

## **Bankruptcy Circuit Update**

### ***Featuring Cases from May 2019***

*We will be convening our next section-wide conference call on **Friday, June 28, 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@diamonddmccarthy.com](mailto:csullivan@diamonddmccarthy.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**

#### ***Ashmore v. CGI Grp., Inc., 18-2392 (2nd Cir., May 8, 2019)***

In this case, the Second Circuit held that the doctrine of judicial estoppel should not be used to prevent a litigant from proceeding with a suit in district court when such litigant is also a *pro se* debtor whose initial bankruptcy filings did not properly list his pending district court litigation as an “asset,” but who otherwise disclosed that lawsuit, both in his initial filings and to the trustee and bankruptcy court on numerous subsequent occasions.

#### *Procedural Background*

This case arose out of two separate proceedings: (i) a lawsuit filed by Benjamin J. Ashmore, Sr. (“Ashmore”) under Section 806 of the Sarbanes-Oxley (“SOX”) Act in the Southern District of New York (“SDNY”) in 2011, and (ii) a voluntary *pro se* Chapter 7 bankruptcy case filed in the Bankruptcy Court for the District of New Jersey in 2013.

In 2011, Ashmore filed a whistleblower complaint in which he alleged that defendants CGI Group Inc. and CGI Federal Inc. (collectively, “CGI”) had improperly terminated his employment in retaliation for various actions he took upon discovering that CGI was developing fraudulent schemes to generate business. In addition to his SOX claim, Ashmore brought a contract claim for a bonus he claimed he was owed upon termination.

In 2013, Ashmore filed for bankruptcy, and in the schedules of assets filed in connection with his bankruptcy case, Ashmore did not include the SOX litigation. However, Ashmore did list the SOX litigation in his statement of financial affairs, and he also mentioned the litigation to the chapter 7 trustee during the initial creditor meeting required by Bankruptcy Code section 341(a).

A few months later, Ashmore moved to dismiss his bankruptcy action, claiming that his filing was a mistake and that he would be able to meet his obligations due to “intervening matters.” The chapter 7 trustee asked Ashmore to clarify the nature of the intervening matters, and Ashmore replied with an explanatory letter attaching the SOX complaint. The trustee published the letter on the bankruptcy court docket and proceeded to oppose dismissal of the bankruptcy petition, arguing that the lawsuit was a potential asset that she should administer on behalf of the estate.

The bankruptcy court denied the motion to dismiss, and Ashmore then notified the district court that he was involved in bankruptcy proceedings and requested a 30-day stay for the chapter 7 trustee to retain counsel and move to be substituted in as the party-in-interest.

However, the chapter 7 trustee soon reversed course. After learning that the SOX litigation was not nearing an imminent conclusion, the trustee told Ashmore that she was willing to close the bankruptcy case so that Ashmore could continue with the SOX litigation without delay or jeopardy, provided that Ashmore consented to reopening the case if he prevailed in the SOX litigation and collected an amount sufficient to generate a distribution to unsecured creditors. Ashmore agreed and entered into a letter agreement with the trustee. The trustee then filed a "Report of No Distribution" with the bankruptcy court in which she stated that "there is no property available for distribution," and that the estate had thus been "fully administered." She did not mention the SOX litigation. The same day, the trustee notified the SDNY judge that she had closed the bankruptcy proceeding and that the SOX litigation could thus "proceed outside of the Bankruptcy Court jurisdiction."

For approximately two years, Ashmore's SOX case proceeded in the SDNY with no further reference to his standing to maintain the action or to his bankruptcy filings. In 2015, however, CGI retained new counsel, who promptly contacted the trustee to inform her that Ashmore had rejected substantial settlement offers made by CGI. The trustee then immediately moved to reopen the bankruptcy case, stating that she had been advised that settlement offers over \$800,000 had been made. CGI then moved to stay all proceedings pending the resolution of the trustee's motion to reopen Ashmore's bankruptcy case, which the SDNY judge granted.

Upon learning that the SOX litigation had been stayed, the trustee withdrew her motion to reopen the bankruptcy proceedings and contacted the SDNY court with a clear statement of intent, noting that she had intended for Ashmore to prosecute the SOX litigation because any recovery would be a valuable component of the bankruptcy estate, and that she was withdrawing the motion to reopen because it was creating confusion as to who was in a position to prosecute the SOX litigation. In response, the SDNY judge lifted the stay. CGI then moved to dismiss for lack of standing, arguing that the case had not been abandoned to Ashmore to prosecute.

The trustee then made a second motion to reopen the bankruptcy case, stating that she was concerned that a valuable asset would be lost for both the debtor and his creditors if the SOX litigation was dismissed for lack of standing. The bankruptcy court eventually reopened Ashmore's bankruptcy case for the limited purpose of administering the SOX litigation. Once the bankruptcy case was reopened, the trustee issued a notice informing creditors that assets had been located and they could file proofs of claim.

In this posture, with the bankruptcy case reopened for the limited purpose of administering the SOX litigation, and the SDNY action stayed, the parties continued to argue in both courts about whether Ashmore had been, and continued to be, a proper party-in-interest. First, the SDNY judge held that the trustee had not abandoned the SOX litigation to Ashmore pursuant to Bankruptcy Code section 554(c) because Ashmore had failed to list the Sox litigation on his schedule of assets, dismissing the action as to Ashmore and directing the trustee to substitute in as the proper party-in-interest.

Meanwhile, the trustee and Ashmore moved in bankruptcy court for approval of a settlement in which Edwards would officially abandon the SOX action under Bankruptcy Code section 554(a) in exchange for Ashmore paying in full any creditors who had filed proofs of claim. In anticipation of this settlement, Ashmore officially amended his schedule of assets to include the SOX litigation. The bankruptcy court approved the proposed settlement over CGI's objections, and Ashmore paid all creditors who had filed proofs of claim since the reopening of the bankruptcy case.

After the SOX litigation was officially abandoned by the trustee, she and Ashmore jointly moved in the district court to restore Ashmore as the plaintiff and proper party-in-interest. Ashmore also renewed an earlier motion for reconsideration of the earlier order dismissing the case for lack of standing, and CGI renewed an earlier motion for dismissal on the grounds of judicial estoppel.

In 2018, the SDNY judge resolved all outstanding motions, granting Ashmore's motion to be substituted as plaintiff, then denying his motion for reconsideration as moot in light of the trustee's official abandonment of the SOX action, and finally granting CGI's motion to dismiss on the grounds of judicial estoppel. Ashmore appealed the decision to the Second Circuit, challenging (i) the 2018 SDNY order in which the district court dismissed his case on the grounds of judicial estoppel, (ii) the 2016 SDNY order in which the district court found that the trustee had not abandoned the litigation to Ashmore and so dismissed the case for lack of standing, and (iii) the 2015 SDNY decision of the district court granting summary judgment to CGI on his contract claims.

### *The Second Circuit Opinion*

Turning first to the order implicating judicial estoppel, the Second Circuit noted that the doctrine is intended to prevent a litigant from gaining an unfair advantage through the adoption of inconsistent positions in successive suits. Specifically, the Second Circuit stated that judicial estoppel is properly invoked where: (i) a party's later position is clearly inconsistent with its earlier position, and (ii) the party's former position has been adopted in some way by the court in an earlier proceeding. The Second Circuit has also often, but not always, required a showing that the party asserting the two inconsistent positions would derive an unfair advantage against the party seeking estoppel.

In the bankruptcy context, judicial estoppel is regularly invoked to prevent a party who failed to disclose a claim in bankruptcy proceedings from asserting that claim after emerging from bankruptcy. Further, whether a party is advancing inconsistent claims in the bankruptcy context is impacted by the bankruptcy court's treatment of those claims. For the purposes of judicial estoppel, the Second Circuit typically finds that a bankruptcy court "adopted" a particular position when the bankruptcy court confirms a plan pursuant to which creditors release their claims against the debtor.

The Second Circuit noted that it had recently affirmed the use of judicial estoppel in two opinions dealing with failure to disclose assets in bankruptcy court. First, in *Adelphia Recovery Tr. v. Goldman, Sachs & Co.*, 748 F.3d 110, 118 (2d Cir. 2014), the Second Circuit affirmed the use of judicial estoppel where the debtor cable company had failed to list in its bankruptcy filings

an account whose ownership was in question. Throughout a five-year bankruptcy proceeding, the debtor never claimed the account as one of its assets; however, it later brought suit in the district court claiming that it owned the account. The Second Circuit held that judicial estoppel was properly invoked, concluding that a different ruling would threaten the integrity of the bankruptcy process by encouraging parties to alter their positions as to ownership of assets depending on their litigation needs.

Second, in *BPP Illinois, LLC v. Royal Bank of Scotland Grp. PLC*, 859 F.3d 188, 191 (2d Cir. 2017), the Second Circuit affirmed the use of judicial estoppel where a group of hotel-related debtor businesses brought a fraudulent inducement suit against several banks, but where, in a parallel bankruptcy proceeding, their schedules of assets omitted the claims and the debtors never disclosed the parallel legal proceedings throughout a two-year bankruptcy proceeding.

In contrast, in *Clark v. AII Acquisition, LLC*, 886 F.3d 261, 264 (2d Cir. 2018), the Second Circuit held that the district court abused its discretion in applying the doctrine of judicial estoppel to a case involving a debtor who was unsure of whether his bankruptcy asset schedules needed to be updated to reflect his diagnosis of mesothelioma and his intention to litigate. The debtor alerted his bankruptcy counsel and trusted him to do what was required under the law, but the debtor's counsel failed to convey the information to the bankruptcy court, and the district court subsequently dismissed the debtor's personal injury suit on judicial estoppel grounds. Noting that "judicial estoppel is not a mechanical rule," the Second Circuit held that the record did not evince any intentional gamesmanship and that equitable principles therefore required the courts to entertain the personal injury claims.

After reviewing this Second Circuit precedent, the Second Circuit looked to the law of the circuit in which the bankruptcy proceeding was filed for the limited purpose of determining whether the failure to list a particular claim on a debtor's bankruptcy filings is equivalent to an assertion that the debtor did not have such a claim. Here, because Ashmore's bankruptcy case was filed in New Jersey, the Second Circuit examined whether, under Third Circuit law, failure to list a claim amounts to a denial that the claim exists.

In this context, the Third Circuit's analysis depends on the facts and circumstances of the case, and is intertwined with that circuit's judicial estoppel standard. Specifically, the Third Circuit test focuses heavily on the intersection between inconsistent assertions and bad faith on behalf of the party accused of making the contradictory statements. In both of the leading cases on the intersection of judicial estoppel and bankruptcy-related nondisclosures in the Third Circuit, the court held that the application of judicial estoppel was not appropriate, because there was no evidence that the nondisclosure was intentional and manipulative.

Accordingly, the Second Circuit noted that it was not able to discern an absolute answer in Third Circuit law to the narrow question of whether any nondisclosure on behalf of Ashmore constitutes an assertion that the litigation does not exist. The Second Circuit then proceeded to an examination of the four factors that Second Circuit precedent requires a court to consider in this context.

### *1. Advancement of Inconsistent Factual Positions*

The first requirement for the application of judicial estoppel is that a party's later position is clearly inconsistent with its earlier position. In this context, the district court had analyzed Third Circuit law and concluded that the failure to list a pending action in the schedule of assets constitutes an assertion that the action does not exist. The Second Circuit, however, found this reasoning unpersuasive, noting that the Third Circuit seems to focus its analysis on the good or bad faith of the debtor.

The Second Circuit also disagreed with the district court's conclusion that Ashmore's conduct suggested an effort to conceal the existence of the SOX action as an asset in order to shield it from his creditors. The district court cited to three actions as supporting its conclusion: (1) the fact that Ashmore's initial motion to dismiss his bankruptcy case cited only to "intervening matters;" (2) that Ashmore and the trustee failed to disclose their letter agreement to the bankruptcy court; and (3) that Ashmore opposed the trustee's second motion to reopen and argued in the district court that she had abandoned the action to him. The Second Circuit held that these actions could not bear the weight assigned to them by the district court, especially in light of the numerous actions that Ashmore took that demonstrated candor about the SOX litigation.

With regard to that candor, the Second Circuit noted that in Ashmore's very first bankruptcy filing, as part of the statement of financial affairs, he listed the SOX litigation by name and docket number. While he should have also listed it on the schedule of assets, the Second Circuit noted that it is difficult to attribute to a *pro se* debtor a scheme to hide a fact that he disclosed on what would surely appear to a lay person to be a parallel schedule. Moreover, Ashmore also mentioned the litigation to the trustee at the creditors' meeting, and provided her with a copy of the complaint a few weeks later. Shortly thereafter, the trustee provided that communication to the bankruptcy judge and posted it on the docket where it was publicly accessible. The Second Circuit noted that it was therefore undisputed that three months after his initial filing, both the trustee and the bankruptcy judge were fully aware of the SOX litigation, and thus well situated to protect the creditors' interests.

The Second Circuit also did not find that Ashmore's initial lack of disclosure regarding the letter agreement with the trustee to be evidence of bad faith. If anything, the Second Circuit noted that such nondisclosure was evidence of the trustee's dereliction of duty under Bankruptcy Rule 9019(a), which requires the court to approve a "compromise or settlement" with notice to the creditors. Indeed, the Second Circuit found it difficult to fault Ashmore, a *pro se* debtor, when the trustee (i) was the only party with the authority to move the bankruptcy court for approval of the letter agreement, and (ii) was the party charged with serving as the representative of the creditors and as an officer of the court.

Under these circumstances, the Second Circuit was not able to conclude that Ashmore asserted clearly inconsistent positions. In fact, the Second Circuit found Ashmore's position in the district court — that he did indeed have a SOX claim — to be consistent with: (1) listing the litigation on his statement of financial affairs at the time of filing; (2) disclosing at least the existence of the litigation at the creditors' meeting; (3) attaching the complaint at the trustee's request when he first attempted to dismiss the bankruptcy action; or (4) giving in-depth testimony at the bankruptcy court hearing in 2013 as to the nature of the SOX action and his desire to control the litigation. The Second Circuit held that the limited facts relied upon by the district court were not sufficient, in the face of these actions, to support a finding that Ashmore intended to persuade

the bankruptcy court that he did not have a claim against CGI. The Second Circuit therefore held that the district court clearly erred in finding that Ashmore's positions were "clearly inconsistent," and that it erroneously interpreted Third Circuit law when it concluded that his failure to list the claim on his schedule of assets was, in and of itself, an assertion that the litigation did not exist.

## *2. Adoption*

The second requirement for judicial estoppel is a finding that the party's former position has been adopted in some way by the court in the earlier proceeding. Here, the district court had concluded that the bankruptcy court adopted the position that there was no SOX litigation, citing several district court cases for the proposition that a discharge of debts, together with the closing of a bankruptcy case without the distribution of an asset, constitutes an adoption of the position that the asset does not exist. The district court thus found that, when the bankruptcy court originally discharged Ashmore's debts without the distribution of any assets in 2013, it adopted the position that the SOX litigation did not exist.

Upon a thorough review of the record, the Second Circuit found that the district court had again come to the wrong conclusion. While the record is silent as to why the bankruptcy judge did not inquire about the SOX litigation when he discharged Ashmore's debts, it does, however, make clear that the judge was fully aware of the potential of the SOX litigation to generate assets for the creditors. Accordingly, the Second Circuit was unable to conclude that the bankruptcy court adopted a position that the SOX litigation did not exist and held that the district court's analysis of the adoption question was erroneous.

## *3. Unfair Advantage/Detriment*

In addition to the two requirements discussed above, the Second Circuit often requires that the party seeking to assert an inconsistent position would derive an unfair advantage or impose an unfair detriment on the opposing party if not estopped. Here, the district court considered this factor and concluded that Ashmore derived an unfair advantage from his failure to disclose the SOX action as an asset to the Bankruptcy Court.

However, the Second Circuit found that conclusion to also be erroneous, as the argument that Ashmore gained any advantage at the expense of his creditors is theoretical and speculative. Although Ashmore was initially discharged of his debts in 2013, the letter agreement provided that he would consent to reopen the case if he succeeded in the SOX litigation. And regardless of such agreement, the bankruptcy case was in fact later reopened and the creditors were advised of the litigation and invited to submit proofs of claim against the estate. Though it recognized these facts, the district court analyzed Ashmore's potential unfair advantage over his creditors by comparing the original amount of liabilities that Ashmore listed at the time of the 2013 filing with the aggregate amount of the proofs of claim that were filed upon the reopening of his bankruptcy action.

However, the Second Circuit noted that the large discrepancies between these amounts ultimately derived primarily from (i) nondischargeable student loans, and (ii) debts owed to Ashmore's wife and his wife's attorney as part of a divorce proceeding. With such amounts removed from this analysis, Ashmore owed approximately \$65,000 to creditors, and proofs of

claim were filed in the amount of \$50,356.88. The Second Circuit held that to conclude that Ashmore was unfairly advantaged because no claims were filed for the approximately \$15,000 in outstanding claims is to engage in an undue speculation, especially when every creditor was notified in 2016 of the opportunity to file a claim in light of the potentially valuable SOX litigation. The Second Circuit noted that the reasons individual creditors chose to file or did not choose to file are presumably various, and that there is no evidence that any of them were disadvantaged by anything that happened in either proceeding.

#### *4. Impact on Judicial Integrity*

The final factor requires that the doctrine of judicial estoppel only be applied when a negative impact on judicial integrity is certain, as judicial estoppel is primarily concerned with protecting the judicial process. Here, the district court concluded that invoking judicial estoppel was necessary to protect judicial integrity, because the court was concerned that a contrary outcome would serve to incentivize debtors from not fully disclosing assets to the bankruptcy court.

The Second Circuit disagreed that judicial integrity required dismissal in this case, noting that both the bankruptcy court and the trustee made a series of strategic decisions in an attempt to best preserve the SOX litigation as a potential asset for Ashmore's creditors, concluding in an official settlement whereby Ashmore paid the claims of all creditors who sought relief, and the trustee officially abandoned the litigation to him. The Second Circuit held that to now find that Ashmore concealed the action from that same court would undermine the years of hearings and motions on exactly this issue.

#### *Conclusion*

The Second Circuit then compared the facts of this case to other cases analyzing issues of judicial estoppel and bankruptcy disclosures. Ultimately, the Second Circuit held that where, as here, a *pro se* debtor has listed his pending litigation on the statement of financial affairs, rather than the schedule of assets as it was constituted at the time of Ashmore's filing, and then disclosed it to the trustee and the bankruptcy court prior to discharge of his debt, and the trustee and the bankruptcy court were on sufficient notice to take steps to protect the creditors' interests, the debtor is not estopped from pursuing that litigation by virtue of the doctrine of judicial estoppel. The Second Circuit held that for estoppel to apply, there must be greater indicia than presented here of an intent to deceive the court for the debtor's benefit.

Finally, the Second Circuit addressed the other issues in the case, holding that (i) the abandonment order was moot because the trustee had unquestionably effected a successful abandonment of the litigation, thus leaving no question as to Ashmore's standing, (ii) the district court correctly granted summary judgment to CGI on Ashmore's contract claims, and (iii) Ashmore's request for reassignment to a new judge in SDNY should be denied because Ashmore failed to identify any specific instances of impartiality or animus.

Accordingly, the Second Circuit vacated the judgment of the district court as it applied to either judicial estoppel or lack of standing to dismiss Ashmore's claims under the Sarbanes-Oxley

Act, affirmed the judgment dismissing Ashmore's breach of contract claim, and remanded the case for further proceedings consistent with its opinion.

***Ladder 3 Corp. v. OTR Media Grp., Inc. (In re Ladder 3 Corp.),***  
**18-1799 (2nd Cir., May 29, 2019)**

The Second Circuit affirmed the judgment of the district court affirming the bankruptcy court's order granting the summary judgment motion of debtor Robert J. Musso ("Ladder 3") and denying the summary judgment motion of OTR Media Group, Inc. ("OTR").

On appeal, OTR argued that a stipulated settlement (the "Stipulation"), which settled all claims between OTR and Ladder 3 and was approved by the bankruptcy court under Bankruptcy Rule 9019(a), was rendered null by operation of Bankruptcy Code section 349(b)(3) when Ladder 3's underlying bankruptcy case was dismissed. Section 349(b)(3) states that "[u]nless the court, for cause, orders otherwise," the dismissal of a bankruptcy case "revests the property of the estate in the entity in which such property was vested immediately before the commencement of the case."

OTR argued that Ladder 3's underlying bankruptcy case created a bankruptcy estate for Ladder 3. Then, the parties entered into the Stipulation, which vested in Ladder 3's estate the right to certain payments from OTR. Next, the underlying bankruptcy case was dismissed. That dismissal, according to OTR, nullified the Stipulation and revested the right to payments from OTR in OTR.

Both the bankruptcy court and the district court disagreed with this reasoning. The bankruptcy court concluded that section 349(b)(3) did not apply to the right to payments from OTR, because no property of the estate was vested in OTR prior to the underlying bankruptcy proceeding. The right to payment on Ladder 3's claims against OTR was not vested in any entity other than Ladder 3 prior to initiation of that proceeding. In fact, OTR had no right to payment with respect to the claims asserted by Ladder 3 against it. Further, the bankruptcy court held that the compromise of OTR's counterclaims pursuant to the Stipulation did not constitute a transfer of property to Ladder 3 that was vested in OTR prior to the underlying bankruptcy proceeding. The Stipulation provided for the full and final settlement of those counterclaims along with the claims asserted by Ladder 3 against OTR. The counterclaims were not assigned to Ladder 3.

The district court agreed, stating that section 349(b)(3) did not revest the right to payment in OTR upon dismissal of the underlying bankruptcy case because OTR could not possibly have a right to payment on claims for which it was being sued. Thus, bankruptcy court's opinion, firmly rooted in well-established legal principles, clearly established that section 349(b) has no effect on the enforcement of the court-ordered Stipulation.

The Second Circuit agreed with both lower courts, noting that under the plain meaning of section 349(b)(3), the provision operates only to revest property in entities that had a vested right in the property prior to the initiation of bankruptcy proceedings. Here, OTR did not have a vested right to payments from itself prior to Ladder 3's initiation of the underlying bankruptcy case. As a result, the Second Circuit held that section 349(b)(3) is inapposite and affirmed the judgment of the district court.

***Speer v. Clipper Realty Tr. (In re Speer), 17-1323 (2nd Cir., May 8, 2019)***

The Second Circuit affirmed the orders of the district court (i) dismissing the appeal of debtor Sheri Speer (“Speer”) of the bankruptcy court’s order granting an involuntary petition against her as moot after her case was converted to chapter 11, and (ii) converting Speer’s case back to chapter 7.

In 2014, Clipper Realty Trust, Michael Teiger, SLS Heating, LLC, and Seaport Capital Partners, LLC (the “Creditors”) brought an involuntary Chapter 7 petition against Speer. The bankruptcy court later granted the Creditors’ Chapter 7 petition, and Speer appealed that grant to the district court. However, while the appeal was pending, the bankruptcy court granted Speer’s motion to convert her case from Chapter 7 to Chapter 11. The district court then granted the Creditors’ motion to dismiss the appeal as moot, in light of the conversion.

Several months later, the bankruptcy court granted one of the Creditor’s motion to reconvert the case back to Chapter 7. In a separate proceeding, Speer appealed the reconversion grant to the district court, and the district court affirmed the reconversion order. Speer appealed that judgment to the Second Circuit but defaulted on her appeal when she failed to file a required form, and her appeal was dismissed.

In late 2015, in the proceeding that formed the basis of this appeal, the district court granted Speer’s motion to reopen her initial appeal of the bankruptcy court’s order granting the Creditors’ Chapter 7 petition, but ultimately dismissed the appeal as moot, again because of the original conversion to Chapter 11. Speer appealed again, and though the Second Circuit found her arguments on appeal to be “far from clear,” she appeared to be making two primary claims: (i) the original conversion of Speer’s case from Chapter 7 to Chapter 11 did not moot her appeal; and (ii) the district court erred in reconverting Speer’s case back to Chapter 7.

Turning first to the original conversion of Speer’s case, the Second Circuit held that the original conversion of Speer’s case from Chapter 7 to Chapter 11 mooted her appeal of the bankruptcy court’s grant of the Creditors’ Chapter 7 petition. The Second Circuit noted that a case becomes moot when it is impossible for a court to grant any effectual relief whatever to the prevailing party. In a bankruptcy case, mootness can also be based on jurisdictional and equitable considerations stemming from the impracticability of fashioning fair and effective judicial relief. As is especially relevant here, the conversion of a petition from one chapter to another generally moots an appeal taken from an order in the original chapter, because a voluntary conversion is an election of remedies that obviates the need for further litigation of issues based on the original bankruptcy petition. Moreover, a conversion generally renders a plan under the prior chapter irrelevant and leaves courts unable to provide effective relief with respect to that plan.

Here, the bankruptcy court granted Speer’s motion to convert her case from Chapter 7 to Chapter 11. Accordingly, the Second Circuit held that Speer’s appeal of the bankruptcy court’s grant of the Chapter 7 petition was moot.

The Second Circuit then turned to Speer’s apparent challenge of the re-conversion of her case back to Chapter 7. While the Second Circuit noted that Speer may have been challenging the grounds of the re-conversion on the merits, such objections were not properly before the Second

Circuit, as this case derived from an appeal of the district court's decision not to reopen Speer's initial objections to the first Chapter 7 order. Such appeal did not bring the reconversion order itself up for review.

The Second Circuit noted that Speer may also have been challenging the reconversion on the grounds that, by reconverting the case to Chapter 7 from Chapter 11, the court unmooted the challenge she originally made to the first Chapter 7 order. And the reconversion arguably unmooted her appeal of the grant of the Chapter 7 petition. The Second Circuit noted that it has not addressed the mootness implications of a converted petition being reconverted back to the original chapter. Other courts, however, have suggested that such a reconversion unmoots the appeal.

While the Second Circuit had some doubt as to whether Speer's arguments remained moot once the case was reconverted back to a Chapter 7 case, the Second Circuit noted that it need not reach this issue because it concluded that Speer's claim as to the reconversion was barred by *res judicata*. In the circumstances of this case, Speer could have raised her arguments concerning the reconversion of the case to a Chapter 7 proceeding in her prior appeal. Speer, however, failed to raise this claim during that appeal, all of the Creditors were included on that appeal, and that appeal was finally adjudicated. While the final adjudication consisted of a default judgment, the Second Circuit has long held that default judgments can support *res judicata* because *res judicata* does not require the precluded claim to actually have been litigated; its concern, rather, is that the party against whom the doctrine is asserted had a full and fair opportunity to litigate the claim. Accordingly, the Second Circuit held that Speer's claim that the bankruptcy court erred in reconverting the case to a Chapter 7 proceeding was barred by the doctrine of *res judicata*, and affirmed the orders of the district court.

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## **Fifth Circuit**

### ***In re Robertson*, No. 18-4060, 2019 WL 2296210 (10<sup>th</sup> Cir. May 29, 2019)**

In *In re Robertson*, No. 18-4060, 2019 WL 2296210 (10<sup>th</sup> Cir. May 29, 2019) (*per curiam*), the Tenth Circuit affirmed the BAP’s dismissal of a *pro se* litigant’s appeal of an adverse order of the bankruptcy court on the basis that an untimely Rule 9023 motion is ineffective to toll the time to file a notice of appeal under 28 U.S.C. § 158(c)(2) and Bankruptcy Rule 8002(a) regardless of whether the bankruptcy court adjudicates the motion on the merits or the opposing party challenged the bankruptcy court’s ability to adjudicate the motion. Factually, 14 days after the bankruptcy court entered an adverse order granting summary judgment in favor of the plaintiff seeking a determination of non-dischargeability the defendant / putative appellant *mailed* his motion for reconsideration to the bankruptcy court. The motion was docketed the next day—15 days after entry of the adverse summary judgment order. The plaintiff did not challenge the timeliness of the motion for rehearing which was adjudicated adversely to the defendant / appellant on the merits with no mention of whether the motion was timely. Fourteen days later the defendant / appellant filed a notice of appeal to the BAP which entered an order to show cause why the appeal should not be dismissed for lack of subject matter jurisdiction. The BAP dismissed the appeal and, in doing so, rejected the defendant / appellant’s contention that the Rule 9023 motion was timely because he mailed it on the 14<sup>th</sup> day after the underlying order of the bankruptcy court. The Tenth Circuit concluded that (i) the Rule 9023 motion was untimely because “filing” means filed with the bankruptcy court, not when mailed, citing Fed.R.Civ.P.5 and cases including *United States v. Lombardo*, 241 U.S. 73, 76 (1916); (ii) Rule 8002(a) 14-day time limit is “jurisdictional” as opposed to a non-jurisdictional “claims processing rule” discussed in cases like *Kontrick v. Ryan*, 540 U.S. 443 (2004); and (iii) the late-filed motion under Rule 9023, which incorporates Fed.R.Civ.P. 59 and despite being a claim processing rule, did not toll the 14-day deadline by which an appeal must be taken, citing cases including *Browder v. Director, Dept. of Corrections*, 434 U.S. 257, 265 (1978) and several circuit court cases, including *In re Crescent Res., LLC*, 496 Fed. Appx. 421, 424 (5<sup>th</sup> Cir. 2012) (*per curiam*). The Tenth Circuit summarily rejected the defendant / appellant’s contention that the BAP erroneously raised the jurisdictional issue *sua sponte* on the basis that, regardless if the issue is not raised by the parties the BAP—like all federal courts—had an obligation to ensure it possessed subject matter jurisdiction.

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***In the Matter of Riley, 923 F.3d 433 (5th Cir. 2019)***

Appellant, counsel for Chapter 13 debtor, challenged the Bankruptcy Court's change in its standing order on "no-look" attorney fee. Previously, the Bankruptcy Court had treated attorney fees and pre-filing expenses advanced such as filing fees, credit counseling fees, and credit report fees not more than a set amount will be deemed presumptively reasonable and included as an administrative expense. The Bankruptcy Court then changed its standing order to exclude the three fees other than those from attorney fees in the "no-look" categorization. Appellant contended that those three fees, under the new standing order, should be reimbursable outside of and in addition to the permissible "no-look" fee amount and that the fees are necessary to preserve the estate. The Bankruptcy Court held that the fees were not separately reimbursable under the new standing order and even if the Appellant's application for fees was treated as a formal application, the fees would never be reimbursable as compensation under § 330(a). The District Court affirmed the holding of the Bankruptcy Court.

The Fifth Circuit held that the Bankruptcy Court's interpretation of the new standing order was correct, as the standing order is an administrative creation for the purpose of quickly identifying debtor's counsel's reasonable compensation to speed the administration of the case. Given the purpose of the standing order, the exclusion by silence of the expenses that amount under the pre-approved "no-look" fee amount and that the new standing order does not provide compensation to debtor counsel to be reimbursed for the advanced fees. As to the necessity of the fees to preserve the estate, the Court applied a two-prong test to determine whether a debt is necessary to preserve the estate. First, the debt must arise from a post-petition transaction with the estate, rather than a transaction with the debtor personally, and, second, if the goods or services received directly benefitted the estate. In applying the test, the Court held that the payment of the fees was a pre-petition personal transaction and that the payment of the fees did not add to or maintain the value of the estate and as such, were not necessary to maintain the estate.

Finally, in addressing the argument that the fees are permissible compensation for debtor counsel, the Court held that § 330(a)(4)(B) permits bankruptcy courts to reimburse debtor's counsel for the costs of the fees as reasonable compensation, but does not require it, vacating the District Court's holding to the contrary. The Court reasoned that § 330(a)(4)(B) provides bankruptcy courts with the discretion to authorize compensation for debtor counsel for costs incurred when then underlying activity fulfills a personal obligation of the debtor, such as the cost of a filing fee, so long as that obligation is an interest of the debtor connected with the bankruptcy case.

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***In the Matter of VCR I, L.L.C., 922 F.3d 323 (5th Cir. 2019)***

A Chapter 7 Trustee moved for authority to sell debtor assets at public auction, free of all encumbrances and Appellant, a prospective purchaser that had previously negotiated a selling price with the Trustee under an Agreed Order, objected. Both the Bankruptcy and District Court overruled Appellant's objection and Appellant appealed. Appellant contended that the motion by Trustee breached the Agreed Order and that the Agreed Order constituted a settlement agreement that was fair and equitable to the Debtor, binding the Trustee to file a motion for authority to sell the property to Appellant, subject only to the objection of creditors not participating in the settlement, further contending that the Agreed Order did not contemplate the auction process.

The Court, affirming both the Bankruptcy and District Courts, held that such a sale triggers § 363. When a settlement agreement in a bankruptcy proceeding involves the sale of the debtor's property, such agreement triggers the requirements of § 363. Specifically, such sale requires notice and a hearing and is subject to court approval and that the sale must be supported by an articulated business justification, good business judgment, or sound business reasons. In this case, the Agreed Order required the Trustee to seek court approval for authority to sell. The Trustee clearly articulated that the price offered by Appellant was substantially lower than the appraised price of the assets, exercising its sound business judgment. Thus, the Trustee did not breach the Agreed Order by seeking authority to sell the assets at public auction.

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***Janvey v. GMAG LLC, \_\_\_ F.3d \_\_\_ (5th Cir. 2019)***

The case arises from the Stanford International Bank ("SIB") Ponzi scheme. Defendant-Appellee Gary Magness ("Magness"), one of SIB's largest investors, was sued by SIB's receiver for fraudulent transfer relating to approximately \$88 million he received from SIB after the SEC's investigation of SIB was publicly reported. The parties proceeded to trial solely on the issue of whether Magness had received the transfers in good faith under the Texas Uniform Fraudulent Transfer Act ("TUFTA"). After trial, the jury found Magness had inquiry, but not actual, notice that SIB was a Ponzi scheme. Nevertheless, the jury also found that had Magness conducted an investigation into SIB, it would have been futile, meaning it would not have revealed to a reasonable person that SIB was a Ponzi scheme. Based on these findings, the district court held that Magness satisfied his good faith defense.

On an initial appeal, the Fifth Circuit reversed, holding that the jury's finding on inquiry notice defeated Magness's good faith defense as a matter of law. See *Janvey v. GMAG LLC*, 913 F.3d 542 (5th Cir. 2019). Magness then filed a petition for rehearing and asserted that the question of whether TUFTA's good faith defense includes an investigation requirement or futility exception should be certified to the Texas Supreme Court based on that court's prior interpretations

of the term “good faith” in the real property context. Magness also argued certification was appropriate because other state courts have interpreted their UFTA provisions to include a diligent inquiry requirement for those on inquiry notice.

The Fifth Circuit made clear it found Magness’s arguments unpersuasive, noting that the most widely accepted definition of the term “good faith” mandates that a transferee cannot retain his good faith defense if he possesses either inquiry or actual notice of a transfer’s fraudulent nature. The Fifth Circuit also cited a number of state and federal district court cases that held a transferee’s failure to conduct an investigation once on inquiry notice defeats a good faith defense. In the end, however, the Court found certification appropriate given that Texas courts had not yet discussed the applicability of the diligent inquiry requirement or the futility exception to TUFTA. Thus, it certified the following question to the Texas Supreme Court: “Is the Texas Uniform Fraudulent Transfer Act’s “good faith” defense against fraudulent transfer clawbacks, as codified at Tex. Bus. & Com. Code § 24.009(a), available to a transferee who had inquiry notice of the fraudulent behavior, did not conduct a diligent inquiry, but who would not have been reasonably able to discover that fraudulent activity through diligent inquiry?”

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***Life Partners Creditors’ Tr. v. Crowley et al (In re Life Partners Holdings, Inc.),  
—F.3d—, No. 17-11477, 2019 WL 2315028 (5th Cir. May 31, 2019)***

Three related entities, Life Partners Holdings, Inc., Life Partners, Inc., and LPI Financial Services (“Debtors”), filed for bankruptcy. Pre-petition, Debtors operated a business that sold life insurance policies through hired individuals and entities called “Licensees,” who referred potential investors to Debtors in exchange for sales commissions. The bankruptcy trustee filed five adversary proceedings against various groups of Licensees on behalf of a Creditors’ Trust; the lawsuits included: (1) claims for liabilities owed to Debtors’ bankruptcy estates (“Estate Claims”), and (2) claims alleged against certain Licensees by individual investors (“Investor Claims”).

Estate Claims were for actual fraudulent transfer under the Texas Uniform Fraudulent Transfer Act (“TUFTA”), constructive fraudulent transfer under TUFTA, actual fraudulent transfer under § 548(a)(1)(A), constructive fraudulent transfer under § 548(a)(1)(B), preferences under § 547, recovery of avoided transfers under § 550, equitable subordination of Licensee’s claims under § 510(c), and disallowance of Licensee’s claims against Debtors’ estates under

§ 502(d). Investor Claims against Licensees were for negligent misrepresentation, breach of the Texas Securities Act, and breach of fiduciary duty. Many of the Licensees filed motions to dismiss.

After withdrawing the reference in the bankruptcy proceeding, the district court referred the motions to dismiss to the bankruptcy judge, who recommended dismissal of the fraudulent transfer claims, the preference claim, the negligent misrepresentation claim, and the breach of fiduciary duty claim. The bankruptcy judge recommended partial dismissal of the Texas Securities Acts claims, the equitable subordination claims, and the disallowance claims. Finally, the bankruptcy judge recommended that Creditors' Trust be granted leave to amend its complaint. After reviewing the bankruptcy judge's report and recommendation, the district court dismissed all of Creditors' Trust's claims against the Licensees with prejudice and refused to allow Creditors' Trust to amend its complaint. The district court also denied Creditors' Trust's motion for reconsideration, again refusing to allow Creditors' Trust to amend its complaint to include additional and more detailed exhibits.

The Fifth Circuit refused to opine on whether Rule 8(a) or the heightened pleading standard of Rule 9(b) applied to claims for actual fraud and constructive fraud because Creditors' Trust adequately stated its claims under both rules. The court required Creditors' Trust to replead the preference claims under an undisputed Rule 8(a) standard because the complaint did not plead facts to demonstrate whether the transfers caused Licensees to receive more than they would have in a chapter 7 liquidation. The court found that equitable subordination claims needed only to satisfy Rule 8(a) to be adequately plead; however, Creditors' Trust's equitable subordination claim needed to be replead because facts provided were conclusory in that they did not allege extent of the harm, that Licensees were fiduciaries of the Debtors, or that Licensees controlled the Debtors.

The Fifth Circuit found that Creditors' Trust properly plead its negligent misrepresentation claims under Rule 8(a) because the claims relied on a different set of misrepresentations and different underlying facts than the fraudulent transfer claims. The parties agreed that claims for violations of the Texas Securities Act could be plead under Rule 8(a), but the court determined that Creditors' Trust's failure to explain which sections of the Act were violated and which Licensees violated the Act meant that Creditors' Trust failed to adequately state a claim under the Act. The court determined that Creditors' Trust's count for breach of fiduciary duty did not rely on fraudulent conduct by Licensees but rather Licensees' failure to exercise reasonable care; as such, Rule 8(a) applies. Creditors' Trust, however, failed to plead facts as to the nature of their fiduciary relationship with individual Licensees, so it was required to replead. The Fifth Circuit further held that Creditors' Trust's oral request to replead, which occurred at the hearing in front of the bankruptcy judge, was sufficient as a motion for leave to amend the complaint.

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## **Seventh Circuit**

### ***Garvin v. Cook Investments NW, SPNWX, LLC, 922 F.3d 1031 (9th Cir. 2019)***

Michael Cook owned and managed five real estate holding companies. Cook Investments, NW, DARR, LLC (“Cook DARR”), one of the real estate holding companies, owned commercial real estate in Darrington, Washington (the “Darrington Property”). Cook DARR leased the Darrington Property to two tenants, one of which is Green Haven. The lease with Green Haven provided that Green Haven would use the Darrington Property exclusively as a marijuana establishment. In 2009, one of the Cook companies defaulted on a loan from Columbia State Bank that was secured by Cook’s real estate holdings, including the Darrington Property. The bank won default judgments against Cook in state court. Although Cook and the bank reached forbearance agreements, Cook failed to fulfill the agreements’ terms.

Facing insolvency, Cook’s companies, including Cook DARR, filed Chapter 11 petitions, which the bankruptcy court jointly administered. The trustee filed a motion to dismiss Cook DARR’s Chapter 11 case, arguing that the lease with Green Haven constituted gross mismanagement and as such, cause to dismiss under 11 U.S.C. § 112(b). The bankruptcy court denied the motion to dismiss but with leave to renew at the plan confirmation hearing. Cook filed the Amended Plan, which provided for repayment of all creditors’ claims in full and for Cook to continue as a going concern. The bankruptcy court confirmed the Amended Plan over the Trustee’s objection that it violated Section 1129(a)(3)’s requirement a plan be “proposed in good faith and not by any means forbidden by law.” Because the Trustee failed to renew its motion to dismiss the at the confirmation hearing, the district court affirmed the denial of the motion to dismiss the Cook DARR’s case. Following the confirmation, the Trustee moved for a stay but the district court denied the request. The Trustee appealed, among other things, the bankruptcy court’s confirmation of the Amended Plan.

The Ninth Circuit faced an issue of first impression: whether Section 1129(a)(3) forbids confirmation of a plan that is proposed in an unlawful manner as opposed to a plan with substantive provisions that depend on illegality. Like the First Circuit Bankruptcy Appellate Panel in *Irving Tanning Co. v. Me. Superintendent of Ins. (In re Irving Tanning Co.)*, 496 B.R. 644, 660 (B.A.P. 1st Circ. 2013), the court concluded that Section 1129(a)(3) directs courts to look only to the proposal of a plan, not the terms of the plan. A plain reading of the statutory text, which does not refer to the substance of the plan, support’s the court’s decision in addition to the weight of persuasive authority. The court acknowledged a contrary decision from the bankruptcy court in Colorado but noted that the decision failed to address section 1129(a)(3)’s explicit focus on the plan’s proposal. Echoing the Texas Bankruptcy court’s decision in *In re Food City, Inc.*, 110 B.R. 808, 812 (Bankr. W.D. Tex. 1990), confirmation of a plan does not insulate debtors from prosecution for criminal activity, even if the activity is part of the plan itself. Thus, there is no need to “convert the bankruptcy judge into an ombudsman without portfolio, gratuitously seeking out possible ‘illegalities’ in every plan.”

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

In *In re Mrdutt*, the 9th Circuit BAP reversed the bankruptcy court’s order authorizing the Mrdutts to modify their Chapter 13 plan to surrender their home after the 60-month period of §1329(c).

Debtors originally sought a loan modification with Wells Fargo to cure pre-petition arrears of approximately \$65,000. Debtors’ plan provided that the default would either be cured through an approved loan modification or debtors would file a modified plan to pay the arrears. The debtors also agreed to make all post-petition mortgage payments directly to Wells Fargo. Wells Fargo eventually denied the modification after the court confirmed the plan.

After debtors made their final plan payment, Wells Fargo moved for stay relief and asserted that debtors had failed to make regular post-petition payments totaling \$123,819. The Chapter 13 trustee moved to close the case without a discharge and debtors responded by filing a motion to modify the plan to surrender the house. The bankruptcy court approved the modified plan under §1329(a) because payments were not complete under the plan. The Trustee appealed.

The BAP joined the “overwhelming majority of courts holding that a chapter 13 debtor’s direct payments to creditors, if provided for in the plan, are ‘payments under the plan’ for purposes of a discharge under §1328(a)” and “that this same rule should apply in the context of post-confirmation plan modifications under §1329(a).” However, the BAP reversed the bankruptcy court decision because surrender of the home was a “payment” for purposes of §1329(c) and the bankruptcy court had no authority to modify a confirmed plan to provide for a payment beyond the 60-month period.

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***Trinity 83 Dev., LLC v. ColFin Midwest Funding, LLC*,  
917 F.3d 599 (7th Cir. 2019)**

In 2006, Trinity 83 Development borrowed approximately \$2 million from a bank. In 2011, the bank sold the note and mortgage to ColFin Midwest Funding. ColFin relied on Midland Loan Services to collect the payments. In 2013, Midland recorded a “satisfaction” stating that the loan had been paid and the mortgage was released. In 2015, ColFin realized Midland’s mistake and recorded a document cancelling the “satisfaction.” Shortly thereafter, Trinity stopped paying

and ColFin filed a foreclosure action in state court. Trinity then filed bankruptcy and subsequently filed an adversary action against ColFin related to the foreclosure action.

Trinity contended in the adversary proceeding that Midland's 2013 release extinguished ColFin's security interest. The bankruptcy court disagreed, finding that because the release was a unilateral error and no other entity recorded a security interest in the interim, ColFin retained its original lien rights. The district court affirmed and Trinity appealed to the Seventh Circuit. Before the appellate court heard the case, the property was sold to a third party and the proceeds went to ColFin.

Bankruptcy Code section 363(m) provides that a court-authorized bankruptcy sale or lease that is later reversed or modified on appeal is still valid so long as the purchaser or lessee took the property in good faith, regardless if the party was aware of the pending appeal. ColFin argued that the appeal was now moot under section 363(m) because no stay had been issued and that there was no actual controversy for the court to consider. The Seventh Circuit rejected this argument, finding that a party's claim is not rendered moot simply because the opposing party has a statutory defense. There was still a case or controversy under Article III: Trinity wanted money from ColFin. Regarding the scope of section 363(m) and whether it prohibits a party from recovering only the purchased property or also the proceeds from the sale, the Seventh Circuit determined that is for the bankruptcy court.

Finally, Trinity maintained that the release erroneously filed in 2013 abrogated ColFin's rights. The bankruptcy judge and district judge concluded, however, that Trinity did not obtain rights from the 2013 filing because it was unilateral and without consideration. Therefore, there was not a contract, and because no one, including Trinity, detrimentally relied on the release, ColFin could rescind it. The Seventh Circuit confirmed that the lower courts' analysis was sound under Illinois law.

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## **Supreme Court**

***Taggart v. Lorenzen*, No. 18-489, 2019 WL 2331303 (S. Ct. June 3, 2019)**

In Taggart v. Lorenzen, No. 18-489, 2019 WL 2331303 (S. Ct. June 3, 2019), the Supreme Court ruled by a 9-0 decision that a creditor's subjective good faith in violating the discharge injunction under 11 U.S.C. § 524 was the improper standard to apply to a creditor's conduct. In reversing the Ninth Circuit, the Court held that the standard a court should employ in evaluating whether a creditor's conduct is subject to contempt is the "no fair ground of doubt" standard. In doing so, Justice Stephen Breyer found that a court's enforcement of an injunction rests upon

whether “there is no objectively reasonable basis for concluding that the creditor's conduct might be lawful.”

Taggart (“Petitioner”) owned an interest in a business park with two other owners. The two owners, who are some of the Respondents in the case, claimed that Petitioner violated the business park’s operating agreement and filed suit in Oregon state court against Petitioner. Before trial, Petitioner filed chapter 7 bankruptcy. Petitioner received a chapter 7 discharge under § 727 of the Code.

The Oregon state court granted judgment against Petitioner after Petitioner received his chapter 7 discharge. Further, Respondents sought attorney’s fees in state court for litigation fees incurred after Petitioner filed his chapter 7 petition. Notably, under Ninth Circuit precedent, a discharge order would cover post-petition attorney’s fees from a pre-petition lawsuit unless the discharged debtor “returned to the fray” (elected to participate in the litigation) after filing for bankruptcy. *In re Ybarra*, 424 F.3d 1018, 1024 (9th Cir. 2005). Respondents argued that Taggart had returned to the fray, and, as such, was liable for post-petition attorney’s fees. The state court agreed and awarded Respondents \$45,000.00.

Petitioner then sought relief in bankruptcy court, arguing that he had not returned to the fray and that *Ybarra* did not apply. The bankruptcy court disagreed and found that Respondents did not violate the discharge order and were not in contempt. On appeal, the district court found that Petitioner had not returned to the fray and remanded the case back to the bankruptcy court. On remand, the bankruptcy court applied a “strict liability” standard to Respondents’ conduct and held Respondents in civil contempt, awarding Petitioner \$105,000 in attorney’s fees and \$7,000.00 in damages. Respondents appealed to the Ninth Circuit BAP who vacated the sanctions. The Ninth Circuit affirmed, holding that “a creditor’s good faith belief” that the discharge order does not apply to creditor’s claim precludes a finding of civil contempt even if the creditor’s belief is unreasonable.

The Supreme Court began its analysis by noting that the question presented concerns the legal standard a bankruptcy court should use to hold a creditor in contempt for attempting to collect a debt that a discharge has “immunized” from collection. The Court noted that § 524(a)(2) operates as an injunction and that a bankruptcy court can issue any order or judgment necessary to carry out the injunctive features of § 524(a)(2), including civil contempt under § 105(a) of the Code. That said, the Court found that the bankruptcy statutes do not grant bankruptcy courts unlimited authority to grant civil contempt.

The Court observed that outside the bankruptcy context, civil contempt should not be “resorted to where there is a fair ground of doubt as to wrongfulness of defendant’s conduct.” The Court noted that this standard should be followed because civil contempt is a severe remedy, and that basic fairness requires that those enjoined receive explicit notice of the conduct that is restrained. The Court noted that the typical discharge order is not detailed, but that Congress has carefully delineated those debts that are exempt from discharge. Therefore, under the fair ground of doubt standard, a court may hold a creditor in contempt for violating a discharge order based upon “an objectively reasonable understanding of the discharge order or the statutes that govern its scope.”

In reaching its conclusion, the Court found that the Ninth Circuit's standard of a "creditor's good faith belief" that the discharge order does not apply, even if unreasonable, is unworkable. The Court ruled that a party should not be able to insulate itself from contempt based upon its subjective good faith. Moreover, such a standard relies too heavily on state of mind and would force a debtor back into litigation over a discharge that is intended to protect a debtor. Further, the Court found the bankruptcy court's "strict liability" standard difficult because it would cause a creditor to be risk averse and seek a bankruptcy court's determination over discharge matters that ordinarily would be restrained under a facial reading of § 523. A strict liability standard would also increase the amount of litigation with the attendant delay and costs.

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