her revocable trust to the debtor's revocable trust. The debtor's trust

subsequently pledged the property in a mortgage to the defendant bank to secure a loan.

The bankruptcy trustee sought to avoid the mortgage, arguing the mortgage was invalid because the debtor's trust never held any interest in the property. In particular, the bankruptcy trustee argued the transfer from the wife's trust to the debtor's trust was invalid because: (1) the ex-wife's marital interest in the real property ceased at divorce, before the purported transfer to the debtor's trust; and (2) the ex-wife's trust never had any interest in the real property to convey to the debtor's trust. The bank asserted the trustee could not avoid its mortgage, arguing the wife's transfer to the husband at divorce was invalid because the wife never executed a quit-claim deed in favor of the husband, so the subsequent transfer from her revocable trust to the debtor's revocable trust was valid and the trustee had constructive notice of the bank's properly recorded mortgage. The bankruptcy court granted summary judgment in favor of the trustee.

The BAP agreed with the trustee and bankruptcy court. First, the trustee, as a bona fide purchaser, was entitled to rely on the Summary Real Estate Disposition of Judgment because there was no evidence of any defect in the dissolution proceeding and the ex-wife's marital interest in the property ceased at divorce. Moreover, the ex-wife's trust never held and interest in the property. Consequently, the debtor's trust never held any interest in the property and could not mortgage the property to the Bank. The bankruptcy court did not err in granting the trustee's motion for summary judgment.

Discharge & Dischargeability – BAP

W. *Page v. JP Morgan Chase Bank (In re Page)*, 592 B.R. 334 (B.A.P. 8th Cir. 2018)

Bankruptcy Judge: Charles Rendlen, III

Debtor appealed the bankruptcy court's order granting judgment in favor of the creditor and denying the debtor's motion for summary judgment. Debtor sought discharge of her debt under § 523(a)(8), arguing that the loan was not an "educational loan" within the meaning of the statute.

Instead of focusing on the loan's features, the BAP ruled that courts should look at the purpose of a loan to determine whether it is "educational." When considering exceptions to discharge under this bankruptcy code provision, the BAP detailed how courts have considered whether a nonprofit entity played any meaningful part in the procurement of the loan under the program. This "meaningful part" test depends on whether the nonprofit entity committed financial resources or something of value to the loan program in order to make the program successful.

Reversing and remanding, the BAP held that the bankruptcy court construed too broadly the term "funded" in the context of the nonprofit at issue. Such an approach was inconsistent with Congress's intent that exceptions to discharge be

narrowly construed against the creditor and liberally in favor of the debtor. The BAP further held that the evidence did not establish that the nonprofit entity guaranteed the loan, processed the loan, or even received all the loan; instead, the entity merely provided an address to which the application could be delivered, which was insufficient to support an inference of the nonprofit "funding" this loan program.

X. *Snyder v. Dykes (In re Dykes)*, 590 B.R. 904 (B.A.P. 8th Cir. 2018) (on appeal)

Bankruptcy Judge: Kathleen Sanberg

Debtors appealed the bankruptcy court's order denying their discharge under § 727(a)(3) for failure to maintain adequate records concerning a series of expensive watch purchases over several years. Debtors' failure to do so left the court, the United States Trustee, and other third parties without any way to ascertain the debtors' financial condition and business transactions. Further, the debtors failed to keep an inventory of personal property that, following foreclosure on their home, were placed in storage and ultimately repossessed by the storage company when the debtors failed to pay.

The BAP agreed with the bankruptcy court's findings, as well as its characterizations of the watch transactions as "sloppy and informal." Further, the BAP found that the bankruptcy court properly considered the debtors' education and sophistication in determining that the debtors failed to provide adequate records, and that the absence of accounting was clearly a proper basis for finding that the debtors failed to provide adequate records. Debtors' subjective beliefs that they would never file for bankruptcy were irrelevant.

Y. *Conway v. Heyl (In re Heyl)*, 590 B.R. 898 (B.A.P. 8th Cir. 2018)

Bankruptcy Judge: Charles Rendlen, III

Investors appealed the bankruptcy court's dismissal of a complaint to except a debt from discharge for false pretenses, false representation, and actual fraud and an order denying their motion to reconsider. In the first adversary proceeding, the bankruptcy court found that the debt was not the proximate result of any representation. Subsequently, one of the investors then complained to the Missouri Security Division of the Office of Secretary of State asserting similar issues. As a result of that office's investigation, the debtor entered into a consent order with the state. The investors then filed the second adversary proceeding to except the debt from discharge under 11 U.S.C. § 523(a)(19). The bankruptcy court granted the debtor's motion dismissing the second complaint for failure to state a claim, as the consent order merely referenced the investor as someone who the debtor had defrauded.

The BAP agreed with the bankruptcy court because there was no debt to the investors resulting from the consent order; the only debt that resulted from the consent order was a debt owed by the debtor to the state for a civil penalty and costs. In order for a debt to be excepted from discharge under § 523(a)(19), the debt must actually result from the judgment, order, consent order, or decree on which the creditor relies to memorialize the obligation.

Sanctions – 8th Circuit

Z. *First State Bank of Roscoe v. Stabler*, 914 F.3d 1129 (8th Cir. 2019)

Bankruptcy Judge: Chuck Nail

Creditors appealed the order of the district court affirming the bankruptcy court's order holding them in contempt of court and sanctioning them for violating the discharge injunction. Creditors, a bank and owners of that bank, lent money to the debtors. When the debtors fell into financial distress, the creditors recommended to the debtors that they file for bankruptcy. The bank also offered the services of a bankruptcy attorney who had previously served as the bank's attorney. Debtors hired this attorney, but he failed to list all the debts owed to the bank. Post-discharge, the bank obtained from the debtors and one of the debtor's parents a commitment to pay a new note with an amount in excess of the bank's security interests that had survived the bankruptcy. When the debtors fell behind on payments, the bank started collection efforts. Debtors then sued in bankruptcy court.

The bankruptcy court abstained to allow the pending state court proceeding to be completed. There, a jury returned a verdict in favor of the debtors. Specifically, the jury found that the new loan was obtained by fraud as the bank had coerced the debtors into reaffirming their debt. The bankruptcy court then held the creditors in contempt based on the state court judgment.

The Eighth Circuit affirmed, rejecting the creditors' argument that the bankruptcy court was precluded from finding contempt due to its decision to abstain from the state court proceeding. In addition, the Eighth Circuit rejected the creditors' argument that they had acted in good faith.

III. Tenth Circuit Cases

A. *William F. Sandoval Irrevocable Trust v. Taylor (In re Taylor)*, 899 F.3d 1126 (10th Cir. 2018)

This case deals with avoidance of judicial liens on property owned by joint tenants when only one of the property owners seeks bankruptcy relief. The question is whether when a court considers the issue of whether a judicial lien impairs the

debtor's homestead interest, the court should consider the full amount of the liens, or a proportional amount of the liens based upon the debtor's percentage of ownership. The bankruptcy court held that the entire amount of the liens should be considered in determining impairment. Upon direct appeal, the United State Court of Appeals for the Tenth Circuit reversed. In reversing, the court noted that three other circuits have concluded that the prior liens should be considered in proportion to the debtor's interest and not in their entirety because the failure to do so "produces an unreasonably high impairment that has the effect of creating additional equity for the debtor at the expense of the lienholder" (quoting an Eighth Circuit case).

It is important to note that this case arose under Colorado law, where (like in Missouri) a debtor has a limited homestead exemption of $37,500. Query whether the result would be the same where the debtor had an unlimited homestead exemption (like in Kansas).

B. *Lazzo v. Rose Hill Bank (In re Schupbach Investments, LLC)*, 808 F.3d 1215 (10th Cir. 2015)

In this case, the Tenth Circuit Court of Appeals affirmed its prior ruling in *In re Land*, 943 F.2d 1265 (10th Cir. 1991), holding that *nunc pro tunc* approval of the employment of debtor's counsel "is only appropriate in the most extraordinary circumstances" and that "simple neglect" will not suffice. In this case, debtor's counsel did not file an application to be employed until the case had been pending slightly over one month. Over objection, the bankruptcy court approved the employment as of the date of filing, finding that the disclosure of compensation coupled with the actions of counsel in the case put everyone on sufficient notice of counsel's retention. Both the Bankruptcy Appellate Panel and the Tenth Circuit disagreed. Counsel was not compensated for that first month's work. But wait, there's more.

Several secured creditors filed a plan of liquidation that was ultimately confirmed. Under the terms of the plan, the debtor was required to transfer ownership of various assets and undertake tasks necessary to the plan's implementation. Those tasks were performed by the debtor with the assistance of debtor's counsel, who sought compensation from the bankruptcy estate. The bankruptcy court granted this fee request. The Bankruptcy Appellate Panel reversed, stating that confirmation of the liquidating plan terminated debtor's status as a debtor in possession, and terminated the bankruptcy estate, thus rendering inapplicable §§ 327 through 330 of the Bankruptcy Code. One lone BAP judge (yeah, that was me) dissented, and would have paid debtor's counsel for performing services that all agreed were necessary to the implementation of the creditors' plan.

The Tenth Circuit Court of Appeals agreed with the majority of the BAP, holding that "when a debtor's status as debtor-in-possession terminates, this also terminates an attorney's authorization under § 327 to provide service as an attorney for the debtor-in-possession" (citing *Lamie v. U.S. Trustee*, 540 U.S. 532 (2004)). The court reasoned that once the debtor lost its status as a debtor-in-possession, the estate

could not be required to pay the fees of debtor's counsel. As a result, debtor's counsel went unpaid for those services related to the confirmed creditors' plan.

C. *Connolly v. Office of the U.S. Trustee (In re Morreale)*, 595 B.R. 409 (B.A.P. 10th Cir. 2019)

This appeal involves a question of statutory interpretation of § 326(a), the Bankruptcy Code provision that limits the maximum amount of compensation a Chapter 7 trustee may receive to tiered commission rates applied to a base amount of "moneys disbursed or turned over *in the* case by the trustee . . . ."11 U.S.C. § 326(a). The Chapter 7 trustee appealed the bankruptcy court's compensation order that excluded monies disbursed in the Chapter 11 case of the Chapter 7 debtor's single-member limited liability company from the compensation base. As a result, instead of receiving the $265,115.91 in fees and expenses sought, the trustee was awarded $86,778.25, roughly one third of the amount sought. Ouch.

The BAP affirmed the bankruptcy court decision. Concluding that the language of § 326(a) is plain and unambiguous, the BAP held that the Chapter 7 trustee's commission base was limited to the case in which he was appointed trustee, the case in which he provided trustee services, and the monies he disbursed as trustee in the Chapter 7 case. It did not include moneys disbursed in a separate debtor's Chapter 11 case where the Chapter 7 trustee removed and replaced the Chapter 7 debtor as the manager of the Chapter 11 debtor and liquidated assets of the Chapter 11 debtor.

Morreale is currently on appeal to the Tenth Circuit. It has been briefed but not yet argued. Stay tuned.

D. *Mendoza v. Montoya (In re Mendoza)*, 595 B.R. 849 (B.A.P. 10th Cir. 2019)

These appeals deal with an issue common in many bankruptcy cases: whether debtors may reopen their cases, amend their bankruptcy schedules to include assets, and claim those assets as exempt. The fight is not about including the asset in the bankruptcy estate; the fight is over who gets the money. (Isn't that always the case?)

In these two cases, debtors reopened their cases and filed amended bankruptcy schedules disclosing personal injury claims and claiming them as exempt. In both cases, the Chapter 7 trustee objected to the amended claims of exemption (but not the amended schedule listing the asset). The bankruptcy courts sustained the Chapter 7 trustees' objections to the amended claims of exemption, interpreting Fed. R. Bankr. P. 1009 as creating a "specified period" in which the debtors may amend their schedules. As the period expired upon closing of the cases, the bankruptcy courts held Fed. R. Bankr. P. 9006(b) required the debtors to show excusable neglect to amend their claimed exemptions. As a result, the personal injury claims belonged to the trustee. Debtors appealed.

On appeal, the BAP reversed, concluding Fed. R. Bankr. P. 1009(a) does not create a "specified period" as provided in Rule 9006(b). Both cases were remanded for consideration of the merits of any objections to the claims of exemption.

Postscript: on remand, the trustee in both cases withdrew his objection to the claim of exemption. The exemptions were allowed.

E. *Minerals Tech., Inc. v. Novinda Corp. (In re Novinda Corp.)*, 585 B.R. 145 (B.A.P. 10th Cir. 2018)

What happens when debt and equity mix in a Chapter 11 case? Let's thicken the plot a bit and have that debt/equity mix also become the target of litigation of the Chapter 11 debtor. Such is the recipe found in the *Novinda* case.

Among the unsecured creditors of the debtor were nine equity holders who also loaned approximately $7 million to the debtor. The debtor's production costs increased to the point that it was forced to seek Chapter 11 protection. The debtor also had claims of breach of contract, breach of fiduciary duty, and fraud against the nine debt/equity holders.

Debtor filed a Chapter 11 case and sold its tangible assets early in the case, leaving the litigation claims against the debt/equity holders as the main asset in the bankruptcy estate. The debtor filed a liquidating plan that classified the debt/equity holders separately from other unsecured creditors and created an "administrative convenience" class of unsecured creditors who held claims of $1,000 or less. The debt/equity holders objected to confirmation, arguing that their separate classification as well as the creation of an administrative convenience class was unfair and was done solely to gerrymander an accepting class of creditors. The bankruptcy court entered orders confirming the debtor's Chapter 11 plan of reorganization and overruling the debt/equity holders' objections to plan confirmation. The bankruptcy court specifically found no gerrymandering, noting that a separate impaired class had voted to accept the plan. The bankruptcy court found a valid purpose for the administrative convenience class, as well as for separate classification of the debt/equity holders. As it did so, the bankruptcy court noted its belief that the main motivation of the debt/equity holders was to remove themselves as targets of the debtor's litigation.

The debt/equity holders appealed these orders, arguing the bankruptcy court erred in confirming the debtor's plan because the plan permitted separate classification of their claims and this treatment constituted unfair discrimination under 11 U.S.C. § 1129(b)(1). The BAP affirmed the bankruptcy court, holding that the bankruptcy court did not err as the record supports its findings regarding separate classification and findings that the plan was proposed in good faith and does not unfairly discriminate against the debt/equity holders. The BAP opinion notes that there is no clear Tenth Circuit guidance on these issues and contains an excellent review of the law in other jurisdictions.

F. *In re Wright*, 591 B.R. 68 (Bankr. N.D. Okla. 2018)

This opinion actually deals with the conduct of debtor's counsel in seventeen (yes, count 'em, **seventeen**) cases. Although the opinion covers many facets of counsel's conduct, the two of greatest interest relate to disclosure of factoring arrangements and bifurcation of services.

The attorney in this case attended a seminar where he was told of the virtues of factoring his bankruptcy fees with an entity known as "BK Billing." Counsel entered into a factoring agreement with BK Billing in which his clients in Chapter 7 cases agreed to pay a small amount prior to the filing of the case, with the balance to be collected after the case was filed, often in the form of automatic debits from the debtor's checking accounts. In an attempt to keep the balance due non-dischargeable, the form agreement provided that the fees to be collected under the agreement were for services rendered after the filing of the case, a statement that was determined to be less than accurate.

Initially, debtor's counsel failed to disclose the existence of the factoring arrangements. The court found that this failure to disclose violated § 329 of the Bankruptcy Code, as well as his ethical duty of candor to the court. In addition, the court reviewed and compared the fees charged in the factored cases with the fees charged by counsel in cases where the debtor paid the entire fee up front. A troubling pattern emerged where counsel was charging significantly more when debtors availed themselves of the factoring arrangement. In effect, counsel was passing the costs of factoring onto his clients. Finally, the court also noted that much of the work that related to the factored fees was performed prior to the filing of the case or was the type of work which needed to be performed prior to the filing of the case in order to provide competent representation. The court ordered counsel to disgorge all fees post-petition and to hold his clients harmless from any collection efforts undertaken by BK Billing.

G. *In re Way to Grow, Inc.*, 597 B.R. 111 (Bankr. D. Colo. 2018)

What's a discussion of Tenth Circuit bankruptcy cases without some marijuana-related issues? This Chapter 11 case did not involve the sale of the wacky tobaccy itself, but rather a business involved in the sale of "indoor hydroponic and gardening related supplies." The issue before the bankruptcy court was "whether companies connected to marijuana businesses legal under state law are eligible for bankruptcy protection, where those connections constitute continuing violations of federal law."

The bankruptcy court looked at two separate provisions of the Controlled Substances Act of 1970 (the "CSA"), noting that under the CSA, the growing of marijuana constituted a federal crime. The bankruptcy court first considered whether the sale of indoor gardening supplies constituted "aiding and abetting" in the commission of a crime. The bankruptcy court noted that the supplies at issue could be used to grow a variety of indoor plants (yeah, sure) and that the crime of

"aiding and abetting" required intent to facilitate the commission of the crime and "full knowledge" that the crime was being committed. The bankruptcy court found the sale of indoor gardening supplies that could be used for purposes other than the growing of a controlled substance did not rise to the level of "aiding and abetting" defined in the CSA.

The debtor did not fare so well when it came to the second test applied by the bankruptcy court from the CSA, which made it a crime to "'manufacture' or distribute" any "equipment, chemical, product or material which may be used to manufacture a controlled substance . . . knowing, intending, or having reasonable cause to believe, that it will be used to manufacture a controlled substance . . . ." The bankruptcy court found that the debtor had reasonable cause to believe the items sold would be used to grow marijuana, a controlled substance under the CSA. On that basis, the bankruptcy court determined that the debtor was engaged in a business that violated federal law and thus rendered it ineligible for bankruptcy protection. The case was dismissed.

This case is also currently on appeal to a higher court (pun intended).

H. *In re Summers*, 594 B.R. 707 (Bankr. D. Colo. 2018)

In 2013, the Tenth Circuit Court of Appeals held that the absolute priority rule can apply to individual Chapter 11 cases after the passage of BAPCPA. *Dill Oil Co., LLC v. Stephens (In re Stephens)*, 704 F.3d 1279 (10th Cir. 2013). In this case, the debtor made a creative attempt to do indirectly what he was not allowed to directly; namely, retain property under the terms of a Chapter 11 plan without paying all prior interests in full. The attempt was rejected by the bankruptcy court.

The debtor proposed a Chapter 11 plan to pay creditors 7% of their claims. The plan contained a provision that "[i]f confirmation of this Plan is sought pursuant to 11 U.S.C. § 1129(b), all property of the Debtor which is property of the Debtor's bankruptcy case as of the Effective Date of the Plan shall remain property of the estate during the term of the Plan." The class of unsecured creditors rejected the plan, making resort to cramdown necessary. Debtor argued the plan could be confirmed for two reasons: first, the debtor was not retaining any property under the terms of the plan, as all property remained property of the bankruptcy estate until plan payments were completed; second, the debtor was contributing all of his property to the reorganization effort and allowing such property to remain in the bankruptcy estate, such contribution constituted "new value" for purposes of the absolute priority rule.

The court rejected both propositions. With respect to the idea that debtor retained no property because the property remained property of the bankruptcy estate until all plan payments were made, the court found this to be a distinction without a difference. The debtor retained control of all of the property during the pendency of the plan and used that property to facilitate his reorganization efforts. The control and use of property under these facts equates to its ownership.

With respect to the retention of property by the bankruptcy estate, the court noted that this property was already property of the bankruptcy estate, and thus could not be considered "new value." In addition, the court cited a variety of cases, which held that new value must come from a source other than the debtor. Confirmation denied.

I. *In re Kane*, 603 B.R. 491 (Bankr. D. Kan. 2019) (Somers, C.J.)

Debtor proposed a Chapter 13 repayment plan that paid his large student loan creditor claims before other general unsecured claims, as a special class. The Chapter 13 trustee objected, arguing unfair discrimination under § 1322(b)(1). The Trustee calculated that if Debtor's student loan claims were paid pro rata along with other general unsecured claims, the pro rata share to all unsecured claims would be 71.03%, the student loan creditor would receive approximately $91,362.47, and the other general unsecured claimants would share the balance of approximately $46,263.33. If, however, the student loan was paid 100% from the net pool before any funds went to the other general unsecured creditors as Debtor proposed, then only $9013.78 would be paid to general unsecured creditors, or approximately 13.84%. The difference between the 71.03% dividend and the 13.84% dividend was $37,249.55. Debtor argued the proposed discrimination was permissible under *In re Engen*, 561 B.R. 523 (Bankr. D. Kan. 2016) (Berger, J.). In the *Engen* case, the court concluded that the discrimination in favor of the student loan creditor was not unfair based on two factors: 1) the debtor had provided "a significant prepetition dividend that discriminated against the Student Loan Claims," giving the non-student loan creditors a prepetition dividend of eighty three percent; and 2) the court rejected the argument that nondischargeability, without more, was an insufficient reason for discriminating in favor of student loan claims. But in the present case, there were no facts that could justify the significant proposed discrimination, and Chief Judge Somers previously ruled in *In re Salazar*, 543 B.R. 669 (Bankr. D. Kan. 2015), that nondischargeability alone is not a reason to discriminate in favor of student loan claims under the test articulated in *Bentley v. Boyajian (In re Bentley)*, 266 B.R. 229 (1st Cir. 2001). As a result, the court concluded that Debtor had not met his burden to show that the discriminatory provisions of his proposed plan were fair, and Debtor's plan could not be confirmed as proposed.

J. *In re Phillips*, 599 B.R. 133 (Bankr. D. Kan. 2019) (Somers, C.J.)

Debtor moved for an order determining that a claim, not included by Debtor in his initial Schedule F or matrix, is included in his discharge under § 1328. The claimant contended the debt is excepted from discharge by § 523(a)(3)(A), made applicable to Chapter 13 cases by § 1328(a)(2). Section 523(a)(3)(A) excepts from discharge any debt "neither listed nor scheduled . . . with the name, if known to the debtor, of the creditor to whom such debt is owed in time to permit . . . timely filing of proof of claim."

From approximately the fall of 2007 through sometime in June 2014, Debtor rented his residence from the claimant and/or her husband. The claim was $1,100 for rent and late charges over the period 2010 through 2014. The claimant never informed Debtor of her claim. On August 7, 2014, the claimant, through her counsel, filed a complaint against Debtor to recover the rent claim in state court. The sheriff was unable to serve summons on Debtor, and the case was dismissed for lack of prosecution on August 3, 2015. Shortly thereafter, on August 28, 2015, Debtor filed a voluntary petition under Chapter 13. Debtor filed a Schedule F listing all known creditors but did not include the claim. Debtor's plan was confirmed on November 17, 2015. Notice was given that December 30, 2015, was the deadline to file a proof of claim for all creditors, except a governmental unit. About two and a half years later, in the spring of 2018, the claimant's counsel used their "skip-tracing" method and learned of Debtor's current residential address. A letter dated May 4, 2018, was mailed to Debtor informing him that counsel had been retained to collect $1,100, plus interest.

The Court was absolutely convinced that Debtor had no knowledge of the claim before he received the letter. The Court found that under the facts of the case, where the Debtor legitimately had no knowledge of the claim when he filed his bankruptcy schedules and did not receive notice of the claim until after the claims bar date, the exception to discharge of § 523(a)(3)(A) does not apply.

K. *In re ACI Concrete Placement of Kan., LLC*, 604 B.R. 400 (Bankr. D. Kan. 2019) (Somers, C.J.)

Debtors ACI Concrete Placement of Kansas, LLC, and related entities filed for bankruptcy relief in September 2017 and operated under the protection of Chapter 11 until the spring of 2019, when the bank holding perfected security interests in substantially all of Debtors' assets declared a default as defined by the cash collateral order. Debtors are now out of business, and the cases may be administratively insolvent. The Fund Creditors hold administrative claims which have not been paid in full. They move to disgorge professional fees paid on an interim basis under § 331 to Debtors' counsel and to counsel for the Official Unsecured Creditors Committee so that these funds can be allocated among administrative creditors. The Court denies the motion because the payment of the professional fees sought to be disgorged are the subject of a carve-out in cash collateral orders.

A carve-out is an agreement pursuant to which a secured creditor allows post-petition proceeds otherwise subject to its secured claim to be exclusively earmarked to pay professionals. In other words, the secured creditor agrees to carve out funds to which it is entitled by virtue of its secured status for payment of professionals. Carve-outs are a response to the uncertainty of payment of administrative expenses inherent in Chapter 11 cases.

The cash collateral orders in this case defined the "carve-out costs" as: (1) fees payable to the Clerk of this Court; (2) the Court approved professional fees of attorneys, accountants, and other professionals retained by the Debtors; (3) the

statutory United States Trustee fees; and (4) Creditor Committee expenses. The orders then provided that upon the occurrence of an event of default as defined by the orders, the liens and security interests of the bank in its collateral (including its replacement liens) and its super-priority claim shall be subject only to the right of payment of the carve-out costs. In other words, after default, the bank agreed that its right to collateral and to payment would be reduced by the amount of the carve-out costs, including the professional fees. Rather than the professional fees being paid with unencumbered estate property on a pro rata basis with other similar administrative claims, the bank agreed that after default the professional fees, as defined by the carve-out, are to be paid from property to which the bank is otherwise entitled. The existence of a valid carve-out precludes disgorgement of the interim fees.

L. *In re Duensing*, 18-10201, 2019 WL 937159 (Bankr. D. Kan. Feb. 22, 2019) (Nugent, J.)

The court had to decide two issues in connection with confirmation of a Chapter 12 plan: whether the debtors may direct that all plan payments on their student loans be applied first to principal (while acknowledging they would still be liable for accrued interest, which would be non-dischargeable), and whether the debtors' proposal that their farming assets be transferred to a trust at the end of the five-year plan period with an obligation of the trust to finish paying unsecured creditors over an additional five-year period violated § 1222(c).

As to the first question, the student loan lender (ECMC) argued that non-bankruptcy law (the Higher Education Act of 1965 and related regulations), which governs the relationship between student loan lenders, servicers, guarantors, and borrowers, including how the loan payments are to be applied (first to late charges and collection costs, then to outstanding interest, and finally to principal), overrides contrary provisions of the Bankruptcy Code. But the court believed there was no actual conflict between HEA and related regulations, on the one hand, and the Bankruptcy Code, on the other. The court concluded that modification of the student loan claims is permitted under § 1222(b)(2) and that § 1222(b)(11) provides that post-petition interest on student loans may be paid through the plan only if the debtors' disposable income is sufficient after paying the other allowed claims in full.

As to the second question, the debtors acknowledged that they could not satisfy the "best interest of creditors" test (§ 1225(a)(4)) within five years after confirmation. So, they proposed a seemingly creative solution that included transferring their farming assets to a trust at the end of the five-year plan period and obligating the trust to continue paying unsecured creditors for another five years. The Chapter 12 trustee objected on the ground that paying the unsecured claims over ten years violated § 1222(c). The debtors contended that the transfer to the trust at the end of five years was a "balloon payment." But the court said to qualify as a balloon payment, the obligation needed to be paid in full. Here, the unsecured creditors were not being paid in full until ten years after confirmation. So, the court denied confirmation.

M. *In re Graves Farms*, 18-10893, 2019 WL 3407134 (Bankr. D. Kan. July 26, 2019) (Nugent, J)

This case also involves the confirmation of a Chapter 12 plan. Here, the plan was a joint plan involving three related cases filed by Graves Farms (a partnership) and its two individual partners and their spouses. The decision provides an excellent primer on Chapter 12 confirmation issues, as well as a discussion of Kansas partnership issues. The facts are extensive and complicated. In a nutshell, Graves Farms filed a Chapter 12 petition in May 2018. A few months later, the primary lender (RCB Bank) sought and received charging orders in state court that encumbered the partnership interests of the two partners, Dean and Mike Graves. Dean and his wife filed their Chapter 12 case a few days later. But Mike and his wife waited to file Chapter 12 until after the Bank foreclosed on Mike's partnership interest and purchased that interest at a sheriff's sale that was confirmed by the state court. As a result, the Bank was the "transferee" of Mike's partnership rights under the Kansas Uniform Partnership Act entitling it to claim any of Mike's distribution rights and to seek dissolution and wind up of the partnership. While the debtors were in Chapter 12, Mike's daughter, Kylee, joined the farming operation, acquired farm leases that were formerly the partnership's, personally borrowed money that she contributed to the operations, personally borrowed money to acquire some of the partnership's machinery and equipment, and agreed to acquire the remainder of the partnership's assets that were pledged to the Bank before or at the end of the 5-year plan term.

The court concluded that the joint plan could not be confirmed for a number of reasons. First, the court found that the joint plan did not accurately or adequately describe the "new contract" the plan was supposed to represent under § 1227—in fact, the court said the proponents of the plan had taken multiple positions about the plan's meaning and intent on several key issues. Next, the court said the plan impermissibly provided payment of a non-debtor's (Kylee's) debts—but it's interesting to note that the court suggested that combining the three estates together under the plan to pay the debts of the three estates "might make for a reasonable settlement proposal." The court then looked at the partnership aspects of confirmation and concluded that the Bank would be entitled to Mike's distributions from the partnership and could also seek dissolution and windup of the partnership; moreover, any profits of the partnership during the administration would have to be paid to unsecured creditors as disposable income under § 1225(b). The court also determined that the partners' individual bankruptcy filings caused both of them to "dissociate" as partners, likely resulting in the dissolution of the partnership, which in turn would mean the person winding up the partnership may only preserve the business for a "reasonable time" in order to settle and wind up its business—all of which together called into question the long-term viability of the partnership, and there was nothing in the joint plan to address that concern. The court also concluded that the joint plan was not feasible for any of the debtors.

N. *Wagner v. Union State Bank (In re Wagner)*, 18-5016, 2019 WL 1995606 (Bankr. D. Kan. May 3, 2019)

The debtors filed two bankruptcy cases in less than a year. The first was a Chapter 13 designed to halt the foreclosure of their home. The second was also a Chapter 13 case (later converted to chapter 7). In the second case, the debtors moved to extend the automatic stay under § 362(c)(3) but carved out of that extension *in rem* relief as to their home to allow the lender to complete the foreclosure. The lender also sought *in rem* relief from the automatic stay, which the court granted. But when the lender got to state court, it insisted on the entry of a judgment against the debtors that included *in personam* relief that would allow the lender to pursue the debtors personally if their second bankruptcy case were later dismissed. Counsel for the debtors repeatedly resisted the lender's efforts and objected to entry of such an order at the hearing before the state court. But the state court granted the provisional *in personam* relief anyway, thinking it did not run afoul of the automatic stay or the bankruptcy court's orders.

The debtors then filed an adversary proceeding against the lender to hold it in contempt for violating the automatic stay. The bankruptcy court granted the debtors' motion for summary judgment, concluding that the state court judgment violated the bankruptcy court's order extending the automatic stay (with the carveout for *in rem* relief for the foreclosure), the order granting the lender *in rem* relief from the automatic stay, and the automatic stay. In his decision, Judge Nugent reminds us that a state court judgment entered in violation of the automatic stay is void *ab initio* and has no legal effect in the 10th Circuit (citing *Ellis v. Consol. Diesel Elec. Corp.,* 894 F.2d 371, 372 (10th Cir. 1990) and *Franklin Savs. Ass'n v. Office of Thrift Supervision*, 31 F.3d 1020, 1022 (10th Cir. 1994)). [Note the same is true in the 8th Circuit—*LaBarge v. Vierkant (In re Vierkant)*, 240 B.R. 317, 325 (B.A.P. 8th Cir. 1999)]. Such void orders are "not binding on the bankruptcy court, and cannot be saved by collateral estoppel, res judicata, or the *Rooker-Feldman* doctrine." And the delayed or conditional enforcement of the state court judgment did not cure the stay violaton. Having found the lender violated the automatic stay in such a willful manner, the court set a continued hearing to determine damages. But the parties reached a confidential settlement, and the adversary proceeding was dismissed with prejudice in an agreed journal entry and order.

IV. Other Noteworthy Cases

A. *Thomas v. City of Philadelphia*, 759 F. App'x 110 (3d Cir. 2019)

In this case, the Third Circuit limited nonbankruptcy courts' authority to use § 105(a) to impose sanctions.

After the bankruptcy court entered the discharge injunction in Debtor Milton Thomas' bankruptcy case, the City of Philadelphia attempted to collect discharged tax debts on rental properties Mr. Thomas owned. Mr. Thomas filed a separate action for sanctions in district court, rather than in bankruptcy court. The district court sanctioned the City under 11 U.S.C. § 105(a).

Vacating the district court's imposition of sanctions for lack of subject matter jurisdiction, the Third Circuit held that only bankruptcy courts and district courts sitting in bankruptcy have jurisdiction to sanction creditors for violating the discharge injunction. The Third Circuit explained "§ 105(a) has limited scope, supplementing 'specifically enumerated bankruptcy powers by authorizing orders necessary or appropriate to carry out provisions of the Bankruptcy Code.'" It does not authorize courts to impose sanctions outside of bankruptcy. Because Mr. Thomas sought sanctions in a separate action outside of bankruptcy, his action fell outside the scope of § 105(a), and the district court lacked subject matter jurisdiction.

B. *SummitBridge Nat'l Invs. III, LLC v. Faison (In re Faison)*, 915 F.3d 288 (4th Cir. 2019)

The Bankruptcy Code does not prohibit a creditor from filing an unsecured claim for attorney's fees incurred post-petition if a prepetition contract guarantees them, according to the Fourth Circuit. A bank and debtor executed several promissory notes secured by deeds of trust. The promissory notes stated that if they were placed for collection, the debtor would pay "all costs of collection, including but not limited to reasonable attorneys' fees."

The debtor filed an individual Chapter 11 bankruptcy petition, and the bank assigned its claims to a third party. The third party began defending the proofs of claim and incurred attorneys' fees. The debtor objected to the third party's unsecured claim for post-petition attorneys' fees, principally arguing the Bankruptcy Code did not permit the third party to file a claim for post-petition attorneys' fees. The bankruptcy court sustained the debtor's objection, and the district court affirmed.

The Fourth Circuit reversed and remanded. The Court principally relied on the Supreme Court's decision in *Travelers Casualty & Surety Co. of America v. Pacific Gas & Electric Co.*, 549 U.S. 443 (2007) in which the Court rejected a ruling disallowing post-petition attorneys' fees incurred litigating bankruptcy law-related issues. Under *Travelers*, courts should presume enforceable state law claims are allowed in bankruptcy unless otherwise expressly disallowed.

Additionally, the Fourth Circuit held that neither 11 U.S.C. § 502(b) or § 506(b) expressly disallowed the third party's unsecured claim for post-petition attorneys'

fees. The promissory notes established the third party's rights to post-petition attorneys' fees before the debtor filed his bankruptcy petition, and they were not disallowed under § 502(b). Plus, an over-secured creditor's ability to collect attorneys' fees under § 506(b) did not by negative implication prohibit an under-secured creditor from filing an allowable unsecured claim if the claim was otherwise valid under state law.

C. *McBride v. Riley (In re Riley)*, 923 F.3d 433 (5th Cir. 2019)

This case required the Fifth Circuit to examine a troubling business model gaining traction with debtors' attorneys in the Western District of Louisiana. Under the "no-money-down business model," debtors' attorneys would advance debtors' prepetition costs (including filing fees, credit counseling course fees, and credit report fees) then (1) propose Chapter 13 plans providing for reimbursement of those costs as administrative expenses of the bankruptcy estate, and (2) enter into "no look" fee arrangements that omitted reimbursement for the advanced costs. The bankruptcy court held that the advanced costs were non-reimbursable under the district court's standing order on no-look fees and § 503(b)(1). It also held that bankruptcy courts lack discretion to ever award reimbursement for advanced costs under §§ 502(b)(2) and 330.

The Fifth Circuit affirmed in part and vacated in part. First, the Fifth Circuit determined the bankruptcy court did not err in holding that the district court standing order on no look fee arrangements required no look fees to include advanced costs.

Second, the bankruptcy court did not err in holding that the advanced costs were not reimbursable "administrative expenses." Applying "a two-prong test for determining whether a debt is an 'administrative expense' necessary for preserving the estate," the Fifth Circuit agreed with the bankruptcy court that: (1) the advanced costs did not "arise from a post-petition transaction with the estate," but arose from the attorney's pre-petition transaction with the debtor; and (2) the services received in exchange for the debt for the advanced costs did not "directly benefit the estate."

Finally, the Fifth Circuit vacated the bankruptcy court's holding that bankruptcy courts lack discretion to ever award reimbursement for advanced costs under §§ 502(b)(2) and 330, holding "§ 330(a)(4)(B) permits bankruptcy courts to reimburse debtor's counsel for costs of advancing such fees as reasonable compensation, but it does not require them to do so." Under the plain language of § 330(a)(4)(B) bankruptcy courts have discretion to determine whether reimbursement for the advanced costs constitutes "reasonable compensation for representing the interests of the debtor in connection with the bankruptcy case" "based on a consideration of the benefit and necessity of such services to the debtor and other factors set forth in [§330]."

D. *In re Jaffe*, 932 F.3d 602 (7th Cir. 2019)

Under Illinois exemption law, a Chapter 7 debtor was not entitled to avoid a judgment lien on tenancy by the entirety property. At filing, the debtor claimed an exemption in property he and his non-filing spouse owned in tenancy by the entirety. When his wife died post-petition, the debtor sought to avoid a judgment lien on the property as impairing his tenancy by the entirety exemption under § 522(b)(3)(B). The bankruptcy court denied his motion to avoid the lien. The district court reversed and remanded.

The Seventh Circuit reversed the district court, holding that the debtor could not avoid the lien because his interest in the property was a nonexempt contingent future interest. First, under Illinois law, the judgment lien attached only to the debtor's "survivorship interest in the entire property at the event of the other tenant's death" (a contingent, future interest), not to his present tenancy interest. Second, though Illinois law exempts present tenancy interests (which prevented the lender from foreclosing during his spouse's life), it does not exempt contingent, future interests in tenancy property. Because § 522(b)(3)(B) exempts an interest in property only to the extent state law exempts "such interest," the Seventh Circuit focused on the interest the debtor sought to exempt: his survivorship interest in the tenancy property. Illinois did not exempt such survivorship interest, so the debtor was not entitled to claim the federal exemption.

Note: compare this case to *CRP Holdings A-1, LLC v. O'Sullivan (In re O'Sullivan)*, 914 F.3d 1162 (8th Cir. 2019) (summarized above), where the Eighth Circuit permitted a husband to avoid as impairing his homestead exemption a judgment lien on property he and his spouse held in tenancy by the entirety. For a discussion of these cases, see the *Rochelle's Daily Wire* articles dated February 5, 2019 ("A Judgment Lien on Entireties Property Is Avoidable in Missouri, Eighth Circuit Says"), and August 7, 2019 ("A Judgment Lien on Entireties Property Isn't Avoidable in Illinois, Seventh Circuit Says").

E. *Cranberry Growers Coop. v. Layng*, 930 F.3d 844 (7th Cir. 2019)

Payments made by a debtor's customers directly to a prepetition/debtor-in-possession (DIP) lender used to pay down a revolving line of credit were disbursements for the purposes of calculating United States Trustee (UST) quarterly fees. When the debtor filed for Chapter 11 bankruptcy relief, it owed a bank over $8.1 million on its revolving line of credit. The bank also lent the debtor $5 million of DIP-financing, and the debtor agreed that proceeds from its inventory sales would be paid directly to the bank, first paying off the prepetition debt and then the post-petition amount. Thus, the debtor's customers directly paid the bank when they purchased inventory, and the bank extended funds for operating expenses to the debtor on a weekly basis.

The UST filed an administrative claim seeking additional quarterly fees, arguing the direct revolver payments were disbursements for the purposes of calculating UST quarterly fees under 28 U.S.C. § 1930(a)(6). The debtor objected to the claim, arguing the direct revolver payments were accounts receivable that paid

down the revolving line of credit, which the debtor would draw on to finance its operations. The bankruptcy court sustained the objection, and the UST filed a direct appeal to the Seventh Circuit.

The Seventh Circuit reversed. Giving the term "disbursements" its plain and ordinary meaning because it is not otherwise defined in the Bankruptcy Code, the Seventh Circuit held disbursements are payments made in the ordinary course of business to secured or unsecured creditors directly or indirectly paid on the debtor's behalf, including payments on revolving lines of credit. The Seventh Circuit rejected the debtor's argument that the amount of direct revolver payments affected the amount of credit they were extended for operating expenses because the bank funded operating expenses weekly based on a budget the debtor submitted to the bank. The direct revolver payments and the weekly funding of operating funds were therefore separate transactions.

The Seventh Circuit refused to consider the debtor's constitutional argument that the UST's amended fee schedule violated the Bankruptcy Clause of the Constitution because it was not uniformly applied nationwide until October 2018. The Seventh Circuit nevertheless gave an extensive history of the UST fee system and explained that the debtor's failure to raise the constitutional argument with the bankruptcy court made the argument untimely and was a blatant effort to offset the amount it owed the UST.

F. *In re Fulton*, 926 F.3d 916 (7th Cir. 2019)

In this case, the Seventh Circuit considered and rejected the City of Chicago's arguments that the automatic stay did not apply to it.

After enacting an ordinance that subjected impounded vehicles to possessory liens in favor of the City, the City of Chicago began refusing to release impounded vehicles to Chapter 13 debtors. In four cases consolidated on appeal, the bankruptcy court sanctioned the City for violating the automatic stay and ordered it to return the debtors' vehicles.

The Seventh Circuit affirmed. Under *Thompson v. General Motors Acceptance Corp.*, 566 F.3d 699 (7th Cir. 2009), the City's post-petition retention of the impounded vehicles violated the automatic stay and turnover of the vehicles was compulsory despite the creditor's right to seek adequate protection. Rejecting the City's "necessity" defense, the court determined City did not need to retain the vehicles to prevent their loss or destruction because the City could seek adequate protection through other methods available under the Bankruptcy Code.

The Seventh Circuit also held that neither § 362(b)(2) nor § 362(b)(4) excepted the City from the automatic stay. Section 362(b)(2) did not apply because the City's lien would survive involuntary loss of possession of the vehicles. Section 362(b)(4) also did not apply under either governing test: the "pecuniary purpose test" did not apply because permitting the City to retain possession would give it an advantage over other interested parties; the "public policy test" did not apply because the principal purpose of the impoundment was to collect revenue, not effectuate public

policy. In any event, the automatic stay prevented the City from enforcing its judgments against the debtors because the determinations of the debtors' liability constituted "money judgments" "that cannot be enforced without violating the automatic stay if [they] require payment."

G. *Derham-Burk v. Mrdutt (In re Mrdutt)*, 600 B.R. 72 (B.A.P. 9th Cir. 2019)

Failure to make direct mortgage payments provided for in a Chapter 13 plan will cause debtors to forfeit their discharge because direct mortgage payments are payments under the plan. Chapter 13 debtors confirmed a 0% plan providing for direct ongoing mortgage payments and for either a mortgage loan modification or repayment over time for curing their nearly $65,000 in prepetition mortgage arrears. Five years later, one of the debtors died from cancer, and the surviving spouse made the last plan payment. The mortgage lender filed a motion for relief from the automatic stay because the debtors failed to make over $120,000 in ongoing mortgage payments. The surviving spouse filed a motion to modify the plan to surrender the home. The bankruptcy court approved the plan modification, but the BAP reversed.

The BAP first determined that under 11 U.S.C. § 1328(a), direct mortgage payments are payments under the plan if the plan provides for them. Citing the Fifth Circuit's decision in *Kessler v. Wilson (In re Kessler)* and the "overwhelming majority" of bankruptcy courts holding similarly, the BAP interpreted the "provided for by the plan" language of § 1328(a) to include claims for which the plan cures a default and allows for the maintenance of regular payments. The BAP stated this interpretation avoids creating different outcomes in jurisdictions where the trustee makes ongoing maintenance payments versus jurisdictions where the trustee does not. In any jurisdiction, the promise to make ongoing payments to a mortgage creditor is a non-severable and mandatory element of the treatment of claims subject to § 1322(b)(5).

The BAP also noted that it would be inequitable to allow debtors in cases paying less than a 100% dividend to unsecured creditors to receive a discharge if they failed to make their ongoing mortgage payment because debtors got to reduce the amount of their disposable income under the means test by the amount of their monthly mortgage payment. The BAP felt this issue was especially relevant in the case before it because the debtors' plan paid a 0% dividend, raising questions of good faith when the plan was confirmed and even presently as the surviving spouse was seeking to modify the plan.

Because the debtors failed to pay their ongoing mortgage payments, their plan payments were not complete, meaning the motion to modify was timely. This, however, was of little benefit, because the surviving spouse's motion to modify the plan to surrender the residence called for a payment to be made outside of the 60-month time limit of § 1329(c). Despite strictly characterizing the time limit of § 1329(c), the BAP expressed a more relaxed view of the time limit for debtors who seek reasonable extensions of time beyond 60 months to catch up on missed plan payments. The surviving spouse's request to surrender the home seven months after

the expiration of the 60-month period was not reasonable, so the BAP declined to extend the time-period.

H. *Moore v. Auto. Fin. Corp.*, No. 2:19-cv-223-ALB, 2019 WL 3323328 (M.D. Ala. July 24, 2019)

After Plaintiff Ray Moore received a bankruptcy discharge of his debt to Defendant Automotive Finance Corporation, he applied to a third-party entity, AuctionAccess, to obtain credentials to access automobile auction sites. At Automotive Finance's request, AuctionAccess rejected Mr. Moore's application. Automotive Finance later agreed to allow Mr. Moore to obtain credentials through AuctionAccess if he paid Automotive Finance $2,000. Mr. Moore sought civil contempt sanctions against Automotive Finance for allegedly attempting to collect a discharged debt in violation of the discharge injunction. Automotive Finance filed a motion to dismiss for failure to state a claim.

The bankruptcy court dismissed with prejudice, and the district court affirmed. Applying *Taggart v. Lorenzen*, 139 S.Ct. 1795 (June 3, 2019), the district court concluded Mr. Moore's complaint failed to state a claim because "there is an objectively reasonable basis for concluding that the creditor's conduct might be lawful." It summarized the effect of the discharge injunction as follows: (1) "the bankruptcy discharge does not eliminate the underlying debt, but only the debtor's personal liability for paying the debt," citing *Matter of Edgeworth*, 993 F.2d 51, 53 (5th Cir. 1993); (2) with some exceptions, "a creditor is not required to do business with a debtor just because the debtor has received a discharge in bankruptcy," citing *Brown v. Penn. State Emps. Credit Union*, 851 F.2d 81, 85 (2d Cir. 1988); (3) "a creditor can require a debtor to pay a discharged debt as a condition of continuing a business relationship," citing *DuBois v. Ford Motor Credit Co.*, 276 F.3d 1019, 1023–24 (8th Cir. 2001); and, (4) "a debtor may choose—because of a business relationship, a feeling of personal responsibility, or for some other reason—to pay a discharged debt," citing § 524(f). Because "a creditor can lawfully tell a third-party credentialing service that it should not credential a debtor because of a discharged debt," "at the very least" there was an objectively reasonable basis to conclude AuctionAccess acted lawfully. Thus, the bankruptcy court did not err in dismissing Mr. Moore's complaint.

THIS CASE IS CURRENTLY ON APPEAL BEFORE THE 11TH CIRCUIT.

I. *In re Imerys Talc America, Inc., et al.*, No. 19-103, 2019 WL 3253366 (D. Del. Jul. 19, 2019)

Sending a whopping 2400 lawsuits back to various state courts, the district court held that an indemnification agreement does not provide "related to" jurisdiction to a federal court unless the obligation to indemnify and defend is automatic as a matter of contract.

The removed causes of action concern Johnson & Johnson (J&J) and its talc supplier. Both companies have been mired in personal injury and wrongful death litigation, alleging the talc-based baby powder caused cancer. The supplier filed for

Chapter 11 bankruptcy relief, and J&J removed nearly 2400 lawsuits from state to federal court. J&J asked the district court to determine that the District of Delaware was the proper venue for all the removed causes of action.

J&J argued the removed causes of action were related to the supplier's bankruptcy because the indemnification agreement between the companies provided the supplier would indemnify, defend, and hold J&J harmless from "all liabilities arising out of any violation by [the supplier] of any law, ordinance[, or] regulation" but not any acts or omissions directed by J&J.

The district court disagreed and held that a federal court does not have related to jurisdiction over removed causes of action when the basis for related to jurisdiction is contingent third-party indemnification claims against a debtor. The factual and legal basis for J&J's claim of indemnification against the supplier had not yet been clearly established by any court. Therefore, the removed causes of action would not have a conceivable effect on the debtor's bankruptcy and the district court lacked jurisdiction over the removed causes of action.

The district court was also unmoved by J&J's argument that the district court had jurisdiction because J&J and the supplier have shared insurance and any judgment against J&J would reduce the coverage available to the supplier, thus impacting its bankruptcy estate. The district court also rejected J&J's argument that it and the supplier shared an identity of interest because the supplier provided the talc used in J&J's baby powder.

As an alternative basis for the district court's holding, it exercised its discretion to permissively abstain, principally citing the length of time the removed causes of action had been pending in state courts and the state law issues predominating them. The district court also noted J&J's attempt to remove the state law causes of action was an unvarnished and self-interested attempt to forum shop.

J. *Swafford v. Dept. of Educ. (In re Swafford)*, 604 B.R. 46 (Bankr. N.D. Iowa 2019)

A bankruptcy court wiped out nearly $175,000 of a couples' $200,000 in combined student loans when the wife was unemployed and staying at home to care for their three dependent children and the husband worked a manufacturing job with a stagnant salary and minimal prospects for promotion. The debtors, both of whom are in their thirties, both enrolled in a nursing program but flunked out. The husband previously obtained a Bachelor's degree in psychology but did not find bountiful employment in the field.

The debtors filed an adversary proceeding to determine repaying their student loans would impose an undue hardship on them and were thus dischargeable. The bankruptcy court applied the "totality of the circumstances" test to each of the debtors' student loans. First, the bankruptcy court determined the husband's annual income was not likely to increase because he lacked training to obtain a promotion. Similarly, the wife, who had been employed part-time only occasionally as a waitress in the past, was not likely to contribute a meaningful amount of income to the

household because any income she earned would be offset by childcare costs and a child support wage garnishment.

The bankruptcy court determined the debtors could reduce some of their household expenses. While the bankruptcy court did not suggest which expenses to reduce, it mentioned the couples' $400 monthly budget for eating out, travel expenses related to recreational sporting events, and recurring car repairs were excessive. However, the bankruptcy court noted that even eliminating these expenses would not give them enough disposable income to repay their student loans.

Last, despite the couple's eligibility for income-based repayment (IBR) programs, the inevitable continuing growth of their debt at a $0 monthly student loan payment in an IBR and the emotional toll of the growing debt on their marriage weighed in favor of discharging at least some of their student loans. Ultimately, the bankruptcy court determined that the debtors could repay three of the husband's smallest student loans, leaving them with about $24,000 (or 12% of the original $200,000) to repay.

A Comment on the "Totality of the Circumstances" test v. the Brunner *test:* Under the "totality of the circumstances" test, courts in the Eighth Circuit may only conduct an "all-or-nothing" undue hardship analysis on a loan-by-loan basis. Query whether the outcome would have been different (1) under the *Brunner* test, which permits partial discharges, or (2) if the husband had consolidated his student loans before filing for bankruptcy.

K. *In re Family Pharmacy, Inc.*, No. 18-60521, 2019 WL 3558023 (Bankr. W.D. Mo. Aug. 5, 2019) (on appeal)

This case required the court to determine whether to allow or disallow a senior secured lender's claim to postpetition default interest.

After a § 363 sale of consolidated Chapter 11 debtors' assets, the senior oversecured lender requested (among other amounts) $442,843.51 in postpetition interest calculated at an 18% default rate. Though the debtors were current at filing and the lender did not notify the debtors of the alleged default, the senior lender argued the debtors' failure to make postpetition payments triggered the default rate under the parties' contract. The debtors and a junior secured lender objected, arguing the debtors were not in default and requesting the court disallow the postpetition interest as an unenforceable penalty and for equitable reasons.

The court first considered whether the debtors' failure to make postpetition payments constituted a default. The parties cited no relevant authority on the issue, and "the case law is murky." Though the court noted "common sense might dictate that a debtor should not continue to make regular payments to secured creditors absent court order," and the court's cash collateral orders—which did not authorize the debtors to make postpetition payments to the senior lender—might have been a valid legal defense to the lender's claim, the court concluded that, under the facts of the case, the court did not need to determine whether the debtor was in postpetition

default because it determined default interest was not allowable under Missouri and federal bankruptcy law.

Turning to the allowability of default interest under Missouri law, the court explained that an 18% interest rate "is not *per se* illegal under Missouri law" if the parties agreed to it as liquidated damages, at contracting it was a "a reasonable prediction for the harm caused by breach," and the harms were "of a kind difficult to estimate accurately." However, if the clause was "unreasonably disproportionate to the amount of harm anticipated when the contract was made" or if the parties fail to present evidence of damages, the clause becomes an unenforceable penalty. In this case, the 18% default interest was an unenforceable penalty because the senior lender adduced no evidence of damages or evidence that the default rate was a reasonable prediction of harm and acceleration on the entire debt without clear and unequivocal notice was unduly harsh and uncorrelated to the senior lender's damages.

The court also disallowed the default interest under federal bankruptcy law. Though no Eighth Circuit authority controlled, most courts to have considered the issue permit disallowance of contractual postpetition interest for equitable reasons. In light of the large difference between default and nondefault interest rates, the unreasonableness of that differential, the potential windfall to the lender to the detriment of other creditors, the prejudice caused by the senior lender's tardiness in requesting default interest, and a junior lender's role in providing DIP financing that benefitted the senior lender, the court determined allowance of default interest would be inequitable under federal bankruptcy law. It denied the senior lender's request.

Note: the senior lender has appealed this decision to the Eighth Circuit Bankruptcy Appellate Panel.

L. *In re Bean*, No. 18-43091, 2019 WL 2713117 (Bankr. W.D. Mo. June 20, 2019)

A Chapter 7 trustee objected to a debtor claiming a $2650 head of family exemption under Mo. Rev. Stat. § 513.440. While the trustee conceded the debtor was the head of her family and could claim the $1250 base exemption amount, he argued the debtor could not claim the additional $350 per-child exemption for her four minor grandchildren because they were not her biological children. The debtor's counsel argued she should get the per-child exemption because she has custody of her grandchildren, she exclusively provides their financial support, she is biologically related to them, and she claims them as her dependents on her federal income tax return.

The bankruptcy court held that a non-parent relative may not claim the per-child exemption because the plain language of § 513.440 and Eighth Circuit Bankruptcy Appellate Panel precedent interpreting the statute make clear that "absent biological parenthood or its legal equivalent," a debtor may not claim the additional per-child exemption for grandchildren. Allowing the debtor to do so based on the facts before the court would conflict with the statute's unambiguous use of the word "children." Additionally, the court determined its holding was consistent with

In re Turpen, 482 B.R. 273 (B.A.P. 8th Cir. 2012), which held that "children" means the head of family's sons or daughters or children to whom the head of family has a biological or adoptive parental relationship.

M. *Reed v. PLT Construction Co., Inc. (In re BFN Operations LLC)*, 604 B.R. 268 (Bankr. N.D. Tex. 2019)

Adopting the "majority position," the U.S. Bankruptcy Court for the Northern District of Texas held that a contractor with the right to file a lien for uncompensated work and materials cannot receive a preference if the contractor's claim would have been fully secured if perfected prepetition.

Defendant constructed buildings on property the debtor leased, then executed a "Final Payment Lien Wavier," agreeing to release all liens in consideration for payment in full. The debtor paid in full its debt to the defendant after the parties executed the final payment lien waiver but before the debtor filed its Chapter 7 case. The Chapter 7 trustee sought to avoid a portion of the debtor's payments to the defendant as preferences. The only preference element at issue was whether the relevant payments "enabled the creditor to receive a larger share of the estate then if the transfer had not been made.

The court granted summary judgment in favor of the defendant, holding the relevant transfers did not meet the definition of a preference: they did not enable the contractor to receive a larger share of the estate than it would have received in a hypothetical liquidation because the contractor had a right to file a lien on the petition date. Had the contractor not been paid in full, it would have had a claim secured by the debtor's leasehold interest because, under the terms of the final payment lien waiver, the defendant did not waive its statutory inchoate lien rights in the debtor's leasehold interest until paid in full. The defendant also was not required to perfect its inchoate lien prepetition because state law permitted the creditor to perfect its lien at the time it received the final payment. Finally, the trustee failed to meet its burden to prove the defendant would not have received the full value of its claim in a hypothetical Chapter 7 liquidation. Finding no genuine dispute of material fact, the court determined the defendant was entitled to summary judgment.

N. *In re Edwards*, 603 B.R. 516 (Bankr. S.D. Fla. 2019)

In light of the Supreme Court's decision in *United Student Aid Funds, Inc. v. Espinosa*, 559 U.S. 260 (2010), a homestead mortgage lender's failure to object to a plan violating the anti-modification provision of 11 U.S.C. § 1322(b)(2) allowed a debtor to receive a Chapter 13 discharge even though she underpaid her mortgage by about $5000. The decision suggested that the Eleventh Circuit case *Universal Am. Mrt. Co. v. Bateman (In re Bateman)*, 331 F.3d 821 (11th Cir. 2003), holding a mortgage lender's allowed prepetition arrearage claim survives plan confirmation, was no longer good law.

After several attempts, the debtor confirmed a second plan that misstated the ongoing mortgage payment, causing the debtor to underpay her mortgage by about $5000. The lender received notice of each version of the proposed amended plan and did not object. The lender also sent four notices of mortgage payment change, and the debtor never amended her plan. Four years later, the lender objected to the trustee's notice of final cure. The debtor received her discharge and filed a motion for an order stating her mortgage was current and that any claim for post-petition arrears was unenforceable. The mortgage lender argued the debtor was not current on her mortgage under § 1322(b)(5).

The bankruptcy court held the debtor did not have to pay the post-petition mortgage arrears because the confirmed plan controls under § 1327(a), as the Supreme Court explained in *Espinosa*. A confirmed plan "is binding on all parties in interest, provided the debtor afforded such parties adequate notice, even if the plan violates the Bankruptcy Code and/or the Bankruptcy Rules." The bankruptcy court emphasized the binding effect of a confirmation order goes even beyond the estoppel principle of res judicata because it "extends to any issue actually litigated by the parties and any issue necessarily determined by the confirmation order, including whether the plan complies with [§§ 1322 and 1325]." The bankruptcy court also cited Eleventh Circuit decisions applying *Espinosa* in the claim objections context and holding similarly.

The bankruptcy court also declined to allow modification on equitable grounds, determining it was unclear whether the debtor had an affirmative duty to amend her plan in response to the mortgage lender's four notices of mortgage payment change that listed the correct mortgage payment. The bankruptcy court declined to do so especially because the mortgage lender "slept on its rights" to object or appeal the confirmation of her second plan. The lender did not appeal the decision.

Note: the bankruptcy court's application of *Espinosa* to *Bateman* may not make it bad law because *Bateman* concerned prepetition arrears, while the bankruptcy court addressed post-petition arrears.

O. *In re Schatz*, 601 B.R. 864 (Bankr. D. Conn. 2019)

Heed this case's warning: disclose, disclose, disclose.

In her disclosure of compensation, Chapter 7 debtor's attorney agreed not to share compensation with non-members of her firm. She agreed to receive $10,000 compensation for legal services (including for attendance at § 341 meetings) and received $2,500 compensation prepetition. However, an attorney who did not work at the debtor's attorney's firm attended several hearings and § 341 meetings as the debtor's "appearance counsel." Though the debtor's attorney and the appearance counsel informed the debtor that the appearance counsel would share some of the debtor's attorney's compensation, the appearance counsel did not timely file with the court a notice of appearance or disclosure of compensation. The attorneys provided poor representation: their failure to prosecute the debtor's motion to extend the automatic stay caused the court to deny the motion, the appearance counsel did not

adequately prepare for the hearings he attended, and the debtor's attorney routinely missed hearings and § 341 meetings.

The bankruptcy court determined the attorneys violated §§ 329 and 524, Rule 2016(b), and Rules 1.1 and 1.5 of the Connecticut Rules of Professional Conduct. The court ordered the debtor's attorney to disgorge all fees except the $2,500 she received prepetition and $310 reimbursement of expenses, ordered the appearance counsel to disgorge $500 in amounts the debtor's attorney had paid him, and denied the both the debtor's attorney and appearance counsel's late-filed fee applications.