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# Southeast Bankruptcy Workshop 2021

*Consumer Track*

## **Intersection of State Court Causes of Action in Bankruptcy**

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**“Oh what a tangled web we weave ...”<sup>1</sup>**

**When Bankruptcy Meets Divorce – making sense of the  
many complexities for consumer practitioners**

Divorce cases, by their very nature, are messy. Bankruptcy cases, because bankruptcy law is so very unique, are often complex. Thus, it stands to reason, that when these two areas of the law collide numerous issues arise for both Bankruptcy Practitioners and Domestic Attorneys. This intersection of laws can create impediments to plan confirmation, non-dischargeable obligations, automatic stay issues and even ethical dilemmas for the practitioner. Even though the passage of The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (“BAPCPA”)<sup>2</sup> significantly changed the impact that consumer bankruptcy filings have on domestic cases<sup>3</sup>, the interplay between the two still creates numerous issues the bankruptcy practitioner must address. This article will briefly outline the many issues the consumer bankruptcy attorney is likely to face when bankruptcy meets divorce. Whether the practitioner is retained before the divorce decree is entered but imminent, retained after the divorce decree is entered [but not consulted prior to the entry of said order] or having been retained by joint

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<sup>1</sup> Often attributed to Shakespeare, this is actually the writings of 19<sup>th</sup> century writer Sir Walter Scott.

<sup>2</sup> Publ. No. 109-8, 119 Stat 23 (2005)(hereinafter referred to as “BAPCPA”).

<sup>3</sup> The threat of a bankruptcy discharge to domestic obligation was largely eliminated except for 11 U.S.C. § 523(a)(15) in Chapter 13 cases only.

debtors who contemplate divorce during the pendency of a Chapter 13 case, each scenario presents unique challenges to the bankruptcy practitioner.

**A. Unique Considerations when one or both parties consult when divorce is imminent but not yet final**

Marriage termination is exclusively a matter of state law.<sup>4</sup> Either by agreement or by Court order after trial, couples terminate their marriage by a judicial decree of divorce. This state court order or decree can have profound implications for future bankruptcy filings (both chapter 13 and chapter 7) both for the parties and the consumer practitioner.

Certainly if both parties can consult together and be in agreement with the plan of action the inherent domestic issues in a consumer case can be minimized. But that is not always the case. What are some things to consider from a practical and “best practice” standpoint for the consumer practitioner when one or both parties consult prior to a divorce decree being entered?

- Do they pass the Means Test as a couple?
- Do they pass the Means Test only if they are divorced and DSO obligations are taken into account?
- Do they pass the Means Test if they are legally separated?
- Can you represent both in separate cases?
- Is Chapter 7 a proper course of action for both parties?

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<sup>4</sup> *Desylva v. Ballentine*, 351 U.S. 570, 580 (1956).

- What if one party needs a Chapter 7 and one party would benefit more from a Chapter 13?
- Can you represent both in separate cases?
- Are exemptions better as married or divorced?
- Interaction with Domestic Counsel and crafting a divorce decree when only one party consults?
- Close examination of language and construction of divorce decree?
- Hold harmless agreement language impact?
- How will the pending (and not yet known aspects of) divorce affect the feasibility of a chapter 13 petition?

As the practitioner can see, many issues are present when the divorce has happened or is about to happen prior to the filing of the bankruptcy petition whether that be Chapter 7 or Chapter 13. The practitioner for the debtor must be mindful of these issues when crafting the bankruptcy case.

As stated in *Goldilocks Bankruptcy and Divorce: Are the Adversarial Relationships Too Much Not Enough or Just Right*, “a pre-divorce chapter 7 bankruptcy can eliminate the need for domestic relations courts to ‘allocate’ the debt of the parties between the parties, and

instead can concentrate on allocating income and the parties' remaining assets between the parties to permit them a chance at a fresh start with their lives.<sup>5</sup>

**B. The Automatic Stay**

The cornerstone of any consumer case is the hailed *Automatic Stay*. 11 U.S.C. § 362 provides for that “automatic stay” or injunction which immediately comes into effect upon the filing of a petition for bankruptcy. This injunction prohibits almost any enforcement, liquidation or collection of any claim that arose pre-bankruptcy. But, just as the terms of the Bankruptcy Code giveth, the Code also taketh. BAPCPA greatly expanded exceptions to the automatic stay for domestic relations issues.<sup>6</sup>

11 U.S.C. § 362 provides:

(b) The filing of a petition under section [301](#), [302](#), or [303](#) of this title, or of an application under section 5(a)(3) of the [Securities Investor Protection Act of 1970](#), does not operate as a stay—

(2) under subsection (a)—

(A) of the commencement or continuation of a civil action or proceeding—

(i) for the establishment of paternity;

(ii) for the establishment or modification of an order for domestic support obligations;

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<sup>5</sup> ABI Journal June 2002.

<sup>6</sup> See generally 11 U.S.C. § 362(b)(2)

(iii) concerning child custody or visitation;

(iv) for the dissolution of a marriage, except to the extent that such proceeding seeks to determine the division of property that is property of the estate; or

(v) regarding domestic violence;

(B) of the collection of a domestic support obligation from property that is not property of the estate;

(C) with respect to the withholding of income that is property of the estate or property of the debtor for payment of a domestic support obligation under a judicial or administrative order or a statute;

(D) of the withholding, suspension, or restriction of a driver's license, a professional or occupational license, or a recreational license, under State law, as specified in section 466(a)(16) of the [Social Security Act](#);

(E) of the reporting of overdue support owed by a parent to any consumer reporting agency as specified in section 466(a)(7) of the [Social Security Act](#);

(F) of the interception of a tax refund, as specified in sections 464 and 466(a)(3) of the [Social Security Act](#) or under an analogous State law; or

(G) of the enforcement of a medical obligation, as specified under title IV of the [Social Security Act](#).

As such, under BAPCPA, most happenings in domestic relations cases the Automatic Stay is NOT applicable - perhaps the only true exceptions being the collection of DSO from

assets which are property of the estate<sup>7</sup> and the dissolution of the marriage WITH a corresponding determination of division of assets that are property of the estate.

However, even in the instance where there is a pending divorce action, lift of stay is often freely given or negotiated by counsel subject to limitations and ultimate oversight by the bankruptcy court. As an example, Relief from stay under Code § 362(d)(1) was granted to permit the divorce action to proceed. The bankruptcy court held that the equities weighed in favor of granting relief from the automatic stay to allow the non-filing husband's divorce suit against the debtor to be filed, and to allow the state court to make an equitable distribution award. However, no judgment affecting any rights the debtor had or claimed on the filing date of the bankruptcy petition in property that had not either been abandoned by the trustee or exempted by the debtor could be enforced without further order of the bankruptcy court. The entry of this order was without prejudice to the bankruptcy court's power, notwithstanding the pendency of any divorce litigation, to decree or approve the sale of property that might be subject to equitable distribution in the divorce case.<sup>8</sup>

### **C. Dischargeability of Marital and Support Debts**

We could write many long treatises about non-dischargeability of domestic obligations.

We could also dive deep on the issue of which domestic obligations constitute domestic support

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<sup>7</sup> See In re Coffey 2008 WL 234236 (Bankr. S.D. Ala. 2008). See also In re Rodriguez, 2010 WL 597224 (11th Cir., Feb. 22, 2010). Prior to confirmation, a child support creditor is unable to collect child support from the debtor because, at that point, all of the debtor's property is property of the bankruptcy estate and Code § 362(b)(2)(B), which excepts "the collection of a domestic support obligation from property that is not property of the estate," allows for an exception for the stay only as to funds that are not part of the bankruptcy estate. Following confirmation of the debtor's Chapter 13 plan, the exception permits creditor collection action, as, pursuant to the interpretation of Code § 1327(b) in Telfair v. First Union Mortgage Corporation, 216 F.3d 1333 (11th Cir. 2000), upon confirmation all of the estate property not necessary to fulfill the requirements of the plan reverts in the debtor personally as a matter of law. The creditor may nonetheless be precluded from collection activity, however, by the effect of the bankruptcy court's plan confirmation order.

<sup>8</sup> In re Takacs, 2008 WL 4401395 (Bankr. E.D. Va., Sept. 19, 2008)

obligations (“DSO”) and what constitutes property obligations. This paper will not attempt to dive into those complexities, but rather give a high level view of the dischargeability issues a practitioner must consider. For an excellent analysis of these issues see a prior ABI article entitled *Bankruptcy and Divorce: Critical Issues for Attorneys (and the Start of a Sad Country Song)*.<sup>9</sup>

There are two provisions in the Bankruptcy Code that apply to render marital and support debts non-dischargeable: 11 U.S.C. § 523(a)(5) and 523(a)(15). 11 U.S.C. 523(a)(5) renders non-dischargeable a debt that is a “domestic support obligation” and is applicable in Chapter 7, 11, 12 and 13. Whereas, 11 U.S.C. § 523(a)(15) is NOT applicable to chapter 13 cases and renders a debt a debt “to a spouse, former spouse, or child of the debtor,” other than a domestic support obligation, “that is incurred by the debtor in the course of a divorce or separation or in connection with a separation agreement, divorce decree or other order of a court of record, or a determination made in accordance with State or territorial law by a governmental unit.”<sup>10</sup>

There are four elements that must be established for a debt to be a domestic support obligation as defined in Code § 101(14A)(A)). The debt must be: (1) Owed to or recoverable by the debtor’s spouse, former spouse, or child (or the child’s parent, legal guardian, or responsible relative), or a governmental unit. (2) In the nature of alimony, maintenance, or support (including assistance provided by a governmental unit) of the spouse, former spouse, or child, without regard to whether the debt is expressly so designated. (3) Established or subject to establishment before, on, or after the date of the order for relief, by reason of applicable provisions of (i) a separation agreement, divorce decree, or property settlement agreement; (ii) an order of a court

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<sup>9</sup> ABI 2015 written by C.R. Bowles, David Badger, Justin Little and Hon. C. Ray Mullins.

<sup>10</sup> See 11 U.S.C. § 523(a)(5) and § 523(a)(15).

of record; or (iii) a determination made in accordance with applicable non-bankruptcy law by a governmental unit. (4) Not assigned to a nongovernmental entity, unless that obligation is assigned voluntarily for the purpose of collecting the debt.

Federal law, not state law, governs the determination of whether a debt is in the nature of support.<sup>11</sup> The court must look beyond the label given the debt in the parties' agreement or the state court order to examine whether the debt actually is in the nature of support or alimony.<sup>12</sup>

Where the debt arose from the parties' agreement, most courts state that a debt is in the nature of support or alimony if at the time of its creation the parties intended the obligation to function as support or alimony.<sup>13</sup> Similarly, when the debt was established in a court order, courts will look to the intent of the court to determine if the award was support or a property settlement.<sup>14</sup> In determining the intent of the parties, or of the domestic relations court, most courts will look beyond the text of the agreement or the order and consider the surrounding circumstances.<sup>15</sup>

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<sup>11</sup> In re Brody, 3 F.3d 35 (2d Cir. 1993); In re Jestice, 168 Fed. Appx. 39 (6th Cir. 2006) (the Sixth Circuit has created a four-part test for determining whether an obligation not designated as alimony or maintenance is actually in the nature of support and thus nondischargeable for purposes of § 523(a)(5)); In re Harrell, 754 F.2d 902 (11th Cir. 1985)

<sup>12</sup> In re Farelli, 312 Fed. Appx. 445 (3rd Cir. 2008); Cline v. Cline, 259 Fed. Appx. 127 (10th Cir. 2007).

<sup>13</sup> See In re Brody, 3 F.3d 35 (2d Cir. 1993); In re Gianakas, 917 F.2d 759 (3rd Cir. 1990); Tilley v. Jessee, 789 F.2d 1074 (4th Cir. 1986); In re Evert, 342 F.3d 358 (5th Cir. 2003); In re Reines, 142 F.3d 970 (7th Cir. 1998); In re Zamos, 300 Fed. Appx. 451 (9th Cir. 2008); Cummings v. Cummings, 244 F.3d 1263 (11th Cir. 2001).

<sup>14</sup> See, e.g., In re Smith, 586 F.3d 69 (1st Cir. 2009); In re Farelli, 312 Fed. Appx. 445 (3rd Cir. 2008); In re Kline, 65 F.3d 749 (8th Cir. 1995); In re Young, 35 F.3d 499 (10th Cir. 1994); Cummings v. Cummings, 244 F.3d 1263 (11th Cir. 2001).

See, e.g., In re Smith, 586 F.3d 69 (1st Cir. 2009) (to discern the divorce court's intent, in determining whether particular obligation constitutes a nondischargeable domestic support obligation under the Bankruptcy Code, bankruptcy courts look to a range of factors, including the language used by the divorce court and whether the award seems designed to assuage need, as discerned from the structure of the award and the financial circumstances of the recipients); In re Farelli, 312 Fed. Appx. 445 (3rd Cir. 2008) (the bankruptcy court properly considered the circumstances at the time of the state court decree to discern the intent of the state court when it divided the marital property); In re Yeates, 807 F.2d 874 (10th Cir. 1986) (the determination of the parties' intent "must be made by looking at the substance of the agreement viewed in the crucible of surrounding circumstances"); Cummings v. Cummings, 244 F.3d 1263 (11th Cir. 2001) (all evidence, direct or circumstantial, which tends to illuminate the parties' subjective intent is relevant to whether a particular obligation is in the nature of support).

However, some courts hold that it is proper to look beyond the text of the agreement or the order only if that document is ambiguous, in which case extrinsic evidence may be considered.<sup>16</sup>

So, a good flow chart for the consumer practitioner is as follows:

1. Is there a “debt” per the divorce decree?
2. Is there a “hold harmless” agreement?
3. Is the debt a domestic support obligation (“DSO”) pursuant to 11 U.S.C. § 101(14A)
4. If yes, then non-dischargeable pursuant to 11 U.S.C. § 523(a)(5) in either a chapter 13 or a chapter 7 and must be paid as a 11 U.S.C. § 507(a)(1)(A) or (B) priority through any plan of reorganization. Also, remember the implications of 11 U.S.C. § 704 and 11 U.S.C. § 1307.
5. If the debt is not a “DSO” should the client consider a chapter 13 instead of a Chapter 7 because of the interplay between 11 U.S.C. § 523(a)(15) and 11 U.S.C. § 1328?

#### **E. Impact of Property of the Estate**

What are some issues that arise regarding property of the estate in the context of when bankruptcy and domestic law intersects?

First, the automatic stay provisions ARE applicable if there is property division in the divorce decree where the subject property is property of the estate. Thus, the stay would need to be lifted to proceed with such a division and oversight by the Bankruptcy Court (see discussion *infra*).

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<sup>16</sup> See, e.g., *In re Littleton*, 189 Fed. Appx. 294 (5th Cir. 2006); *In re Yeates*, 807 F.2d 874 (10th Cir. 1986). This is because, in the case of a written agreement between the parties, the agreement is persuasive evidence of intent. *Tilley v. Jessee*, 789 F.2d 1074 (4th Cir. 1986).

At least one court has held that a Debtor's right to equitable distribution of marital assets WAS property of the estate.<sup>17</sup> In *In re Radinicki*, the bankruptcy court held that, under Pennsylvania law, a marital interest in property vests immediately upon the initiation of a divorce action when combined with the request for division of the assets. Thus, here, the debtor's marital interest in her estranged spouse's individual retirement account was property of the estate, where the debtor filed for divorce and requested equitable distribution of marital assets owned by herself and her estranged spouse prior to filing her bankruptcy petition, although on the petition date the state had neither granted a divorce nor resolved the debtor's request for equitable distribution.<sup>18</sup>

However, two separate opinions arising out of New Jersey state that a Chapter 7 debtor's interest in an equitable distribution award to be made to the debtor in a divorce action pending on the petition date is not part of the bankruptcy estate unless issued within 180 days post-petition.<sup>19</sup> Important in many of these cases is when the judgment of divorce is actually entered.

What about receipt of child support arrears? An Alabama bankruptcy court has held that a payment of \$11,207.64 the debtor received post-petition from the Alabama Department of Human Resources for child support arrears belonged to the Debtor, and not the adult son, and thus was property of the estate.<sup>20</sup>

#### **F. Fraudulent Conveyances Following Divorce**

Found in virtually every decree of divorce is a "property settlement" provision. Most often these transfers that are (or should be) disclosed in the bankruptcy petition are not

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<sup>17</sup> *In re Radinicki*, 419 B.R. 291 (W.D. Pa., 2009).

<sup>18</sup> See *In re Radinicki* *infra*.

<sup>19</sup> See *In re Howell*, 311 B.R. 173 (Bankr. D. N.J. 2004); *In re Berlingeri*, 246 B.R. 196 (Bankr. D. N.J. 2000).

<sup>20</sup> *In re Strikland*, 2010 WL 1417030 (Bankr. N.D. Ala. 2010).

scrutinized by the bankruptcy trustee. However, it can be a pitfall for the practitioner as bankruptcy courts sometimes address this issue and look to see if the property settlement of the divorce decree had the effect of defrauding one of the spouse's creditors.

Affirming In re Beverly, 374 B.R. 221 (9th Cir. B.A.P., July 24, 2007) on this issue, the Ninth Circuit Court of Appeals held that, under Code § 544(b), the Chapter 7 trustee may set aside a marital settlement agreement as actually fraudulent under California law, even where the parties receive reasonably equivalent value. The BAP found that the MSA was actually fraudulent because the debtor (an attorney) and his wife's divorce attorney purposefully structured the MSA so as to assign a \$425,000 community debt to the debtor, while exchanging assets with his wife so that he received approximately \$1 million in exempt assets, while she received nonexempt assets of about the same value.<sup>21</sup>

Also, at least one court has held that transfers within the preference period were avoidable when the transfers were effectuated prior to the agreement. In In re Paschall, 403 B.R. 366 (Bankr. E.D. Va 2009) and affirmed in 408 B.R. 79 (2009), the debtor and his then wife executed a marital agreement, under which the debtor agreed to transfer to the wife his interest in two properties owned as tenants in the entirety, outside the preference period, the Chapter 7 trustee could avoid, as preferential under Code § 547(b), the parties' subsequent conveyance of the properties to the wife via quitclaim deeds. Although the deeds were intended to implement the marital agreement and were executed pursuant to the parties' final divorce decree, they were executed within the preference period, and, because the marital agreement was not recorded, it was ineffective against the trustee. The former wife was an insider at the time of the transfers because the parties executed the quitclaim deeds prior to the date of their divorce. The transfers

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<sup>21</sup> In re Beverly, 551 F.3d 1092 (9th Cir. Dec 24, 2008)

were on account of an antecedent debt, namely, the debtor's obligation under the marital agreement to convey the properties. Although the debtor was not insolvent when the parties executed the marital agreement, he was insolvent by the time they executed the quitclaim deeds. As the quitclaim deeds for the properties were perfected by recordation within 30 days after the deeds were executed, under Code § 547(e)(2) the transfer of the debtor's interests in the properties occurred on the date upon which the quitclaim deeds were executed. The transfer of the two properties did not occur, as the former wife contended, upon execution of the marital agreement.<sup>22</sup>

But, another Court held that the transfer of the residence pursuant to divorce decree was not fraudulent: Amending and superseding its earlier opinion, the court held that a transfer of the parties' residential property from the debtor to her former husband pursuant to the parties' divorce decree was not fraudulent under N.Y. Debt. & Cred. Law § 273 or § 275. The matter turned on the issue of fair consideration, and the court said it had before it a fully negotiated agreement between the debtor and her former husband regarding the disposition of the marital assets that was adopted and incorporated into a valid state court judgment of divorce with no showing of collusion or intent to defraud creditors.<sup>23</sup> And, In In re Dirks, 407 B.R. 442 (6<sup>th</sup> Cir. B.A.P. 2009), the debtor's agreement that she would receive \$11,500 for her interest in the marital homestead and the consummation of that agreement in the divorce decree was a preferential transfer pursuant to 11 U.S.C. § 547(b). The Court held that the transfer was a sale

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<sup>22</sup> See *in Re Paschall infra*.

<sup>23</sup> *In re Cersosimo*, 2009 WL 3182989 (Bankr. E.D. N.Y., Sept. 29, 2009)

of the debtor's property interest in exchange for equivalent value.<sup>24</sup> Finally, the Ninth Circuit has held that a state court marital dissolution judgment that follows from a regularly contested divorce proceeding establishes "reasonably equivalent value" under 11 U.S.C. § 548(a)(1)(B) in the absence of fraud, collusion, or violation of state law.<sup>25</sup>

### G. Conflict of Interest

One of perhaps the greatest pitfalls and stresses for the consumer practitioner occurs when joint debtors in a pending chapter 13 mention the dreaded word "DIVORCE". What is the proper course of action when this happens?

1. Applicable rules: 1.4 (Communication); 1.6 (Confidentiality); 1.7 (Conflict of Interest General Rule); 1.8 (Conflict of Interest - Prohibited Transactions); 1.9 (Conflict of Interest - Former Client).
  
2. Hypothetical: Husband and Wife file Chapter 13 bankruptcy and some years into the plan they get divorced. They are now fighting about the bankruptcy: who will make the plan payments? How will the assets be divided? They come to their lawyer for advice. Can that lawyer now represent both debtors or does the lawyer have a conflict of interest? What should the lawyer do in this situation?
  
3. Hypothetical: Lawyer has represented husband and wife in a prior joint bankruptcy. They are now divorced. Now one (or both separately) wants to file another bankruptcy case. Can the lawyer ethically represent one or both in separate cases?

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<sup>24</sup> See *In re Dirks infra*.

<sup>25</sup> *In re Bledsoe*, 569 F.3d 1106 (9<sup>th</sup> Cir. 2009).

**H. Employment of other Professionals**

Chapter 13 debtors routinely employ special counsel to pursue pre-petition and post-petition causes of action that constitute property of the estate. Typically this involves some sort of personal injury cause of action where counsel for the Debtor-Plaintiff seeks employment. What about when a debtor or debtors employ divorce counsel. Does the Bankruptcy Code require court approval of special counsel's employment?

**1. 11 U.S.C. § 327**

11 U.S.C. Section 327 provides:

(a) Except as otherwise provided in this section, the trustee, with the court's approval, may employ one or more attorneys, accountants, appraisers, auctioneers, or other professional persons, that do not hold or represent an interest adverse to the estate, and that are disinterested persons, to represent or assist the trustee in carrying out the trustee's duties under this title.

(b) If the trustee is authorized to operate the business of the debtor under section 721 , 1202 , or 1108 of this title, and if the debtor has regularly employed attorneys, accountants, or other professional persons on salary, the trustee may retain or replace such professional persons if necessary in the operation of such business.

(c) In a case under chapter 7, 12, or 11 of this title, a person is not disqualified for employment under this section solely because of such person's employment by or representation of a creditor, unless there is objection by another creditor or the United

States trustee, in which case the court shall disapprove such employment if there is an actual conflict of interest.

(d) The court may authorize the trustee to act as attorney or accountant for the estate if such authorization is in the best interest of the estate.

(e) The trustee, with the court's approval, may employ, for a specified special purpose, other than to represent the trustee in conducting the case, an attorney that has represented the debtor, if in the best interest of the estate, and if such attorney does not represent or hold any interest adverse to the debtor or to the estate with respect to the matter on which such attorney is to be employed.

(f) The trustee may not employ a person that has served as an examiner in the case.

Although section 327 expressly requires court approval for a Chapter 13 TRUSTEE to employ special counsel, it is not entirely clear whether this requirement extends to the chapter 13 debtor. As such, a split has developed amongst the courts.

## **2. “No Approval Required” View**

A number of courts do not require court approval of a chapter 13 debtor’s retention of special counsel. These courts typically focus on the use of the word “trustee” in section 327(c). Typically the view is that section 327 applies only to a trustee, finding “nothing in the Bankruptcy Code suggests that the term ‘trustee’ used in 327(e) is intended to include a chapter 13 debtor.”<sup>26</sup>

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<sup>26</sup> In re Scott, 531 B.R. 640, 645 (Bankr. N.D. Miss 2015); See also In re Jones, 505 B.R. 229 (Bankr. E.D. Wis. 2014)

These courts also stress the absence in chapter 13 of the statutory equivalent to Bankruptcy Code 1107 and 1203, which give chapter 11 and chapter 12 debtors many of the rights and duties of the trustee. These courts conclude that 327 is inapplicable to a chapter 13 debtor's special counsel.

However, these courts also consistently require special counsel to disclose the compensation paid (or agreed to be paid) pursuant to Bankruptcy Code 329. Many of these courts have held that court approval of compensation may not be necessary, but disclosure is still likely required. Thus, most of the professionals retained by a debtor in bankruptcy may receive compensation without court scrutiny so long as they are paid entirely from sources other than the estate. But, counsel for the debtor must submit all of their compensation, regardless of source, to court scrutiny pursuant to Section 329 of the Code.

### **3. “Approval Required” View**

Contrasting, the Courts that have held that retention of special counsel DOES require court approval pursuant to Section 327 focus on the fact that the statutory scheme only makes sense this way and, to hold otherwise, would lead to some absurd results.<sup>27</sup>

### **4. 11 U.S.C. § 329(a) and Bankruptcy Rule 2016(b)**

Bankruptcy Code Section 329(a) mandates the disclosure of an attorney's transactions with a debtor. Federal Rule of Bankruptcy Procedure 2016(b) implements the attorney disclosure requirements contained in Bankruptcy Code Section 329(a). (See 3 Collier on Bankruptcy at 329.02 (16th ed. 2018).) Rule 2016(b) requires a debtor's attorney to disclose the compensation

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<sup>27</sup> See *In re Goines*, 465 B.R. 704 (Bankr. N.D. Ga 2012) and *In re Price* 2007 W.L. 1125639

that he or she has received or to disclose an agreement that he or she has made with a debtor concerning the attorney's compensation.

Rule 2016(b) states: "Every attorney for a debtor, whether or not the attorney applies for compensation, shall file and transmit to the United States trustee within 14 days after the order for relief, or at another time as the court may direct, the statement required by §329 of the Code including whether the attorney has shared or agreed to share the compensation with any other entity. The statement shall include the particulars of any such sharing or agreement to share by the attorney, but the details of any agreement for the sharing of the compensation with a member or regular associate of the attorney's law firm shall not be required. A supplemental statement shall be filed and transmitted to the United States trustee within 14 days after any payment or agreement not previously disclosed. Fed. R. Bankr. P. 2016(b)."

#### **5. Best Practices**

- File Application for Compensation out of abundance of caution
- Consult Local Rules
- At a minimum have divorce counsel file 329 disclosure

#### **CONCLUSION**

The intersection of bankruptcy law and domestic law is complex and full of many pot-holes for the unwary practitioner. These issues can permeate a consumer bankruptcy case before

## **SOUTHEAST BANKRUPTCY WORKSHOP 2021**

the bankruptcy is even filed and sink a case that is pending. The better the bankruptcy practitioner can navigate each of these issues the better the client understanding and outcome of the respective bankruptcy filing.

The Intersection of State Law and Bankruptcy Law

*Limitations on Pursuing State Court Claims: Standing, Collateral Estoppel, and Third-Party Releases*

I. STANDING

*In re Wilton Armetale*, 968 F.3d 273 (3d Cir. 2020)

The distinction between constitutional and bankruptcy standing was recently examined by the U.S. Court of Appeals for the Third Circuit in *Armetale*, in which the court of appeals held that the ability of a creditor to sue in bankruptcy is not a question of standing but, rather, an issue of statutory authority. Although the court was discussing federal court standing, the same analysis applies to claims creditors can seek in state courts as well. *Armetale* at 282.

The filing of a bankruptcy case alone does not cause a creditor to lose its constitutional standing to sue but the creditor could lose the statutory authority to pursue those claims. The Bankruptcy Code shifts statutory authority to pursue certain claims from the creditors to the trustee or the debtor-in-possession. The bankruptcy trustee or, by operation of section 1107(a) of the Bankruptcy Code, a chapter 11 debtor-in-possession, has the exclusive authority to assert estate claims and causes of action. *Id.* at 280. Thus, after a debtor files a bankruptcy petition, the debtor's creditors lack authority—sometimes referred to as "standing"—to assert claims that are estate property. *Id.*; accord *In re Emoral, Inc.*, 740 F.3d 875 (3d Cir. 2014); *In re Seven Seas Petroleum, Inc.*, 522 F.3d 575 (5<sup>th</sup> Cir. 2008); *In re Bogdan*, 414 F.3d 507 (4<sup>th</sup> Cir. 2005).

In *Armetale*, the creditor had a pending federal court action against the debtor's prior owners for fraudulent transfers. Soon after filing the district court case, the debtor filed chapter 7. As part of a bankruptcy settlement agreement, the trustee abandoned certain causes of action including those being brought by the creditor in district court. The debtor's owners moved to dismiss the creditor's pending court action in the district court. Instead of dismissal, the district court referred the action to the bankruptcy court because the creditor's claims were "related to" the bankruptcy. Upon referral, the bankruptcy court held that the creditor lacked standing to sue based on the theory that the claims were property of the estate and only the trustee could pursue the claims. On appeal, the district court agreed that the creditor lacked standing.

The Third Circuit clarified that a "litigant's 'standing' to pursue causes of action that became the estate's property means its *statutory* authority under the Bankruptcy Code, not its *constitutional* standing to invoke the federal judicial power." *Id.* at 280-281. The Third Circuit held that the creditor retained its constitutional standing to bring its claims but only the trustee had the statutory authority to assert the claims until the trustee abandoned the claims. The right to assert a cause of action once abandoned, reverts back to the prior holder. *Id.* at 284. By abandoning the claims, the trustee resurrected the creditor's power to prosecute them in district court.

*In re Hafen*, 616 B.R. 570 (B.A.P. 10<sup>th</sup> Cir. 2020)

In *Hafen*, a bankruptcy appellate panel from the Tenth Circuit ("BAP") held that the bankruptcy court is the only court with subject-matter jurisdiction to decide whether a claim or cause of action is property of a debtor's bankruptcy estate. The BAP concluded that the bankruptcy court abused its discretion by permitting a state court to determine whether creditors had "standing" to sue third-party recipients of alleged fraudulent transfers.

Roy Hafen, the individual chapter 7 debtor, scheduled over 5 million in unsecured debt based on investor claims in his pre-petition Ponzi scheme. Although the investors had notice of the bankruptcy filing, the investors did not take part in the case and the debtor received his discharge. Thirteen years after the bankruptcy case was closed, the investors moved to reopen the case asserting that the debtor fraudulently conveyed or concealed assets that could have been administered by the chapter 7 trustee. At the same time the motion to reopen was pending, the investors filed a state court action based on the Ponzi scheme and sought to recover the undisclosed assets against the Debtor, his wife and other related entities and parties.

The bankruptcy case was reopened and a chapter 7 trustee appointed. The debtor filed an action in the bankruptcy court seeking sanctions against the investors for violating the discharge injunction under §524 and asserting the investors lacked standing to file the state court complaint. The bankruptcy court declined to address the standing issue leaving it for the state court to decide. The debtor appealed.

The BAP determined that the investors were seeking state court relief under two claims: fraudulent conveyance and concealment. If the property subject to the fraudulent conveyance claim was property of the estate, then only the chapter 7 trustee would have standing to pursue the claim. Additionally, concealed assets can also be property of the estate since the discharge does not result in an abandonment of undisclosed property. The BAP stated that the bankruptcy court has exclusive subject matter jurisdiction to determine the question whether a claim is property of the estate and therefore, the issue of standing must be determined by the bankruptcy court, not state court. The panel found that to the extent that the bankruptcy court finds that the claims and assets at issue are property of the estate, the investors would not have standing in the state court lawsuit.

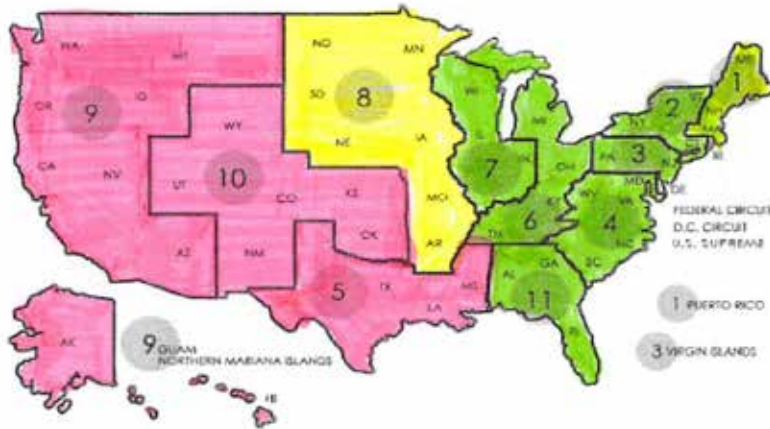
The BAP was also asked to address the bankruptcy court's decision denying the debtor's motion for sanctions for violation of the discharge injunction. In denying the debtor's request, the bankruptcy court relied on the investors' statements that in the state court action it was not their intent to collect from the debtor personally, but instead to collect property in possession of other parties to be held liable. Yet, the BAP pointed out that the investors allege that there was a unity of interest and ownership between the debtor and non-debtor parties to the extent that the separate personalities of the entities and individual no longer exist. If true, the BAP suggested that the safe harbor of §524(e) may not apply. However, absent a record that the state court claims and assets constitute property of the bankruptcy estate, the BAP could not review the bankruptcy court's decision under §524(e) denying the debtor motion for sanctions.





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The circuit courts of appeals are split as to whether a bankruptcy court has the authority to approve chapter 11 plan provisions that grant non-consensual release of nondebtors from liability. The split stems from statutory conflict between section 105(a) and section 524(e). Under section 105(a), a bankruptcy court “may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title,” but does not allow the bankruptcy court to create substantive rights that are otherwise unavailable under applicable law. Section 524(e) provides that the “discharge of a debt of the debtor does not affect the liability of any other entity on, or the property of any other entity for, such debt.” Therefore, many courts have found that §524(e) precludes the bankruptcy court from allowing injunctions of claims against third parties. This strict statutory interpretation against third party releases is a view that completely removes the court’s equitable powers under §105 from consideration. This map illustrates the current split in the circuits. Provided at the end of these materials are cases in each circuit discussing third party releases.



Despite this conflict, a majority of circuits recognize that courts can, in limited circumstances, approve non-consensual non-debtor releases using the broad equitable powers granted to bankruptcy judges in section 105 of the Code when the release is an integral part to a successful reorganization and necessary or appropriate to carry out the provisions of the Bankruptcy Code. In those circumstances, the bankruptcy court has the constitutional authority to approve nonconsensual, third-party releases. *See Behrmann v. National Heritage Foundation, Inc.*, 663 F.3d 704 (4<sup>th</sup> Cir. 2011).

In *Behrmann*, the Fourth Circuit described 7 factors that a court should consider in determining whether to allow a release provision in a chapter 11 plan. *Id.* at 711-712.

The 7 Factors are:

1. There is an identity of interest between the debtor and the third party.
2. The non-debtor has contributed substantial assets to the reorganization.
3. The injunction is essential to reorganization.
4. The impacted class, or classes, has overwhelmingly voted to accept the plan.

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halt the state and federal court actions to allow development of a confirmable plan to include settlement of all claims. The bankruptcy court granted the injunction which was then appealed by several district attorneys asserting that the bankruptcy court lacked subject matter jurisdiction over the government enforcement action between state officials and a third party non-debtor. The debtors' arguments in favor of injunction included:

- The pending state and federal actions would eviscerate the fundamental goals of the bankruptcy case and the value of the debtor's assets would rapidly be eroded by costs of litigation.
- The claims against the non-debtors are substantially identical and inextricably intertwined with claims against the debtor.
- A proposed settlement provided that 100% of the assets of debtor would be placed in trust for benefits of the claimants.
- In exchange for a full release, the debtor and related parties would contribute \$3 billion to the settlement fund.
- The debtor was obligated to indemnify current and former directors while subject to any possible litigation as a result of their role as officer or director.
- Evidence that legal fees to defend state and federal actions would exceed \$100 million in 2019.

The appellants argued that the bankruptcy court lacked jurisdiction to grant the injunction under 28 U.S.C. §1334(b) because the claims against one of the owners, Dr. Sackler, neither "arise in" nor are "related to" the debtors' bankruptcy because (1) the claims were filed prior to the bankruptcy case, (2) the claims are creatures of specific state law; and (3) only Dr. Sackler's personal assets, which were not essential to the debtors' reorganization, were at risk.

The District Court, in finding that the claims against Dr. Sackler were highly interconnected with the claims of the debtor, noted that a finding of liability against Sackler arising from his work on behalf of Purdue was equivalent to finding that Purdue itself was liable under the state court claims. *Id.* at 50. The Court upheld the injunction since the appellants' non-bankruptcy action has a "conceivable effect" on the debtors' estate.

The bankruptcy court judge initially found that the court's jurisdiction fell under the "related to" jurisdiction. Later, when the bankruptcy court extended the injunction, it added a second ground for its jurisdiction as "arising in" jurisdiction of section 1334. On appeal, the District Court disagreed that "arising in" jurisdiction applied. The District Court found that the appellants' claims against Dr. Sackler were only "related to" the Chapter 11 proceeding, not "arising in" the bankruptcy. *Purdue Pharm. at 55*. Matters that "arise in" the bankruptcy are identified as "core proceedings," and include a nonexclusive list of 16 types of cases that the bankruptcy courts may "hear and determine," and in which they may constitutionally enter orders and judgments. *See* 28 U.S.C. §157(b); *Wellness Intern. Network, Ltd. V. Sharif*, 575 U.S. 665, 135 S.Ct. 1932, 191 L.Ed.2d 911 (2015). "[A] bankruptcy court's 'arising in' jurisdiction includes claims that 'are not based on any right expressly created by [T]itle 11, but nevertheless, would have no existence outside of the bankruptcy.'" *Purdue at 55-56, citing In re Motors Liquidation Company*, 829 F.3d 135, 153 (2d Cir.2016). The District Court held that the claims against Sackler



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6<sup>th</sup> Circuit: *In re Dow Corning Corp.*, 280 F.3d 648 (6th Cir. 2002).

7<sup>th</sup> Circuit: *In re Airadigm Communications, Inc.*, 519 F.3d 640 (7th Cir. 2008); *In re Specialty Equip. Co., Inc.* 3 F.3d 1043 (7<sup>th</sup> Cir. 1993).

8<sup>th</sup> Circuit: *In re Armstrong Energy, Inc.*, 613 F.3d 529 (8<sup>th</sup> Cir. B.A.P. 2020).

9<sup>th</sup> Circuit: *In re Lowenschuss*, 67 F.3d 1394 (9th Cir. 1995); *Underhill v. Royal*, 769 F.2d 1426 (9th Cir. 1985).

10<sup>th</sup> Circuit: *In re W. Real Estate Fund, Inc.*, 922 F.2d 592 (10th Cir. 1990).

11<sup>th</sup> Circuit: *In re Seaside Eng'g & Surveying, Inc.*, 780 F.3d 1070 (11th Cir. 2015).

D.C. Circuit: *In re AOV Indus., Inc.*, 792 F.2d 1140 (D.C. Cir. 1986).

**The Intersection of State Law and Bankruptcy Law:  
*When is Abstention Appropriate or Required?***

Michelle M. Harner<sup>1</sup>

**Introduction**

Bankruptcy law generally seeks to consolidate and resolve all of a debtor’s financial matters in one forum, namely the bankruptcy court. Those matters may, however, involve state law claims or causes of action subject to prepetition litigation. Although the filing of the bankruptcy petition and the automatic stay of section 362(a) of the Bankruptcy Code<sup>2</sup> stop most of that litigation, the bankruptcy case does not necessarily eliminate the need to resolve the underlying claims and issues. Questions thus arise concerning the appropriate forum to determine those matters.

Tension between state and federal law is not new or novel, and it certainly is not limited to bankruptcy cases. Federal courts often strive to identify and respect appropriate boundaries with their state court counterparts. That endeavor is aided in bankruptcy cases by statutory guidance. Specifically, section 1334 of title 28 of the U.S. Code addresses when a bankruptcy court *must* and when it *may* abstain from hearing any particular matter in a bankruptcy case. These materials review the key factors in any abstention decision under section 1334 and summarize recent case law analyzing that statute in the context of prepetition state court litigation and state law claims.

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<sup>1</sup> United States Bankruptcy Judge, District of Maryland. These materials are written for educational purposes only, and do not express any opinions or positions regarding any issues that may arise, or any parties that may appear, in any cases before Judge Harner. Judge Harner appreciates the assistance of her paralegal, Kimberly Goodwin-Maigetter, on these materials.

<sup>2</sup> 11 U.S.C. §§ 101 et seq. (the “Code”).

**Abstention Under Section 1334**

A bankruptcy court may be required to abstain from a proceeding or may, in its discretion, abstain under the provisions of section 1334 of title 28 of the U.S. Code. Mandatory abstention is addressed in section 1334(c)(2) of title 28. That section provides:

Upon timely motion of a party in a proceeding based upon a State law claim or State law cause of action, related to a case under title 11 but not arising under title 11 or arising in a case under title 11, with respect to which an action could not have been commenced in a court of the United States absent jurisdiction under this section, the district court shall abstain from hearing such proceeding if an action is commenced, and can be timely adjudicated, in a State forum of appropriate jurisdiction.

28 U.S.C. § 1334(c)(2). A court also has the discretion to exercise permissive abstention under section 1334(c)(1) of title 28. The permissive abstention statute reads:

Except with respect to a case under chapter 15 of title 11, nothing in this section prevents a district court in the interest of justice, or in the interest of comity with State courts or respect for State law, from abstaining from hearing a particular proceeding arising under title 11 or arising in or related to a case under title 11.

28 U.S.C. § 1334(c)(1).

Courts addressing abstention under section 1334 consider a variety of factors. Those factors include the kinds of claims at issue and, with respect to permissive abstention, the facts and circumstances of the particular case. For example, courts generally conclude that they “must abstain when: (i) the case is based on state law causes of action, (ii) the case relates to a bankruptcy case but is not a core proceeding, and (iii) the case could not have been commenced in federal court in the absence of the bankruptcy filing and the case can be timely adjudicated in state court.” *In re Colleen, Inc.*, 406 B.R. 674, 679 (Bankr. D. Md. 2009).<sup>3</sup> Consequently, the characterization of a claim as core or non-

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<sup>3</sup> See also, e.g., *In re Foxwood Hills Prop. Owners Ass’n, Inc.*, No. AP 20-80049-HB, 2021 WL 1812668, at \*7 (Bankr. D.S.C. May 5, 2021) (“If the following six factors are met, the court *must* abstain: (1) the motion to abstain was timely; (2) the action is based on a state law claim; (3) the action is a ‘non-core’, ‘related to’ proceeding; (4) Section 1334 provides the sole basis for federal jurisdiction; (5) the action is commenced in state court; and (6) the action can be timely adjudicated in state court.”) (internal quotations and citations omitted) (emphasis in original); *Commonwealth*

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core under section 157 of title 28 of the U.S. Code and applicable case law often drive the mandatory abstention analysis.

Permissive abstention generally involves consideration of a much broader range of factors, such as:

- 1) efficiency in the administration of the debtor's estate;
- 2) the extent to which state issues predominate over bankruptcy issues;
- 3) whether the issues involve difficult or unsettled questions of state law that would be better addressed by a state court;
- 4) the presence of a related proceeding commenced in state court;
- 5) the existence of a jurisdictional basis other than [Section] 1334;
- 6) the degree of relatedness or remoteness of the proceeding to the main bankruptcy case;
- 7) the substance rather than form of an asserted "core" proceeding;
- 8) the feasibility of severing state law claims from core bankruptcy matters to allow judgments to be entered in state court;
- 9) the burden of the federal court's docket;
- 10) the likelihood that the commencement of the proceeding in federal court involves forum shopping by one of the parties;
- 11) the existence of a right to a jury trial; and
- 12) whether non-debtor parties are involved in the proceeding.

*In re Porter-Hayden Co.*, 304 B.R. 725, 735 (Bankr. D. Md. 2004).<sup>4</sup> From this general list of factors, courts often focus on efficiency in the administration of the debtor's estate, the extent to which state law issues predominate over bankruptcy issues, and the degree of relatedness or remoteness of the proceeding to the main bankruptcy case. Nevertheless, no

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*Assisted Living, LLC, Series E v. Vestavia Hills, Ltd.*, 616 B.R. 159, 170 (Bankr. N.D. Ala. 2020) (explaining that "there are three elements necessary to mandate abstention: (1) 'the proceeding is based on a state law claim which, although related to a title 11 case, does not arise under title 11 or out of a title 11 case;' (2) 'the proceeding could not have been commenced in federal court but for the bankruptcy;' and (3) 'the state court can timely adjudicate the cause of action'"); *In re Charles Evans Trucking Inc.*, 595 B.R. 715, 725 (Bankr. S.D. Miss. 2018) ("Accordingly, upon a party's timely motion, the bankruptcy court must abstain from hearing a state law claim when the following four conditions exist: (1) The only basis for federal jurisdiction is the bankruptcy jurisdiction conferred by 28 U.S.C. § 1334(b); (2) the bankruptcy court has related-to jurisdiction, not core jurisdiction, over the claim; (3) a lawsuit has been commenced in state court; and (4) the lawsuit could be timely adjudicated in state court. *Schuster v. Mims (In re Rupp & Bowman Co.)*, 109 F.3d 237, 239 (5th Cir. 1997) (interpreting 28 U.S.C. § 1334(c)(2)).").

<sup>4</sup> For different articulations of the multi-factor test for permissive abstention, see, e.g., *Masingill v. Servisfirst Bancshares, Inc.*, No. 2:20-CV-524-TFM-MU, 2021 WL 2178560, at \*8 (S.D. Ala. May 26, 2021); *In re Foxwood Hills Prop. Owners Ass'n, Inc.*, No. AP 20-80049-HB, 2021 WL 1812668, at \*9 (Bankr. D.S.C. May 5, 2021); *In re Kennedy*, No. 19-64620-WLH, 2021 WL 1396565, at \*4 (Bankr. N.D. Ga. Apr. 13, 2021); *In re Senior Care Centers, LLC*, 622 B.R. 680, 693 (Bankr. N.D. Tex. 2020).

one factor is a determinative. Rather, courts generally take a totality of the circumstances approach.

The following section summarizes a few recent cases<sup>5</sup> and highlights how courts handle requests to abstain from matters involving state law matters under section 1334.

### **Recent Abstention Decisions**

#### ***Criminal Issues***

- *In re Souffrant*, No. 18-40550-KKS, 2021 WL 1713265 (Bankr. N.D. Fla. Apr. 2, 2021). The debtor in this chapter 7 case was subject to a prepetition criminal action alleging public assistance fraud. The debtor's bankruptcy case appears to have been largely uneventful, and she received a standard discharge three months after the filing. The debtor then entered into a Pretrial Intervention Program Deferred Prosecution Agreement, under which she agreed to pay restitution in lieu of further prosecution. The debtor sought to reopen the bankruptcy case to initiate an adversary proceeding concerning the validity of the debt. In this context, the bankruptcy court examined whether the debtor could address the debt relating to her state law criminal matters in the bankruptcy case. The bankruptcy court relied on the Supreme Court's decision in *Younger v. Harris*,<sup>6</sup> explaining that "the Court opined that one reason for this longstanding public policy is that 'courts of equity should not act, and particularly should not act to restrain a criminal prosecution, when the moving party has an adequate remedy at law and will not suffer irreparable injury if denied equitable relief.'" 2021 WL 1713265, at \*2. It also reviewed Eleventh Circuit case law requiring abstention in matters involving a criminal action for theft by deception<sup>7</sup> and a state law foreclosure sale.<sup>8</sup> The bankruptcy court ultimately denied the requested relief because the debtor sought "no relief related to th[e] bankruptcy case or over which th[e] Court has jurisdiction, and because [the debtor's] Motions present an insufficient basis on which to interfere with state court proceedings." *Id.* at \*3.

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<sup>5</sup> This summary is not exhaustive but attempts to provide examples of issues raised in recent decisions.

<sup>6</sup> 401 U.S. 37 (1971).

<sup>7</sup> See *Barnette v. Evans*, 673 F.2d 1250, 1251 (11th Cir. 1982).

<sup>8</sup> See *Shepherd v. U.S. Bank Nat'l Ass'n as Trustee for Structured Asset Inv. Loan Trust, Mortg. Pass-Through Certificates Servs.*, 839 Fed. Appx. 304 (11th Cir. 2020). This decision is not a bankruptcy case, but rather involved claims against a mortgage lender to prevent foreclosure and quiet title under state law. The Eleventh Circuit held that the Rooker-Feldman doctrine did not apply because the state court litigation was on appeal, but concluded that dismissal was still appropriate under the abstention doctrine. The Eleventh Circuit explained, "we conclude that dismissal of the action was appropriate under the *Younger* abstention doctrine. While this abstention doctrine applies most often in cases involving pending state criminal prosecutions, the Supreme Court has extended it to apply to pending "state civil proceedings that are akin to criminal prosecutions, or that implicate a State's interest in enforcing the orders and judgments of its courts.'" *Id.* at 306 (internal citations omitted). Although section 1334 of title 28 of the U.S. Code generally governs abstention decisions in bankruptcy cases, parties may raise, and courts may consider, abstention under *Younger*. See, e.g., *In re Patriot Nat'l, Inc.*, 623 B.R. 696, 713 (D. Del. 2020) (analyzing abstention under section 1334(c) of title 28 of the U.S. Code and *Younger* and explaining the scope of the *Younger* doctrine); *PAPCO, Inc. v. Oleum Expl., LLC*, No. 3:19-CV-00589, 2019 WL 3252416, at \*5 note 2 (M.D. Pa. July 19, 2019) (in vacating bankruptcy court's order, the district court stated, "I express no view on the merits of the abstention issue, and the parties are free to relitigate it in the Bankruptcy Court through motion under *Younger* or 28 U.S.C. § 1334(c), if applicable, see *In re Kessler*, 430 B.R. 155 (Bankr. M.D. Pa. 2010)."); see also *In re Pacheco*, 616 B.R. 126, 132 (Bankr. D.N.M. 2020) (observing that the "comity doctrine is embodied not only in the bankruptcy permissive abstention doctrine, but also in other doctrines such as Rooker-Feldman and *Younger* abstention").

*Mortgage Issues*

- *In re Kennedy*, No. 19-64620-WLH, 2021 WL 1396565 (Bankr. N.D. Ga. Apr. 13, 2021). The debtor commenced an adversary proceeding against her mortgage lender after her bankruptcy case closed alleging violations of the automatic stay during the pendency of the case. The bankruptcy court first evaluated a court’s subject matter jurisdiction in this context, finding that “[b]ankruptcy courts have subject matter jurisdiction over Section 362(k) claims even where plaintiffs bring them after dismissal of the bankruptcy case.”<sup>9</sup> 2021 WL 1396565 at \*2. The bankruptcy court then considered abstention, noting that matters concerning the automatic stay under section 362 of the Code are core matters that do not require abstention. With respect to permissive abstention, the bankruptcy court used a twelve-factor test to consider the issue and determined that the bankruptcy court had a “strong interest” in resolving matters involving the automatic stay. The bankruptcy court denied the abstention request.
- *In re McAnally*, No. 8:19-AP-00546-RCT, 2020 WL 7333589 (Bankr. M.D. Fla. Dec. 2, 2020). The debtor and her mortgage lender were engaged in extensive prepetition litigation concerning the lender’s standing to enforce the note and mortgage. The debtor sought to resolve the issues in an adversary proceeding in her bankruptcy case. The case was filed under chapter 7, and the debtor had received her discharge. The bankruptcy court invoked section 1334(c)(1) of title 28 of the U.S. Code and permissively abstained. The bankruptcy court reviewed a fourteen-factor test to consider whether permissive abstention was warranted. The bankruptcy court determined that those “factors overwhelmingly weigh in favor of abstention. In addition to the prevalence of issues arising solely under state law and the parties’ long-standing litigation in state court, the Court’s decision is guided by the fact that other than the pendency of this action, Debtor’s chapter 7 case is primed for closure. Debtor has received her discharge, the chapter 7 trustee formally abandoned the Property, and the estate has otherwise been fully administered and the chapter 7 trustee discharged. Put simply, there is nothing left to do.” 2020 WL 7333589, at \*7.
- *In re Nagel*, No. 19-20055, 2020 WL 1182664 (Bankr. E.D. Ky. Feb. 21, 2020). The debtor in a chapter 13 case filed an adversary proceeding seeking to certify a class and bring claims against a third party relating to that party’s purchase and enforcement of tax sale certificates under state law. The debtor’s chapter 13 plan was confirmed and any non-exempt proceeds from the litigation were to be paid to the trustee under the plan. For that reason, the bankruptcy court determined that it had “related to” jurisdiction over the proceeding, and the parties had consented to the bankruptcy court resolving the claims, thereby eliminating any issues concerning the bankruptcy court’s constitutional authority. The bankruptcy court dismissed the debtor’s cause of action concerning the filing of a false proof of claim and then determined all remaining claims were grounded solely in state law. For that and other reasons, the bankruptcy court permissively abstained.<sup>10</sup> The bankruptcy court also denied the debtor’s class certification request as moot under the circumstances of the case.

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<sup>9</sup> The bankruptcy court relied on *Just. Cometh, Ltd. v. Lambert*, 426 F.3d 1342, 1343 (11th Cir. 2005).

<sup>10</sup> The bankruptcy court explained, “Here, the balance of the applicable factors weigh in favor of abstention. There are related proceedings in the state court, and state law issues not only predominate but are exclusively at issue in the remaining counts. The parties’ briefs identify state law issues which may be unsettled or difficult, including whether

***Other State Law Claims (Business Debtor)***

- *In re Eight-115 Assocs., LLC*, 626 B.R. 383 (Bankr. S.D.N.Y. 2021). At the time of the filing of this chapter 7 case, the debtor was involved in state court litigation concerning several prepetition loans and a related guaranty. The lender removed the action to the district court, which referred it to the bankruptcy court. The guarantor moved for various relief in the bankruptcy court, including a request for mandatory abstention and remand on the state law claims asserted against it. The bankruptcy court considered the timeliness of the guarantor’s remand request, as well as the nature of the claims at issue. The bankruptcy court concluded that the motion was timely and that the claims at issue were non-core contractual claims. The bankruptcy court further concluded that, despite an alleged backlog in the state court system, the state court could resolve the claims against the guarantor without disruption to the bankruptcy case.<sup>11</sup>
- *Int’l Union of Operating Engineers Loc. 542 v. Mallinckrodt ARD, Inc.*, No. CV 21-114, 2021 WL 915722 (E.D. Pa. Mar. 10, 2021). The debtor was a pharmaceutical company with state law litigation pending against it in multiple jurisdictions and a bankruptcy case pending in Delaware. The plaintiff in this matter was involved in one such state court litigation matter concerning an alleged price scheme by the debtor for its Acthar medication. The debtor removed the state court litigation to the district court in Pennsylvania and requested a transfer of the case to Delaware. The plaintiff wanted the matter remanded back to the state court in Pennsylvania. The case provides a nice overview of the issues confronted in this kind of dispute, such as whether actions to remove or remand a matter violate the automatic stay of section 362 of the Code;<sup>12</sup> the court’s subject matter jurisdiction over state law claims;<sup>13</sup> and the appropriate court to resolve abstention and remand issues.<sup>14</sup> The district court ultimately decided that the “home court” of the bankruptcy, meaning the Delaware bankruptcy court, should resolve the abstention and remand issues, and transferred the case accordingly.
- *Matter of CrossPlex Vill. QALICB, LLC*, No. 20-02586-DSC, 2021 WL 886377 (Bankr. N.D. Ala. Mar. 9, 2021). This chapter 11 debtor was involved in prepetition arbitration

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attorneys’ fees charged to Debtor’s mortgage can be deemed ‘special damages’ for purposes of a slander of title claim.” 2020 WL 1182664, at \*6.

<sup>11</sup> The bankruptcy court observed that there is no consensus concerning what constitutes “timely adjudication.” It then used the following four-factor test in its analysis: “(1) the backlog of the state court’s calendar relative to the federal court’s calendar; (2) the complexity of the issues presented and the respective expertise of each forum; (3) the status of the title 11 bankruptcy proceeding to which the state law claims are related; and (4) whether the state court proceeding would prolong the administration or liquidation of the estate.” 626 B.R. at 396 (internal citations omitted). In addition to no consensus on the issue, some courts take different approaches to the analysis. For example, “courts within the Fourth Circuit have held that ‘there is a presumption that the state courts operate timely and efficiently and the party seeking abstention is not required to affirmatively prove this facet of the abstention test in the absence of evidence from the opposing party.’” *In re Foxwood Hills Prop. Owners Ass’n, Inc.*, No. AP 20-80049-HB, 2021 WL 1812668, at \*7 (Bankr. D.S.C. May 5, 2021) (some internal quotations and citations omitted).

<sup>12</sup> According to the district court, “[t]he weight of authority permits a case to be removed and remanded despite the automatic stay.” 2021 WL 915722, at \*4.

<sup>13</sup> The district court “agree[d] with the analysis of the Bankruptcy Court that subject matter jurisdiction exists because Plaintiff’s claims are ‘related to’ the Mallinckrodt bankruptcy.” 2021 WL 915722, at \*5.

<sup>14</sup> The district court also explains the various options in this context as mandatory abstention, permissive abstention, and equitable remand. 2021 WL 915722, at \*6–7.

concerning alleged construction defects and related issues. The bankruptcy was filed after the final arbitration hearing but before an arbitration award was entered. The debtor and others filed adversary proceedings concerning the alleged construction defects and warranty claims. The contractor, who prevailed in the arbitration, sought to dismiss the debtor’s adversary proceeding. The bankruptcy court explored the doctrine of res judicata at the motion to dismiss stage and in the face of a prepetition arbitration award. On this issue, the bankruptcy court concluded that, accepting all facts alleged by the debtor as true (as it must under Civil Rule 12(b)(6)), a determination on res judicata was premature and the record was not conclusive on at least one element of res judicata, namely “whether the same cause of action is presented in both actions.” 2021 WL 886377, at \*7. The bankruptcy court performed an extensive analysis of abstention in this context. Specifically, with respect to timely adjudication under mandatory abstention, the bankruptcy court observed, “[t]imely adjudication is not measured against an absolute time guideline, but rather measured by the needs of the bankruptcy case.”<sup>15</sup> *Id.* at 11. The bankruptcy court also rejected permissive abstention. In so doing, the bankruptcy court highlighted that no one factor in the multi-factor analysis is determinative and that “[t]he mere presence of state law issues is insufficient to justify abstention, even if there are no other issues in the proceeding.” *Id.* at 12.

***Other State Law Claims (Individual Debtor)***

- *Masingill v. Servisfirst Bancshares, Inc.*, No. 2:20-CV-524-TFM-MU, 2021 WL 2178560 (S.D. Ala. May 26, 2021). This case is factually and procedurally complex, but ultimately comes down to a straight-forward abstention analysis. The individual debtor filed a chapter 7 petition, in which there was some litigation concerning exceptions to discharge and whether certain property constituted property of the estate. Among the disputed property were certain state law claims (including fraud, negligence, and wantonness) asserted by the debtor against various third parties in state court. The district court first considered subject matter jurisdiction and incorporates a thoughtful discussion of how the core versus non-core distinction relates to issues of jurisdiction under section 1334 of title 28 of the U.S. Code. The district court ultimately concluded that whether the state law claims were property of the estate was a core matter that arises under title 11. Nonetheless, that determination did not resolve the abstention analysis, particularly because the debtor and the chapter 7 trustee settled that dispute, essentially leaving only the underlying state law claims for resolution. Here, the district court declined to follow the “home court” rule and allow the bankruptcy court to consider abstention. 2021 WL 2178560 at \*8. Rather, the district court performed the abstention analysis and held permissive abstention warranted under the particular facts of the case. *Id.* at \*9.
- *In re Keirns*, No. 20-51336, \_\_\_ B.R. \_\_\_, 2021 WL 1906364 (Bankr. S.D. Ohio Apr. 5, 2021). The adversary proceeding in this chapter 7 case involved alleged breaches of a construction contract and claims under the Ohio Consumer Sales Practices Act (“CSPA”). The bankruptcy court initially addressed the parties’ arguments concerning jurisdiction and a pending motion to dismiss, but then focused on abstention under section 1334 of title 28

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<sup>15</sup> The bankruptcy court relied on *In re 3G Properties, LLC*, No. 10-04763-8-JRL, A.P. No. 10-00178-8-JRL, 2010 WL 4027770, at \*3 (Bankr. E.D.N.C. 2010), (citing *Suntrust Bank v. Ferrell (In re Pluma)*), No. 99-11104C-11G, 2000 WL 33673752, \*2 (Bankr. M.D.N.C. 2000) (citing 1 Collier on Bankruptcy ¶ 3.05[2] (15th ed. rev. 2000)) for this proposition.

of the U.S. Code. The bankruptcy court acknowledged the state law nature of the claims and the lack of impact on the estate given it was a no-asset chapter 7 case. Nonetheless, the bankruptcy court declined to abstain from the proceeding, citing factors such as the lack of pending state court litigation and no novel or unsettled issues of state law. The bankruptcy court also stated that “liquidating a state law claim in connection with a dischargeability action is clearly within this Court’s jurisdiction and constitutional authority and is intertwined with that core bankruptcy proceeding.” 2021 WL 1906364, at \*8.

- *In re Dean*, No. 20-20427, 2021 WL 1235354 (Bankr. D. Me. Mar. 24, 2021). The debtor’s interests in certain businesses were subject to prepetition litigation in state court and that litigation involved dissolution, breach of fiduciary duty, and similar claims. The debtor commenced an adversary proceeding in his bankruptcy case to address these issues, and the defendant requested that the bankruptcy court abstain and remand. The bankruptcy court determined that the prepetition litigation was only “related to” the bankruptcy case and that the potential impact of that litigation on the debtor’s reorganization efforts was not sufficient to keep the matters in the bankruptcy. The bankruptcy court found grounds for both mandatory abstention and remand.

# Faculty

**Julie M. Anania** is a staff attorney for Nancy J. Whaley, Standing Chapter 13 Trustee, in Atlanta and has represented the chapter 13 trustee in the Northern District of Georgia for nine years. Prior to that, she represented consumer debtors. Ms. Anania is an active member of the bankruptcy sections of State Bar of Georgia, the Atlanta Bar Association and the Metro-Atlanta Consumer Bankruptcy Attorney Group. She received her undergraduate degree from the University of Alabama at Birmingham, where she also played for the women's soccer team, and her J.D. from Liberty University School of Law.

**Janet B. Haigler** is a practitioner with Haigler Law Firm LLC in Chapin, S.C., and has practiced in the areas of bankruptcy, creditor rights and commercial litigation for more than 25 years. In 2014, she was appointed by the Office of the U.S. Trustee as a chapter 7 panel trustee for the District of South Carolina. Ms. Haigler serves as a mediator for the Loss Mitigation/Mortgage Modification Program and for chapter 13 valuation disputes. She is certified by the South Carolina Supreme Court as a Specialist in Bankruptcy and Debtor-Creditor law, and she serves as the secretary for the J. Bratton Davis Bankruptcy American Inn of Court. Recently, the American College of Bankruptcy announced that Ms. Haigler will be inducted as a Fellow of the College in October 2021. She volunteers for the CARE Program, providing financial literary presentations to local schools and community groups.

**Hon. Michelle M. Harner** is a U.S. Bankruptcy Judge for the District of Maryland in Baltimore, appointed in 2017. Prior to her appointment to the bench, she was the Francis King Carey Professor of Law and the Director of the Business Law Program at the University of Maryland Francis King Carey School of Law, where she taught courses in bankruptcy and creditors' rights, business associations, business planning, corporate finance and the legal profession. Judge Harner lectured frequently during her academic career on various topics involving corporate governance, financially distressed entities, risk management and related legal issues. Her academic scholarship is widely published, with her publications appearing in, among others, the *Vanderbilt Law Review*, *Notre Dame Law Review*, *Washington University Law Review*, *Minnesota Law Review*, *Indiana Law Journal*, *Fordham Law Review* (reprinted in *Corporate Practice Commentator*), *Washington & Lee Law Review*, *William & Mary Law Review*, *University of Illinois Law Review*, *Arizona Law Review* (reprinted in *Corporate Practice Commentator*) and *Florida Law Review*. Judge Harner has served as the Associate Reporter to the Advisory Committee on the Federal Rules of Bankruptcy Procedure, the Reporter to the ABI Commission to Study the Reform of Chapter 11, and most recently chaired the Dodd-Frank Study Working Group for the Administrative Office of the U.S. Courts. She also served as the Robert M. Zinman ABI Resident Scholar for the fall of 2015. Judge Harner is an elected conferee of the National Bankruptcy Conference, an elected Fellow of the American College of Bankruptcy, and an elected member of the American Law Institute. She previously was in private practice in the business restructuring, insolvency, bankruptcy and related transactional fields, most recently as a partner at the Chicago office of the international law firm Jones Day. Judge Harner received her B.A. *cum laude* from Boston College in 1992 and her J.D. *summa cum laude* from The Ohio State University College of Law in 1995.

**Eric M. Wilson** is a solo practitioner with Eric Wilson Law, LLC in Tuscaloosa, Ala., and specializes in consumer bankruptcy, typically on behalf of debtors in chapter 13 and 7 cases. He has handled consumer bankruptcy cases since 1997. Mr. Wilson is a member of NABCA and ABI and is a graduate of Max Gardner's Consumer Defense Academy. He is currently serving a second four-year term as chairman of the Board of Education for the Tuscaloosa City Schools. Mr. Wilson received his B.A. in economics from Vanderbilt University in 1993 and his J.D. from the University of Alabama in 1996, where he served as senior editor of the *Alabama Law Review*.