

Bankruptcy Circuit Update

Featuring Cases from June 2019

*We will be convening our next section-wide conference call on **Friday, August 23, 2019 at 3:30 EST/12:30 PST** to present and discuss notable cases from the past few months of the summaries. We are seeking volunteers to summarize significant or interesting cases. Please send an email to csullivan@diamondmccarthy.com if you are interested in presenting a case. The call-in information is: **Dial-In: 866-690-2070 / Code 787-594-2077.** We hope you will join us for this call.*

Second Circuit

Fed. Trade Comm'n v. Rensin, 17-1587 (2nd Cir., June 26, 2019)

The Second Circuit vacated the judgment of the district court holding that the automatic stay imposed by the chapter 7 bankruptcy of Joseph Rensin (“Rensin”) did not apply to efforts to enforce a district court order seeking to hold Rensin in contempt pursuant to the “governmental unit” exception of Bankruptcy Code section 362(b)(4).

The district court order at issue in this case sought to hold Rensin in contempt for failing to comply with an order from the Federal Trade Commission (“FTC”) imposing approximately \$13.4 million in compensatory contempt sanctions on Rensin. On appeal, Rensin argued that the contempt proceedings against him constituted the enforcement of a money judgment and therefore fell outside of the “governmental unit” exception to the automatic stay. Accordingly, Rensin argued that the contempt order was void.

The Second Circuit noted that the only issue in this case was whether the district court’s disposition of the FTC’s attempt to pursue the contempt order amounted to the “enforcement of a . . . money judgment” and therefore fell outside of the governmental unit exception and violated the automatic stay. While the governmental unit exception of Bankruptcy Code section 362(b)(4) permits the entry of a money judgment against a debtor, anything beyond the mere entry of such money judgment is prohibited by the automatic stay. Enforcement of a money judgment, for example, would fall outside the governmental unit exception.

Here, the Second Circuit held that the FTC’s purpose in seeking the entry of the contempt order was simply to enforce a previously entered money judgment against Rensin. In so holding, the Second Circuit noted that the timing of the order’s entry constitutes a crucial factor of the analysis in this context. Here, the Second Circuit noted that not only was the FTC’s request for a contempt order filed after entry of judgment, it also had no other purpose than to enforce the money judgment against Rensin. Although the FTC had filed its request for a contempt order before Rensin filed his bankruptcy petition, once the automatic stay was in place, the district court was prohibited from disposing of that request while Rensin’s bankruptcy remained pending. For that reason, the Second Circuit held that the district court’s conclusion that it could, and

indeed did, decide the contempt issue under the governmental unit exception was erroneous because the contempt proceeding was an attempt to enforce the money judgment. Accordingly, the Second Circuit vacated the orders of the district court.

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Fifth Circuit

***Okla. St. Treas. v. Linn Operating, Inc. (In re Linn Energy)*, —F. App'x—, No. 18-40575, 2019 WL 2520074 (5th Cir. June 19, 2019).**

Linn Energy, LLC (“Debtor”), an oil and gas company, filed for chapter 11 bankruptcy. The Oklahoma State Treasurer (“Treasurer”) filed three proofs of claim seeking “unknown/contingent” amounts on behalf of investors who failed to claim unclaimed-property funds that Debtor owed to them for royalties and working interests from Oklahoma oil and gas operations.

Debtor filed its plan, which provided: (1) any right to payment from a royalty and working interest would be treated as an unsecured claim subject to discharge or relief; (2) property of the estate would vest in Debtor free and clear of all liens, claims, charges, and other encumbrances once the plan became final; and (3) distributions, rights, and treatment under the plan would vest in Debtor free and clear of all liens, claims, and charges once the plan became final. Treasurer did not vote on Debtor’s plan. Treasurer also failed to appeal the order confirming Debtor’s plan.

About two months after Debtor’s confirmation order became final, Debtor objected to Treasurer’s proofs of claim for “unknown/contingent” amounts, asserting that it was not liable for the claims. Treasurer responded to Debtor’s objection and filed an adversary complaint asserting that unclaimed mineral royalties from Debtor’s oil and gas operations were not property of the estate and could not be governed by Debtor’s plan. The bankruptcy court granted Debtor’s motion to dismiss Treasurer’s adversary complaint because Treasurer “received adequate due process” and the complaint was a “collateral attack” on Debtor’s plan. The district court reversed, finding that the unclaimed royalties and working interests never became property of the estate.

On appeal, the Fifth Circuit reversed the district court’s reversal of the bankruptcy court’s judgment. The Fifth Circuit held that the bankruptcy court’s approval of the plan and the subsequent entry of a confirmation order comprised a final judgment that could not be collaterally attacked pursuant to *Travelers Indemnity Co. v. Bailey*, 557 U.S. 137, 129 S. Ct. 2195, 174 L.Ed.2d 99 (2009). Treasurer’s failure to either vote on the plan, object to the plan, or appeal the plan’s treatment of the unclaimed property from Oklahoma oil and gas operations caused the Fifth Circuit

to reinstate the bankruptcy court's decision to dismiss Treasurer's adversary complaint based on res judicata principles.

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Seventh Circuit

***In re Wade*, 926 F.3d 447 (7th Cir. 2019)**

In *Wade*, the debtors Harold and Lorraine Wade (“Debtor-Appellants”) moved for sanctions against a law firm alleging the firm violated the automatic stay arising from their bankruptcy petition by filing a lien against Debtor-Appellants’ home. The Debtor-Appellants had voluntarily dismissed a prior bankruptcy petition just a few months earlier. Accordingly, the bankruptcy judge denied their motion based on 11 U.S.C. § 362(c)(3), which lifts the automatic stay after 30 days in the case of a successive petition. Bankruptcy courts, however, are divided over the proper interpretation of § 362(c)(3), so the judge certified the order for direct appeal to the Seventh Circuit. A timely notice of appeal followed but the Debtor-Appellants did not file a petition for permission to appeal, as required by Rule 8006(g). The law firm-appellee moved to dismiss the appeal.

Rule 8006 of the Federal Rules of Bankruptcy Procedure applies where a bankruptcy court has certified an order for direct review in a court of appeals. Subsection (g) states that “[w]ithin 30 days after the date the certification becomes effective under subdivision (a), a request for permission to take a direct appeal to the court of appeals must be filed with the circuit clerk.” The Seventh Circuit determined that as a procedural rule, rather than a statutory one, Rule 8006(g) was mandatory, not jurisdictional.

The Seventh Circuit rejected the Debtor-Appellants’ reliance on prior Seventh Circuit decisions declining to dismiss direct appeals for the appellants’ failure to request permission to appeal under the Bankruptcy and Appellate Rules. Those cases had found dismissal was unwarranted where the record contained the “functional equivalent” of the requisite petition or the defect was harmless. In *Wade* Seventh Circuit determined those decisions could not be reconciled with the Court’s recent decisions enforcing mandatory rules. The Seventh Circuit further included that in *Nutraceutical Corp. v. Lambert*, 139 S. Ct. 710, 714 (2019), the Supreme Court found that mandatory claim-processing rules are “unalterable[.]”

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Ninth Circuit

***In re Pena*, — B.R. — (9th Cir. BAP 2019).**

In *In re Pena*, the 9th Circuit BAP affirmed the bankruptcy court's order denying Debtor's application for unclaimed funds.

Debtor originally filed a chapter 11 but the court sua sponte converted the case to chapter 7 based on Debtor's unauthorized use of cash collateral. After Debtor appealed the conversion order, the Court authorized the chapter 7 trustee to manage Debtor's 29 rental properties pending the outcome of the appeal. After the conversion order was affirmed, the trustee abandoned the properties and sought to pay the accumulated rents to secured creditors as cash collateral. The secured creditors did not accept the rents and ultimately the trustee deposited the funds in the court registry and closed the case.

Debtor argued that he was entitled to the unclaimed funds because with each property, the secured creditors had either foreclosed or Debtor was current on his payments. Debtor also argued that as a result of the Trustee's *nunc pro tunc* abandonment of the real properties, the rents should be treated as if no bankruptcy case had been filed. The bankruptcy court disagreed and ruled that the estate's unsecured creditors were entitled to the funds.

The BAP affirmed and held that because the rents were separate property of the estate under §541(a)(6) and the abandonment order only pertained to the real properties, the rents remained property of the estate. The BAP also held that because the trustee administered the rents by sending checks to the secured creditors, the rents were not technically abandoned upon closing the case. Finally, the BAP held that the designation of the case as a "no asset" case did not alter the nature of the funds as property of the estate and unsecured creditors should be afforded an opportunity to reopen the case and seek distribution of the funds.

Tenth Circuit

***Stevens, Littman, Biddison, Tharp & Weinberg, LLC v. Walters (In re Wagenknecht)*, No. CO-18-093, 2019 WL 2353534 (BAP 10th Cir. June 4, 2019).**

In *Stevens, Littman, Biddison, Tharp & Weinberg, LLC v. Walters (In re Wagenknecht)*, No. CO-18-093, 2019 WL 2353534 (BAP 10th Cir. June 4, 2019), the BAP affirmed summary judgment for the chapter 7 trustee holding that a prepetition payment of \$21,672.65 made to a law firm that had been representing the debtor for past-due fees where the payment was made in conjunction with (and 3 days after) a promissory note the debtor had issued in favor of his mother for the same amount. In his Statement of Financial Affairs the debtor listed a payment of \$20,000 made during the 90 days preceding the filing by the debtor's mother to the law firm on the debtor's behalf. The trustee sued the law firm as the recipient of a preferential transfer; the law firm moved for summary judgment arguing that the funds it received were not a transfer of an interest of the debtor in property and there was as a result no diminishment of the estate by the payment made by the debtor's mother. The trustee contended that the debtor had an interest in the funds paid to the firm. The bankruptcy court ruled for the trustee, relying on the Tenth Circuit's decision in *Parks v. FIA Card Servcs., N.A. (In re Marshall)*, 550 F.3d 1251 (10th Cir. 2008), holding that payment of a credit card balance through a loan from a new credit card lender (as opposed to the debtor-credit card holder) directly to the old credit card lender constituted a preferential transfer. In affirming, the BAP explained that the debtor's exercise of his ability to control the loan proceeds was evidenced by signing the note in favor of his mother, noting that the debtor did not refuse the loan if the proceeds were not paid to him, and the payment by the debtor's mother was not a gift. In short, the BAP reasoned that the borrowed funds were used to pay the debtor's creditor, meeting the well-known dominion and control test. Again following *Marshall* which held, in part, that a transfer of loan proceeds diminishes the estate, the BAP concluded that the estate was diminished even though one creditor (the old credit card lender) was replaced by another creditor (the new credit card lender).

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