American Bankruptcy Institute
Southwest Bankruptcy Conference

Extraordinary Circumstances in Consumer Cases

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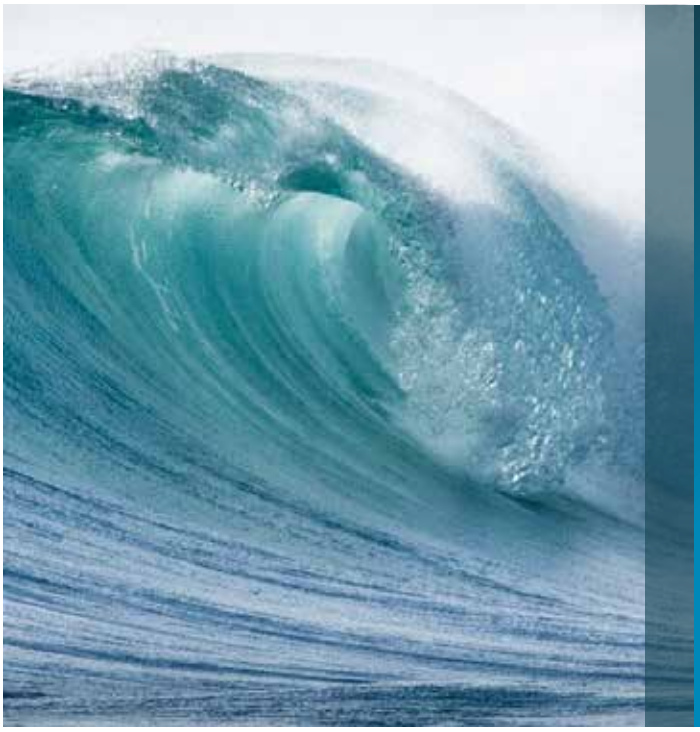
CONCURRENT SESSION
2025



Consumer Litigation Issues

Randy Nussbaum
American Bankruptcy Institute
Southwest Conference, August 2025

ISSUE SPOTTING PRIMER FOR ATTORNEYS NOT REGULARLY LITIGATING IN BANKRUPTCY COURT

1) Is Naming both Spouses Necessary When pursuing an action under 11 USCS 523?
2) Do not miss the deadline to file an 11 USCS 523 adversary.
3) Be careful when defending spouses on an 11 USCS 523 matter.
4) Have a working knowledge of Removal and Remand.
5) Want to try a case to a jury?

PRIMER (CONT.)

6) Make sure the court has jurisdiction.
7) Know the national, local, and court rules.
8) Do you proceed virtually versus in person?
9) Know when to file an adversary under 11 USCS 727.
10) How do you recover legal fees?
11) How to Defend a Preference or Fraudulent Transfer Adversary?
12) Make sure you have a proper way of getting paid.

Your presenter – Randy Nussbaum

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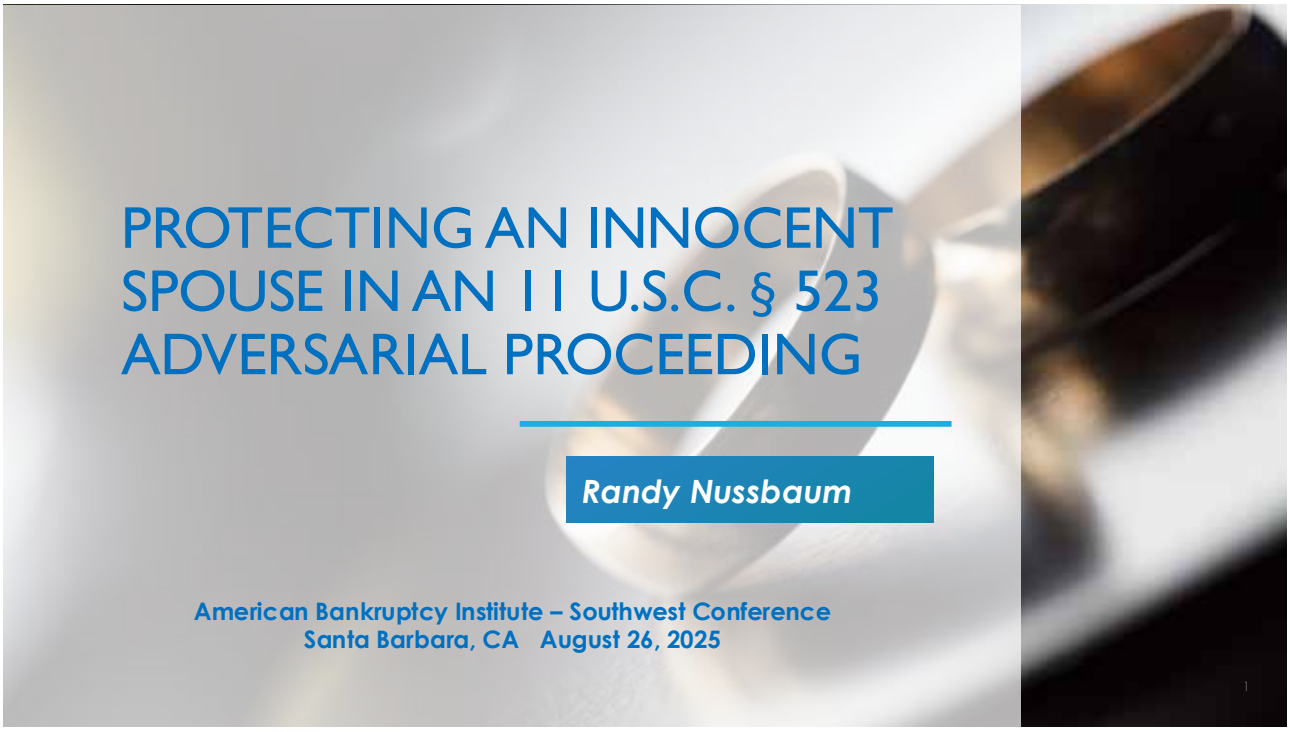


Innocent spouse liability

The issue of an innocent spouse liability in a § 523 bankruptcy adversarial proceeding rises in three different contexts. The following three questions must be asked:

1) Is the debt a community obligation so that liability will be extended to the community in community property states?

2) When will the wrongful acts be imputed to the "innocent spouse?"

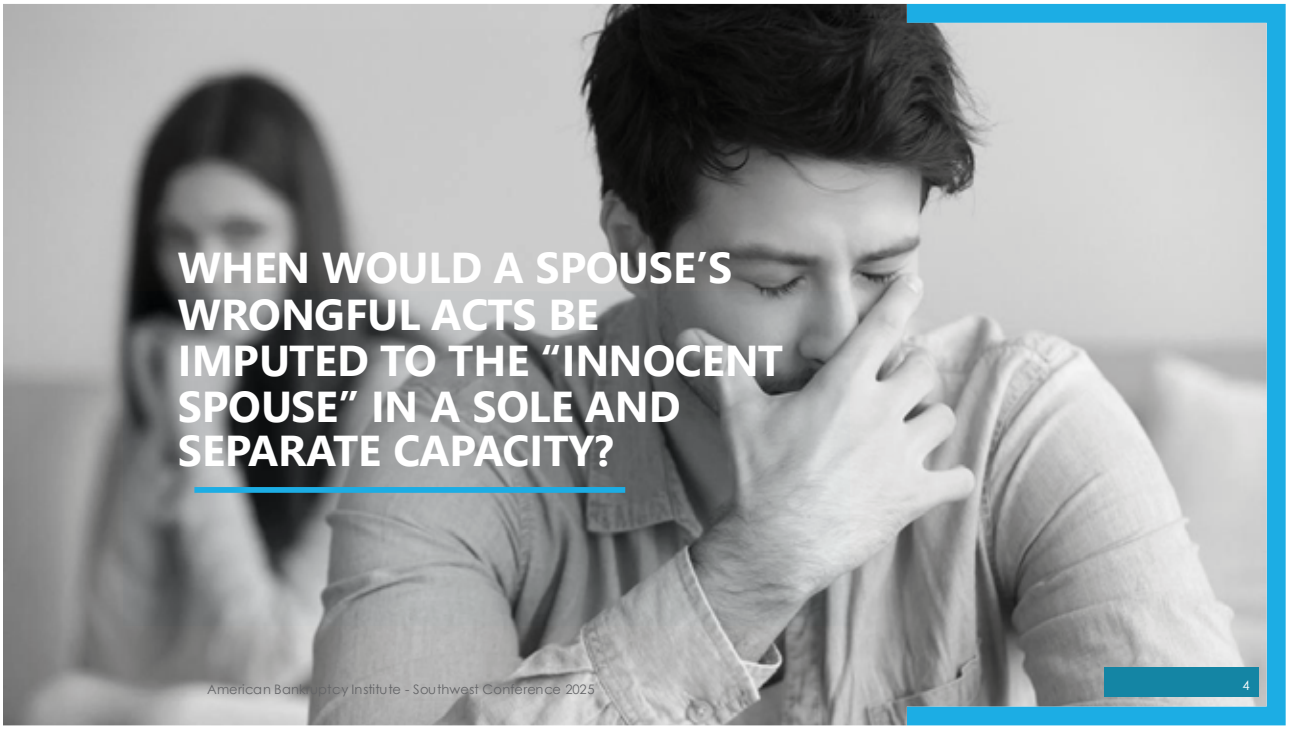
3) Will a community debt follow the "innocent spouse" once that party divorces the wrongdoing spouse?

When is a debt a community obligation

This is a threshold State Law issue. In most community property states, one spouse can unilaterally obligate the community assets. If the debt is not of a community nature, neither the community property nor the sole and separate property of the innocent spouse is liable for a guilty spouse's sole and separate debt. Sole and separate debts are the exception, not the rule.

In most instances, the actions of one spouse will bind the community both as a matter of law and precedent. An "innocent spouse" will face serious financial ramifications when a non-dischargeable debt is a community one. In most instances, a married couple's assets are almost always characterized as community property. An innocent spouse should expect to be financially affected by community-category debt obligations.

In non-community property states, state law will determine when the debts of one spouse may bind an "innocent" spouse as well.



Wrongful acts

In 2023, the United States Supreme Court rreviewed the question of whether an individual spouse who had no knowledge of any relevant alleged fraud may discharge a debt in bankruptcy for money obtained through fraud by her spouse and business partner. The debtor and her business partner were unmarried when the events occurred causing the claim, but they married before being sued and then filed a joint bankruptcy case. *Bartenwerfer v. Buckley*, 143 S. Ct. 665 (2023).

The Bankruptcy Court had initially entered a nondischargeable judgment against David Bartenwerfer (husband), and bound Kate Bartenwerfer (wife) because in its view, the fraud was imputed to the wife, and therefore, the debt was nondischargeable as to her as well.

After an appeal and judgment on remand, the Bankruptcy Court determined that § 523(a)(2)(A) applies only to a debtor who (at the least) knew or should have known (i.e., scienter) of the fraud. The Bankruptcy Appellate Panel upheld this finding in the wife's favor and discharged her debt. *See In re Bartenwerfer*, No. AP 13-03185, 2017 WL 6553392, at *1 (B.A.P. 9th Cir. Dec. 22, 2017).

Wrongful acts (cont.)

The Ninth Circuit reversed. It held that fraud imputed against a debtor is nondischargeable "regardless of her knowledge of the fraud." *See In re Bartenwerfer,* 860 F. App'x 544 (9th Cir. 2021). The Court promoted the proposition that partners cannot escape pecuniary responsibility when one partner makes false or fraudulent misrepresentations, especially when both partners appropriated the benefits of the fraudulent conduct.

On February 22, 2023, the U.S. Supreme Court decided *Bartenwerfer v. Buckley*, No. 21-908, affirming the Ninth Circuit and holding that 11 U.S.C. § 523(a)(2)(A), which bars debtors from discharging any debt obtained by fraud, applies even to debtors who are liable for fraud they did not personally commit.

Bartenwerfer should be compared to two Arizona bankruptcy decisions on this issue. Those cases, *In re LeSueur*, 53 B.R. 414 (Bankr. D. Ariz 1985) and *In re Rollinson*, 322 B.R. 879 (2005), featured dicta stating that an "innocent spouse" could be not held liable in a sole and separate capacity

Wrongful acts (cont.)

in the absence of evidence of the innocent spouse's knowledge of the fraud or participation in the fraud. One can now assume that such dicta is now totally superfluous.

This controversy is important in situations in which an innocent spouse has sole and separate property. Case law under pre-*Bartenwerfer* framework left unclear (due to circuit split) whether lack of knowledge by the innocent spouse prevented the creditor from procuring a nondischargeable judgment against that spouse in a sole and separate capacity.

Divorce

In re Rollinson specifically left unresolved the issue of what recourse a creditor has against an "innocent spouse" whose community property is liable for a community judgment once that spouse is divorced.

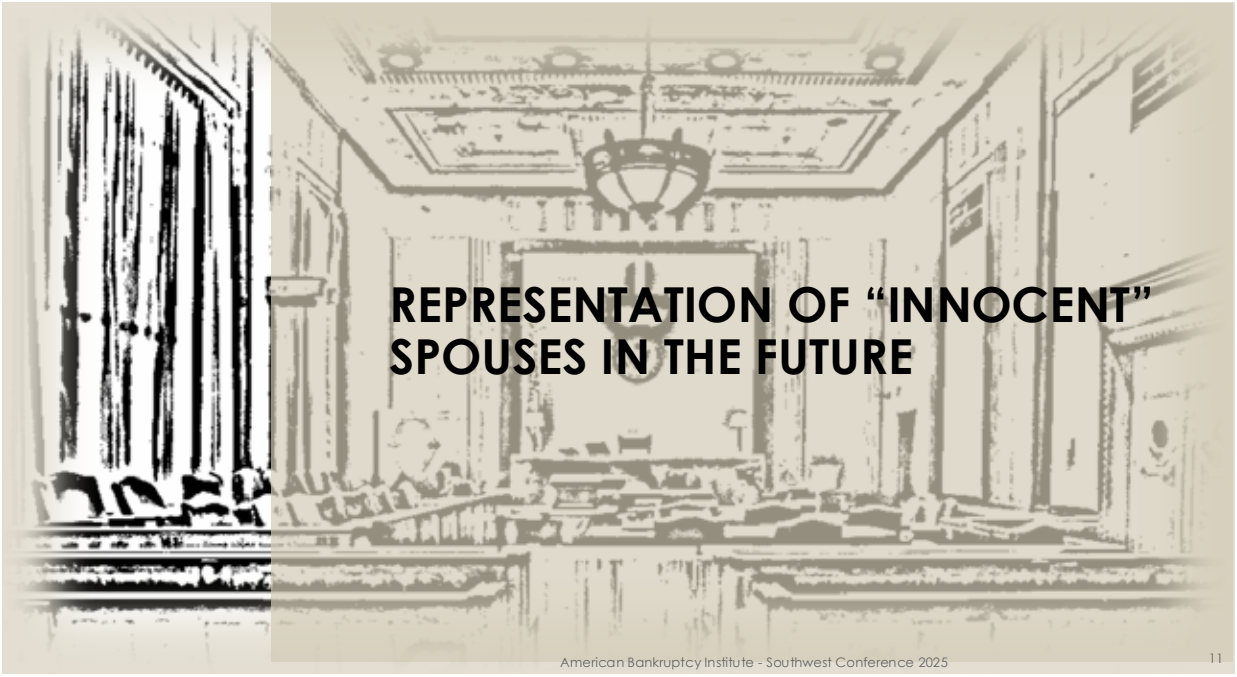
In a posted, but unpublished, opinion, Judge Dan Collins from Arizona directly broached this issue and concluded that once divorced, the innocent spouse should no longer be liable for that indebtedness.

That case, *In re Mangold*, Case No: 2:12-bk-16858, was a Chapter 7 case involving the common situation in which the wrongful conduct of one spouse resulted in a nondischargeable judgment against the wrongful spouse and the community as well. Ms. Mangold, the innocent spouse, argued to the Bankruptcy Court that if she were to divorce her wrongdoing husband, since post-dissolution she would not have any community property, the judgment would no longer be enforceable as to her.

Divorce (cont.)

Judge Collins determined that *Community Guardian Bank v. Hamlin*, 182 Ariz. 627, 631-32 (App. 1995) was inapplicable to the case at point, even though that decision had held that upon dissolution of the marriage, both spouses became liable for the debts of the community. He found it unpersuasive since *Hamlin* was not a bankruptcy case nor did either spouse in *Hamlin* obtain a bankruptcy discharge. So, in one broad sweep, Judge Collins, in an unpublished opinion, rendered a determination, if followed by other bankruptcy courts, would have freed innocent spouses from community obligations upon divorcing.

Now, because of *Bartenwerfer*, any confusion as to the "innocent" spouse's culpability even upon divorcing the actual fraudulent actor is no longer at issue if an agency relationship is established among the spouses. That spouse will be liable under § 523(a)(2)(A) and such liability will follow that spouse even once divorced.



Innocent spouse representation

If Congress were to determine that the current wording of the statute is leading to inequitable results, the statute could be amended to require that the actual debtor engage in the actionable fraud. Interestingly enough, this actually was the case at one time under an earlier version of the pertinent statute.

Alternatively, the lawyer defending the "innocent" spouse will now have to find a way of extricating the innocent spouse under state law principles. Doing so will probably be very difficult since under most states' community property laws , one spouse can bind the community.

Maybe the solution is to ask a state court trier of fact to render a specific finding that the "innocent" spouse is only liable under community property law but otherwise would not be culpable under agency principles.

Future of innocent spouses

Bartenwerfer should sensitize a spouse to the importance of separating herself/himself from a wrongdoing spouse. Specifically knowing that trying to hide behind the argument that the "innocent" spouse is an innocent bystander will likely be futile.

The "innocent" spouse needs to immediately do what she/he can do to isolate herself/himself from that conduct. Simultaneously, that party needs to try to build a record conclusively demonstrating the "innocent" spouse refused to accept the wrongful bounty and specifically took all action possible to stop the wrongful conduct. Otherwise, the sins of the wrongdoer will probably be visited upon the "innocent" spouse.

Reference materials

- Till Death Do Us Part(ner): Imputed Fraud Liability Concerns For Spouses Following The Supreme Court's Decision *In Bartenwerfer v. Buckley*; Vol 59:149, Theresa J. Pulley Radwan. Radwan_Till-Death-Do-Us-PartNer.pdf Radwan_Till-Death-Do-Us-PartNer.pdf
- California Business Divorce: Partner Fraud and Personal Liability: Important Lessons from *Bartenwerfer v. Buckley;* California Business Divorce by Jason Anderson and Jeremey G Suiter, June 13, 2025. California Business Divorce: Partner Fraud and Personal Liability: Important Lessons from Bartenwerfer v. Buckley | Stradling
- Ninth Circuit Bankruptcy Appellate Panel Declines to Extend *Bartenwerfer* to Intentional Torts; Nelson Mullins Red Zone by Adam Herring, May 15, 2025. Nelson Mullins - Ninth Circuit Bankruptcy Appellate Panel Declines to Extend Bartenwerfer to Intentional Torts
- Under Advisement Ruling re Impact of A.R.S. Sec. 25-215(D) on Debtor's Marital Community's Liability for Nondischargeabe Judgment; Stonehedge Interest LCC et al. V. William Warren Stredney United States Bankruptcy Court District of Arizona; adversary No. 2:10-ap-02223-DPC

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OUTLINE

AMERICAN BANKRUPTCY INSTITUTE SOUTHWEST CONFERENCE-
AUGUST 2025

1. Protecting an Innocent Spouse in an 11 U.S.C. § 523 Adversarial Proceeding by Randy Nussbaum August 11, 2025.

2. Till Death Do Us Part(ner): Imputed Fraud Liability Concerns For Spouses Following The Supreme Court's Decision In Bartenwerfer v. Buckley; Vol 59:149, Theresa J. Pulley Radwan. Radwan Till-Death-Do-Us-PartNer.pdf

3. California Business Divorce: Partner Fraud and Personal Liability: Important Lessons from Bartenwerfer v. Buckley; California Business Divorce by Jason Anderson and Jeremey G Suiter, June 13, 2025. California Business Divorce: Partner Fraud and Personal Liability: Important Lessons from Bartenwerfer v. Buckley | Stradling

4. Ninth Circuit Bankruptcy Appellate Panel Declines to Extend Bartenwerfer to Intentional Torts; Nelson Mullins Red Zone by Adam Herring, May 15, 2025. Nelson Mullins - Ninth Circuit Bankruptcy Appellate Panel Declines to Extend Bartenwerfer to Intentional Torts

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PROTECTING AN INNOCENT SPOUSE IN AN 11 U.S.C. § 523 ADVERSARIAL PROCEEDING

The issue of an innocent spouse liability in a § 523 bankruptcy adversarial proceeding rises in three different contexts. The following three questions must be asked:

1) Is the debt a community obligation so that liability will be extended to the community in community property states?
2) When will the wrongful acts be imputed to the "innocent spouse?"
3) Will a community debt follow the "innocent spouse" once that party divorces the wrongdoing spouse?

I. When is the debt a community obligation?

This is a threshold State Law issue to be evaluated under the appropriate applicable state law. In most community property states, one spouse can unilaterally obligate the community assets. If, on the other hand, the debt is not of a community nature, neither the community property nor the sole and separate property of the innocent spouse is liable for a guilty spouse's sole and separate debt. Not surprisingly, purely sole and separate debts are the exception, not the rule.

But, as a practical matter, since in most instances the actions of one spouse will bind the community both as a matter of law and precedent, an "innocent spouse" will face serious financial ramifications from a finding that a nondischargeable debt is a community one. This is the case because in most instances, a married couple's assets are almost always characterized as community property, so an innocent spouse should expect to be financially affected by community-category debt obligations.

In non-community property states, state law will determine when the debts of one spouse may bind an "innocent" spouse as well.

II. When would a spouse's wrongful acts be imputed to the "innocent spouse" in a sole and separate capacity?

In 2023, the United States Supreme Court reviewed the question of whether an individual spouse who had no knowledge of any relevant alleged fraud may discharge a debt in bankruptcy for money obtained through fraud by her spouse and business partner. The debtor and her business partner were unmarried when the events occurred causing the claim, but they married before being sued and then filed a joint bankruptcy case. *Bartenwerfer v. Buckley*, 143 S. Ct. 665 (2023).

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III. Will a divorce extricate an innocent spouse from a community nondischargeable judgment?

In re Rollinson specifically left unresolved the issue of what recourse a creditor has against an "innocent spouse" whose community property is liable for a community judgment once that spouse is divorced.

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IV. Representation of "innocent" spouses in the future.

If Congress were to determine that the current wording of the statute is leading to inequitable results, the statute could be amended to require that the actual debtor engage in the actionable fraud. Interestingly enough, this actually was the case at one time under an earlier version of the pertinent statute.

Alternatively, the lawyer defending the "innocent" spouse will now have to find a way of extricating the innocent spouse under state law principles.

Doing so will probably be very difficult since under most states' community property laws , one spouse can bind the community.

Maybe the solution is to ask a state court trier of fact to render a specific finding that the "innocent" spouse is only liable under community property law but otherwise would not be culpable under agency principles.

V. The future for "innocent" spouses.

First of all, Bartenwerfer should sensitize a spouse to the importance of separating herself/himself from a wrongdoing spouse. Specifically knowing that trying to hide behind the argument that the "innocent" spouse is an innocent bystander will likely be futile. Instead, the "innocent" spouse needs to immediately do what she/he can do to isolate herself/himself from that conduct. Simultaneously, that party needs to try to build a record conclusively demonstrating the "innocent" spouse refused

to accept the wrongful bounty and specifically took all action possible to stop the wrongful conduct. Otherwise, the sins of the wrongdoer will probably be visited upon the "innocent" spouse.

Accompanying this article are updated materials addressing this issue which attempt to bring some "method to the madness."

ABI - Vexatious Litigants

Materials prepared by

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Sanctions for Frivolous Filings

1. Rule 9011
   A. Certification: "By presenting to the court a petition, pleading, written motion, or other document-whether by signing, filing, submitting, or later advocating it-an attorney or unrepresented party certifies that, to the best of the person's knowledge, information, and belief formed after an inquiry reasonable under the circumstances:
      (1) it is not presented for any improper purpose, such as to harass, cause unnecessary delay, or needlessly increase litigation costs;
      (2) the claims, defenses, and other legal contentions are warranted by existing law or by a nonfrivolous argument to extend, modify, or reverse existing law, or to establish new law;
      (3) the allegations and factual contentions have evidentiary support-or if specifically so identified, are likely to have evidentiary support after a reasonable opportunity for further investigation or discovery; and
      (4) the denials of factual contentions are warranted on the evidence-or if specifically so identified, are reasonably based on a lack of information or belief." Rule 9011(b)
   B. Sanctions: If the court determines that (b) has been violated, the court may, subject to the conditions in this subdivision (c), impose an appropriate sanction on any attorney, law firm, or party that committed the violation or is responsible for it.
   C. Damages: If warranted, the court may award to the prevailing party the reasonable expenses and attorney's fees incurred in presenting or opposing the motion.
   D. Limitations on Sanctions: A sanction imposed under this rule must be limited to what suffices to deter repetition of the conduct or deter comparable conduct by others similarly situated. The sanction may include:

(1) a nonmonetary directive;
(2) an order to pay a penalty into court; or
(3) if imposed on motion and warranted for effective deterrence, an order directing payment to the movant of all or part of the reasonable attorney's fees and other expenses directly resulting from the violation.

E. Limitations on a Monetary Sanction. The court must not impose a monetary sanction:
(1) against a represented party for violating (b)(2); or
(2) on its own, unless it issued the show-cause order under (c)(3) before voluntary dismissal or settlement of the claims made by or against the party that is, or whose attorneys are, to be sanctioned.

F. Procedure.
(1) Motion: A motion for sanctions must be made separately from any other motion or request, describe the specific conduct alleged to violate (b), and be served under Rule 7004.
(2) When to File. The motion for sanctions must not be filed or presented to the court if the challenged document, claim, defense, contention, allegation, or denial is withdrawn or appropriately corrected within 21 days after the motion was served (or within another period as the court may order). This limitation does not apply if the conduct alleged is filing a petition in violation of (b).

2. Inherent Power:
A. Federal courts possess certain "inherent powers," not conferred by rule or statute, "to manage their own affairs so as to achieve the orderly and expeditious disposition of cases." Link v. Wabash R. Co., 370 U. S. 626, 630–631 (1962). That authority includes "the ability to fashion an appropriate sanction for conduct which abuses the judicial process." Chambers v. NASCO, Inc., 501 U. S. 32, 44–45 (1991).
B. Due Process: "[W]hen using the inherent sanction power, due process is accorded as long as the sanctionee is 'provided with sufficient, advance notice of exactly which conduct was alleged to be sanctionable, and [was] furthermore aware that [he] stood accused of having acted in bad faith.'" In re Lehtinen, 564 F.3d 1052, 1060 (9th Cir. 2009) (quoting In re DeVille, 361 F.3d 539, 549 (9th Cir. 2004)),

abrogated on other grounds, as stated in In re Gugliuzza, 852 F.3d 887, 898 (9th Cir. 2017).

C. Compensatory Only: Such a sanction "is limited to the fees the innocent party incurred solely because of the misconduct—or put another way, to the fees that party would not have incurred but for the bad faith." Goodyear Tire & Rubber Co. v. Hager, 137 S.Ct. 1178 (2017).

3. Civil Contempt:

A. Compensatory Damages: Civil penalties must either be compensatory or designed to coerce compliance. In re Dyer, 322 F.3d 1178, 1192 (9th Cir. 2003). "A compensatory fine must be limited to actual damages incurred as a result of the violation. Actual loss includes attorneys' fees and costs incurred in securing compliance with the order." In re Count Liberty, LLC, 370 B.R. 259, 274 (Bankr. C.D. Cal. 2007).

B. Specific and definite order. In re Dyer, 322 F.3d 1178, 1190 (9th Cir. 2003) (citation omitted); In re Lehtinen, 564 F.3d 1052, 1058 (9th Cir. 2009), abrogated on other grounds, as stated in In re Gugliuzza, 852 F.3d 887, 898 (9th Cir. 2017).

C. Clear and convincing evidence. FTC v. Affordable Media, LLC, 179 F.3d 1228, 1239 (9th Cir. 1999).

D. Contested matter. Rule 9020; Barrientos v. Wells Fargo Bank, N.A., 633 F.3d 1186, 1190-91 (9th Cir. 2011).

E. Subject Intent Irrelevant: "Because civil contempt serves a remedial purpose, it matters not with what intent the defendant did the prohibited act." In re Dyer, 322 F.3d 1178, 1191 (9th Cir. 2003). See also, In re Taggart, 139 S.Ct. 1795 (2019) (discharge injunction warrants contempt sanctions if there is "no fair ground of doubt" as to whether the inunction barred the creditor's conduct – i.e., "no objectively reasonable basis for concluding that the creditor's conduct might be lawful" – so "subjective good faith" is not a defense).

F. Body Detention: "Incarceration is an appropriate coercive sanction for civil contempt so long as the contemnor can avoid the sentence imposed on him, or purge himself of it, by complying with the terms of the original order." In re Count Liberty, LLC, 370 B.R. 259, 274 (Bankr. C.D. Cal. 2007). "When the petitioners carry the keys of their prison in their own pockets, the action is essentially a civil remedy." Shillitani v. United States, 384 U.S. 364, 368 (1966).

G. Defense of Impossibility: Inability to comply with the court's order is a defense, but the burden is on the contemnor to show "categorically and in detail" how compliance is "impossible." FTC v. Affordable Media, 179 F.3d 1228, 1241 (9th Cir. 1999).

4. Pre-Filing Orders

A. Federal courts can "regulate the activities of abusive litigants by imposing carefully tailored restrictions under appropriate circumstances." De Long v. Hennessey, 912 F.2d 1144, 1147 (9th Cir. 1990) (quotation marks omitted). Pursuant to the All Writs Act, 28 U.S.C. § 1651(a), "enjoining litigants with abusive and lengthy [litigation] histories is one such . . . restriction" that courts may impose. De Long, 912 F.2d at 1147.

B. "Out of regard for the constitutional underpinnings of the right to court access, "pre-filing orders should rarely be filed," and only if courts comply with certain procedural and substantive requirements. De Long, 912 F.2d at 1147. When district courts seek to impose pre-filing restrictions, they must:
(1) give litigants notice and "an opportunity to oppose the order before it [is] entered";
(2) compile an adequate record for appellate review, including "a listing of all the cases and motions that led the district court to conclude that a vexatious litigant order was needed";
(3) make substantive findings of frivolousness or harassment; and
(4) tailor the order narrowly so as "to closely fit [**8] the specific vice encountered." Id. at 1147-48. Ringgold-Lockhart v. Cty. of L.A., 761 F.3d 1057, 1062 (9th Cir. 2014).

C. Factors: "(1) the litigant's history of litigation and in particular whether it entailed vexatious, harassing or duplicative lawsuits; (2) the litigant's motive in pursuing the litigation, e.g., does the litigant have an objective good faith expectation of prevailing?; (3) whether the litigant is represented by counsel; (4) whether the litigant has caused needless expense to other [**9] parties or has posed an unnecessary burden on the courts and their personnel; and (5) whether other sanctions would be adequate to protect the courts and other parties." Ringgold-Lockhart v. Cty. of L.A., 761 F.3d 1057, 1062 (9th Cir. 2014).

5. Referral to District Court for Prosecution of Criminal Contempt

A. "We do not preclude the possibility that a bankruptcy court could initiate criminal contempt proceedings by referring alleged contempt

to the district court. Nor do we address whether the district court could refer those proceedings back to the bankruptcy court if the parties so consented. See 28 U.S.C. § 157(3) (authorizing the bankruptcy court to hold a jury trial only 'if specifically designated to exercise such jurisdiction by the district court and with the express consent of all the parties')." In re Dyer, 322 F.3d 1178, 1194 n.17 (9th Cir. 2003) (additional citations to articles discussing constitutional issues omitted).

6. Barton Doctrine

A. Before suit can be brought against a court-appointed receiver, "leave of the court by which he was appointed must be obtained." Barton v. Barbour, 104 U.S. 126 (1881). The Court held that if leave of court were not obtained, then the other forum lacked subject matter jurisdiction over the suit. Barton, 104 U.S. at 127.

B. The Barton doctrine applies in bankruptcy, because "the trustee in bankruptcy is a statutory successor to the equity receiver," and "just like the equity receiver, a trustee in bankruptcy is working in effect for the court that appointed or approved him, administering property that has come under the court's control by virtue of the Bankruptcy Code." In re Linton, 136 F.3d 544 (7th Cir. 1998). Beck v. Fort James Corp. (In re Crown Vantage, Inc.), 421 F.3d 963 (9th Cir. 2005).

C. There is a circuit split regarding whether Barton continues after a bankruptcy case is closed. See, Chua v. Ekonomou, 1 F.4th 948 (11th Cir. 2021).

D. The majority rule is that Barton does continue. "A few of our sister circuits have concluded that the Barton doctrine applies even after a bankruptcy trusteeship has ended because it protects the court-appointed trustee from suit. See Satterfield v. Malloy, 700 F.3d 1231, 1236 (10th Cir. 2012); Muratore v. Darr, 375 F.3d 140, 147 (1st Cir. 2004); Linton, 136 F.3d at 545; see also In re Crown Vantage, Inc., 421 F.3d 963, 972 (9th Cir. 2005) (citing Muratore and Linton approvingly). The Seventh Circuit, for example, has explained that, unless the Barton doctrine extends past the conclusion of a bankruptcy proceeding, "trusteeship will become a more irksome duty" because the trustee will be forced "to defend against suits by litigants disappointed by his actions on the court's behalf." Linton, 136 F.3d at 545. It reasoned that bankruptcy courts will have a more difficult time [**14] "find[ing] competent people to appoint as trustees" and

any appointees that they can find will "have to pay higher malpractice premiums." Chua v. Ekonomou, 1 F.4th 948, 954 (11th Cir. 2021).

E. Practice Pointer: File a motion and ask the court to enter an order that Barton will continue post-closing and that the court will retain post-closing jurisdiction to determine if leave of court will be granted.

7. Actual Cases that Involved Bodily Detention

A. Jana Olson. 8:15-bk-12496-TA [Debtor adjudicated in contempt of bankruptcy court order to repatriate funds from Cook Islands asset protection trust. Debtor spent more than 13 months in jail after finding of civil contempt. Debtor only released after trustee managed to get the money repatriated].

B. Clifford Brace. 6:11-bk-26154-SY [Debtor adjudicated in civil contempt of bankruptcy court turnover order and unlawful foreclosure of estate property. Debtor apprehended in Arizona and then transferred to the Central District of California. Debtor spent several months in confinement until he purged his contempt].

C. Alicia Richards. 8:21-bk-10635-SC [Debtor violated bankruptcy court order to turn over lapsed homestead or account for disposition of funds. Debtor spent more than two years in custody].

8. Actual Case involving Criminal Contempt and 1-year prison sentence

A. Yan Sui. 8:11-bk-20448-SC; 2:24-cr-00498-1 [Bankruptcy court granted trustee's motion prohibiting debtor from continuing to file lawsuits outside of the bankruptcy court without first obtaining leave under the Barton Doctrine. Debtor had already had four such lawsuits dismissed. Within three weeks after entry of the order, the Debtor filed three more lawsuits. The bankruptcy court granted the trustee's request for a report and recommendation to be transmitted to the district court to prosecute the debtor for three felony counts of violating a federal court order. See, 28 U.S.C. § 401(3) which provides that "A court of the United States shall have power to punish by fine or imprisonment, or both, at its discretion, such contempt of its authority, and none other, as— (1) Misbehavior of any person in its presence or so near thereto as to obstruct the administration of justice; (2) Misbehavior of any of its officers in their official transactions; (3) Disobedience or resistance to its lawful writ, process, order, rule, decree, or command." The district court accepted the report and recommendation and entered an order directing the US Attorneys' Office to appoint a prosecutor. After a

three day jury trial, the jury returned a unanimous verdict on all three counts. The district court later sentenced the debtor to one year in federal prison].

BODILY DETENTION TO COERCE COMPLIANCE WITH A COURT ORDER: DEALING WITH THE INCORRIGIBLE DEBTOR

By: Richard A. Marshack, D. Edward Hays, and Bradford N. Barnhardt

1. The Incorrigible Debtor

The vast majority of debtors, especially those represented by competent counsel, recognize that federal law (*i.e.*, 11 U.S.C. § 521) requires them to cooperate with trustee's administration of the bankruptcy estate. But all trustees, every now and then, encounter an incorrigible debtor. This is the debtor that refuses to provide information. Refuses to turn over estate property. And, in some rare cases, these incorrigible debtors refuse to comply with orders of the bankruptcy court after the trustee is forced to file turnover motions for information and assets. Sometimes (unfortunately) these debtors have to go to jail to compel compliance with court orders.

2. A Bankruptcy Court's Contempt Powers Are Civil in Nature

"[C]ourts have inherent power to enforce compliance with their lawful orders through civil contempt." *Spallone v. United States*, 493 U.S. 265, 276 (1990); *see also* 18 U.S.C. § 401. Every circuit court considering the issue has concluded that bankruptcy courts have civil, but not criminal, contempt powers. *In re Chateaugay Corp.*, 920 F.2d 183, 187 (2d Cir. 1990); *In re Terrebonne Fuel & Lube*, 108 F.3d 609, 612-13 (5th Cir. 1997) (collecting cases from 1st, 4th, 9th, 10th, and 11th Circuits); *Price v. Lehtinen*, 564 F.3d 1052, 1059 (9th Cir. 2009); *In re Skinner*, 917 F.2d 444, 447-48 (10th Cir. 1990); *In re Ocean Warrior, Inc.*, 835 F.3d 1310, 1316-17 (11th Cir. 2016). Moreover, the public rights doctrine, which allows matters to be removed from the jurisdiction of Article III courts, does not extend to criminal matters. *Northern Pipeline Constr. Co. v. Marathon Pipe Line Co.*, 458 U.S. 50, 70 n.24 (1982).

Criminal contempt, on the other hand, is "punitive, to vindicate the authority of the court." *International Union v. Bagwell*, 512 U.S. 821, 828 (1994). The key distinction for civil, as opposed to criminal, contempt is its "character and purpose." *Id.* Crucially, civil contempt is coercive in nature, and compliance with the court's order will allow the contemnor to be released from prison. *See id.*; *see Taggart v. Lorenzen*, 139 S.Ct. 1795, 1801-02 (2019). "The paradigmatic coercive, civil contempt sanction… involves confining a contemnor indefinitely until he complies with an affirmative command." *Bagwell*, 512 U.S. at 828. In these circumstances, the contemnor "can end the sentence and discharge himself at any moment by doing what he previously refused to do." *Gompers v. Bucks Stove & Range Co.*, 221 U.S. 418, 442 (1911).

Although incarceration is the "paradigmatic" example, civil contempt sanctions frequently involve only monetary or compensatory sanctions. It is only where monetary fines and injunctive orders have no coercive effect on a party (such as a recalcitrant debtor) that a bankruptcy court will resort to incarceration as the ultimate means of coercing compliance with its orders. *See, e.g., In re Duggan*, 133 B.R. 671, 672-73 (Bankr. D. Mass. 1991) (debtor incarcerated for noncompliance with turnover as last resort); *In re Tate*, 521 B.R. 427, 447-48 (Bankr. S.D. Ga. 2014) (debtor subject to incarceration order for violation of turnover order); *In re Kenny G*

Enterprises, LLC, 692 Fed.Appx. 950 (9th Cir. 2017) (unpub.) (debtor incarcerated for years based on willful disobedience of turnover order and statutory turnover obligations); *In re Brace*, 2019 Bankr. LEXIS 80, 9th Cir. BAP No. CC-18-1172-LSTa (B.A.P. 9th Cir. January 11, 2019) (debtor subject to incarceration for interference with estate property); *In re Brace*, 2021 U.S. Dist. LEXIS 36059, C.D. Cal. No. 8:20-cv-1641-JGB (C.D. Cal. February 2, 2021) (debtor subjected to second incarceration order for unlawful foreclosure sale of bankruptcy estate property).

3. Civil Contempt Procedure and Examples

Because contempt carries with it serious consequences up to and including bodily detention, the contemnor is entitled to due process prior to the imposition of contempt sanctions. While a debtor has a statutory duty of turnover outlined in 11 U.S.C. § 521 and is directed to turn over assets by 11 U.S.C. § 542(a), courts are reluctant to find that these statutory directives are in and of themselves sufficient to hold a party in contempt. Instead, the trustee must typically obtain a "specific and definite" order of the court to invoke the court's contempt powers. *In re JJE & MM Grp. LLC*, 692 Fed.Appx. 43, 45 (2d Cir. 2017) (unpublished); *Lichtenstein v. Lichtenstein*, 425 F.2d 1111, 1113 (3d Cir. 1970); *Waste Mgmt. v. Kattler*, 776 F.3d 336, 343 (5th Cir. 2015) (confusion over scope of order precluded contempt); *Gascho v. Global Fitness Holdings, LLC*, 875 F.3d 795, 800 (6th Cir. 2017); *In re Betts*, 927 F.2d 983, 986 (7th Cir. 1991); *In re Dyer*, 322 F.3d 1178, 1191 (9th Cir. 2003); *In re Lucre Mgmt. Group, LLC*, 365 F.3d 874, 875 (10th Cir. 2004).

A. Case Example: *In re Jana Olson*, Bankr. C.D. Cal. Case No. 8:15-bk-12496-TA

Ms. Olson filed a voluntary bankruptcy proceeding in 2015 during a contentious marital dissolution action. A chapter 7 trustee, Richard Marshack, was appointed, and debtor refused to cooperate with the turnover of assets and information. Specifically, the debtor refused to repatriate and turn over $3.5 million of funds she transferred to an asset protection trust in the Cook Islands. The court entered an order directing the debtor to comply with her turnover obligations and turn over a list of specified items and assets. Debtor refused. An order to show cause re: civil contempt was issued upon application by the trustee, the debtor was adjudged in civil contempt, and a warrant for debtor's arrest was entered. Included in the civil contempt and body detention order was a provision directing debtor's passports to be surrendered to the U.S. Marshals Service. Debtor had previously been twice-arrested for contempt in state court proceedings, and was transferred to federal custody and held for approximately one month.

While debtor was incarcerated, the trustee took steps to investigate the process by which the offshore assets could be repatriated, and prepared documents for debtor to sign to authorize the return of the funds. After 13 months in custody, debtor agreed to sign certain documents and the money was recovered. It should be noted that the trustee sued the asset-protection attorney who represented the debtor in settling and funding the offshore trust for conspiring with debtor to commite the fraudulent transfer.

B. Case Example: *In re Clifford Allen Brace, Jr.* Bankr. C.D. Cal. Case No. 6:11-bk-26154-SY

Mr. Brace filed a voluntary bankruptcy proceeding in 2011, disclosing almost no assets on his schedules. While the case was originally determined to be a no-asset case by the trustee, a creditor of Mr. Brace's contacted the trustee and informed him of wide-ranging fraud and concealment of assets, including the debtor's prebankruptcy transfer of unencumbered real properties to a self-settled, revocable trust. Despite the entry of a judgment in 2015 determining that these real properties were property of the estate, the debtor filed appeals and ignored the court's judgments and orders directing him not to interfere with estate property. Debtor also would file oppositions to the trustee's motions but then fail to appear at the hearings. Every time the trustee would take possession of the three real properties, debtor would soon after break in and change the locks, and rent out the properties to unwitting tenants. Debtor also secretly conducted a foreclosure sale of one of the properties and received around $229,000 in proceeds. He would foreclose on bogus notes given to family members. The bankruptcy court entered two separate orders to show cause against debtor, who opposed the imposition of sanctions, but failed to appear. Two separate civil contempt orders were issued against debtor, including authorizing a writ of bodily detention. Unlike the *Olson* case discussed above, Mr. Brace's whereabouts were unknown to the trustee and he refused to appear for any hearings. To further complicate the matter, shortly after the entry of the second contempt order, the COVID-19 pandemic resulted in the temporary cessation of the U.S. Marshals' bodily detention activities.

The debtor continued to evade enforcement of the body detention order until January 2022. During this period, the debtor attempted to list the properties for sale or rent, and threatened the title company handling the trustee's proposed sale of one of the properties (causing the title insurance company to decline coverage). In January 2022, the trustee submitted a warrant for debtor's arrest to enforce the still-outstanding body detention order, and the U.S. Marshals Service tracked down the debtor in Maricopa County, Arizona, and brought him before the local bankruptcy judge in Arizona. A remote hearing was conducted, which was presided over by an Arizona bankruptcy judge and by the California judge overseeing the case, where the debtor incorrectly asserted that the bankruptcy court in California had no jurisdiction over him in Arizona. The debtor was transferred from Arizona to Los Angeles – a transit which took approximately one month due to logistics, and the elderly debtor contracting COVID-19 while in custody. This debtor only spent approximately two months in custody before being released. Prior to his incarceration, the debtor defied every court order and judgment ever entered, including prosecuting multiple appeals (including one that wound up before the California Supreme Court on a certified question from the Ninth Circuit Court of Appeals). After one month of incarceration, the debtor agreed to cooperate and to sign and notarize any documents necessary for the sale of estate properties, and granted a power of attorney to his attorney to sign any such documents on his behalf.

4. Criminal Issues

As discussed above, the bankruptcy court's powers are limited to civil contempt powers. Also, because panel trustees are civilians and not government officials, their authority is a civil authority limited to seeking orders from the courts. Bankruptcy trustees have a statutory duty to

report suspected criminal activity. *See* 18 U.S.C. § 3057(a). A trustee may also request that the reference be withdrawn to the District Court for the purposes of considering criminal contempt sanctions. *Taylor v. Blackmon (In re Blackmon)*, 2016 U.S.Dist.LEXIS 89543, W.D.N.C. No. 3:14-cv-00507-RJC (W.D.N.C. July 11, 2016) (partially withdrawing the reference in accordance with 28 U.S.C. Section 157(d) for defendants' contempt of bankruptcy court orders, for the purpose of enforcing the orders and conducting criminal contempt proceedings); *In re Rowett*, 538 B.R. 88, 94-95 (W.D. Wash. 2015) (request by U.S. Trustee to withdraw reference). A bankruptcy court may also issue a report and recommendation to the district court that the reference be withdrawn for the purpose of initiating criminal contempt proceedings, and may recommend a guilty sentence. *See, e.g., In re McConnell*, 2015 Bankr. LEXIS 3517, Bankr. C.D. Cal. No. 2:14-bk-14501-BB (Bankr. C.D. Cal. October 16, 2015); *see also, e.g.*, *In re Yan Sui*, Bankr. C.D. Cal. No. 8:11-bk-20448-SC, ECF No. 981 (Bankr. C.D. Cal. October 31, 2022); *see also, e.g., Ace Motor Acceptance Corp. v. McCoy Motors, LLC*, 2019 U.S. Dist. LEXIS 17932, W.D.N.C. No. 3:18-cv-630-RJC (W.D.N.C. February 5, 2019); *see also, e.g., In re Stage Door Development, Inc.*, 2009 Bankr. LEXIS 2168, Bankr. M.D. Ala. No. 07-11638-DHW (Bankr. M.D. Ala. July 31, 2009); *see also, e.g., In re Johnson*, 2016 Bankr. LEXIS 4587, Bankr. S.D. Ill. No. 15-31025 (Bankr. S.D. Ill. January 5, 2016).

Recently, Richard Marshack as the appointed trustee in *In re Yan Sui*, Bankr. C.D. Cal. Case No. 8:11-bk-20448-SC, sought and obtained from Bankruptcy Judge Scott Clarkson a report and recommendation that Mr. Sui be held in criminal contempt for violating court orders. The U.S. District Court's determination is pending.

5. Conclusion

Obtaining a body detention order is nothing to celebrate or rejoice. It is a sad but necessary event. Our society best functions when rules and laws are followed. Sometimes, for the preservation of the foundation of our legal system incarceration is necessary. In our most recent case, the debtor had $178,000 in her account on the day the court ordered the turnover. Within one day, she withdrew the funds and refused to turn them over. Within a few weeks, the bankruptcy court issued a bodily detention order.

While most participants in a bankruptcy case recognize and respect the authority of the bankruptcy court and the court-appointed bankruptcy trustee, sometimes a party (usually a belligerent debtor) refuses to comply. Sometimes, monetary and injunctive relief is sufficient to coerce compliance. But sometimes, they have to go to jail.[1]

[1] The following five cases are matters in which our firm has been involved where bodily detention orders or reports and recommendations were made:

1) *In re Jana Olson*, Case No. 8:15-bk-12496-TA, ECF No. 166 (Bankr. C.D. Cal. Dec. 15, 2015);
2) *In re Brace*, Case No. 6:11-bk-26154-SY, ECF No. 150 (Bankr. C.D. Cal. June 19, 2018);
3) *In re Duchinets Development LLC*, Case No. 21-51255-MEH, ECF No. 264 (Bankr. N.D. Cal. Oct. 4, 2022);
4) *In re Yan Sui*, Case No. 8:11-bk-20448-SC, ECF No. 981 (Bankr. C.D. Cal. Oct. 31, 2022); and
5) *In re Alicia Richards*, Case No. 8:21-bk-10635-SC, ECF No. 1144 (Bankr. C.D. Cal. Jan. 12, 2023).

Faculty

Hon. Daniel P. Collins is a U.S. Bankruptcy Judge for the District of Arizona in Phoenix, appointed on Jan. 18, 2013. He served as chief judge from 2014-17 and as a conflicts judge in the Districts of Guam, Hawaii and Southern California. Previously, Judge Collins was a shareholder with the Collins, May, Potenza, Baran & Gillespie, P.C. in Phoenix, practicing primarily in the areas of bankruptcy, commercial litigation and commercial transactions. Judge Collins was the 2023 president of the National Conference of Bankruptcy Judges, is a Fellow in the American College of Bankruptcy, is on the Ninth Circuit's Trial Improvement Committee, sits on the JCUS's Bankruptcy Judges Advisory Group, served on ABI's Board of Directors and is currently a Business Court Representative in the American Bar Association's Business Law Section. In addition, he was a founder of the Arizona Bankruptcy American Inn of Court chapter, served as the board chair for the Foundation for Senior Living, was on the St. Teresa Parish Finance Committee and Parish Council, received the St. Thomas More Award for the St. Thomas More Society, was named a Significant Sig by the Sigma Chi fraternity and was named to the Sigma Chi's Beta Phi Chapter Hall of Fame. Judge Collins received both his B.S. in finance and accounting in 1980 and his J.D. in 1983 from the University of Arizona.

D. Edward Hays is a founding member of Marshack Hays LLP in Irvine, Calif., where he focuses his practice on bankruptcy and litigation matters. He was admitted to practice in 1992. Mr. Hays has been a Certified Bankruptcy Law Specialist with the State Bar of California. In 2020, he was the president of the California Bankruptcy Forum. In 2000 and 2017, Mr. Hays chaired the Commercial Law & Bankruptcy Section of the Orange County Bar Association. He also has served as a director or member of the following organizations: the Inland Empire Bankruptcy Forum; the Orange County Bankruptcy Forum; the William P. Gray Legion Lex American Inns of Court, the Federal Bar Association, and the Executive Council for the College of Business at Cal State Fullerton. In 1998 and 1999, Mr. Hays also served as a Judge *Pro Tem* for the Superior Court of the State of California, County of Los Angeles. He has been selected on numerous occasions to present continuing education lectures on various legal topics, including bankruptcy, litigation, exemptions and legal research. He has spoken at the National Conference of Bankruptcy Judges, the National Association of Bankruptcy Trustees, the National Association of Consumer Bankruptcy Attorneys, the California Bankruptcy Forum, the Orange County Bankruptcy Forum, the Inland Empire Bankruptcy Forum, the Orange County Bar Association and the Office of the U.S. Trustee for multiple regions, and he served on the Central District Task Force for Amendments to the Local Bankruptcy Rules. Mr. Hays received his B.A. in business with honors from California State University at Fullerton in 1989 and his J.D. from the University of Southern California Law Center in 1992, where he was a member of the Hale Moot Court Honors program.

Randy Nussbaum is a senior member with The Cavanagh Law Firm in Scottsdale, Ariz., and has assisted individuals and businesses with complex bankruptcy protection (debtor and creditor), transaction and litigation matters for more than 40 years. He is a Certified Bankruptcy Specialist by the Arizona Board of Legal Specialization and Board Certified in Business Bankruptcy Law by the American Board of Certification. Mr. Nussbaum has represented secured and unsecured creditors, surety companies, creditor committees, lessors, professional athletes, doctors, attorneys and trustees in chapter 7, 11 and 13 proceedings, including adversary actions (bankruptcy litigation), involving

such diverse matters as real estate, construction, manufacturing, trucking, asset-based lending, bankruptcy related to divorce, and high-value, complex individual bankruptcies. He has been named to *Super Lawyers*'" Top 50 Arizona" list of attorneys multiple times and has been selected three times by *The Best Lawyers in America* as "Best Lawyer of the Year." Committed to community service, Mr. Nussbaum is a 1990 graduate of Scottsdale Leadership and has volunteered for that organization for more than 30 years. He also serves on its advisory board and is a recipient of the prestigious Frank W. Hodges Alumni Achievement Award. In addition, Mr. Nussbaum serves on the advisory boards for the Scottsdale Center for the Performing Arts, Scottsdale Historical Society and Scottsdale Community College. He served as a Sterling Awards Jurist for the Scottsdale Chamber of Commerce, and he received the Chamber's 2017 Volunteer of the Year Award. In 2018, was inducted into the Scottsdale History Hall of Fame. Mr. Nussbaum received his B.A. *cum laude* and in 1977 his J.D. in 1980 from Arizona State University, graduating in the top 25 percent of his class.

Cristina Perez Hesano is the founder of Perez Law Group, PLLC in Gelndale, Ariz., and has been practicing law for more than 10 years. She primarily focuses her legal practice on bankruptcy, personal injury, wrongful death and estate planning. Ms. Perez established the firm in 2010. She is a 2020 honoree of ABI's "40 Under 40" program and a member of the American Association for Justice, the Arizona Bankruptcy American Inn of Court and the State Bar of Arizona's Bankruptcy Section, for which she serves as its Diversity and Inclusion chair and on its executive board. Ms. Perez received her B.S. in psychology and political science from Hofstra University, her J.D. from Arizona State University's Sandra Day O'Connor College of Law and her M.A. in criminal justice from Arizona State University.