Bankruptcy Circuit Update

Featuring cases from December 2017

Special Announcement
Group Section Conference Call to Discuss Significant Cases

This month our writers Circuit Writers and Section Leaders will be convening our fourth section-wide conference call at **3:30 p.m. E.S.T** on **Friday, January 26, 2018** months of the summaries. Volunteers will be summarizing significant or interesting cases. The presenters will be open for questions and lead discussion of key points. We hope you will join us for this call. The call-in information is: **dial in 866-690-2070 – code 787-594-2077**. If any section–members, whether or not you are a Circuit Writer, would like to volunteer to discuss a significant case or recent bankruptcy development, please e-mail us at csullivan@diamondmccarthy.com.

Fifth Circuit Summary

Haler v. Boyington Capital Group (In re Haler),
2017 WL 6729967 (5th Cir. Dec. 29, 2017)

In this matter, the Fifth Circuit examined whether a debtor's oral statements qualify as "statement[s] respecting . . . financial condition" under 11 U.S.C. § 523(a)(2)(A) (2012) thereby rendering a state-court judgment debt non-dischargeable.

Randall Lee Haler ("Debtor") was the Executive Vice President and a limited partner of McKinney Aerospace, L.P. ("McKinney"). In March 2006, McKinney entered into multiple contracts and one change order with Boyington Capital Group, L.L.C. ("Boyington") to repair and restore a Boyington jet. As a result, Boyington tendered over $400,000 to McKinney. Subsequently, Boyington sent a letter to McKinney requesting that McKinney stop work on the jet and to refund any money paid but not spent. McKinney acknowledged that it needed to return money to Boyington but failed to do so.

In July 2006, Boyington sued Debtor and other parties in Texas-state court for fraud based on two oral representations made by Debtor to Boyington: (1) McKinney was in "very fine legally [sic] financial shape;" and (2) McKinney had "plenty of cash to operate the business during the term that [it was] working on" the jet. The jury found that these statements were false thereby finding Debtor liable for fraud. Ultimately, in June 2015, the state district court issued a judgment in favor of Boyington for damages, which became final and non-appealable.

In June 2010, after the entry of the jury verdict but prior to the final judgment, Debtor filed a chapter 7 bankruptcy petition. Subsequently, Boyington initiated an adversary proceeding seeking a declaration that the state-court judgment was non-dischargeable under 11 U.S.C. § 523(a)(2)(A), (4), and (6). Boyington filed a motion for partial summary judgment arguing that the debt was non-dischargeable under 11 U.S.C. § 523(a)(2)(A) and (a)(4) as a matter of law because Debtor is collaterally estopped from relitigating the determinations rendered in state

court concerning his fraud. The bankruptcy court agreed and granted Boyington's motion. Debtor appealed and the district court affirmed the bankruptcy court.

The Fifth Circuit, disagreeing with the lower courts, held that Debtor's statements were oral "statement[s] respecting . . . financial condition" and therefore did not render the debt non-dischargable under section 523(a)(2)(A).

Under section 523(a)(2)(A), a debt obtained by false pretenses, false representations, or actual fraud are non-dischargeable in bankruptcy. If the debt, however, is obtained by a false oral statement respecting the debtor's financial condition, then the debt is dischargeable. In the Fifth Circuit, statements respecting financial condition are "those that purport to present a picture of the debtor's overall financial health." Bandi v. Vecnel (In re Bandi), 683 F.3d 671, 677 (5th Cir. 2012). Reciting its precedent on the matter, the court stated:

> "[F]inancial condition" mean[s] "the general overall financial condition of an entity or individual, that is, the overall value of property and income as compared to debt and liabilities."
> . . .
>
> As we noted in In re Bandi, a statement respecting financial condition "need not carry the formality of a balance sheet, income statement, statement of changes in financial position, or income and debt statement." The information regarding "overall net worth or overall income flow" contained within such a statement—not the formality of the statement—is what is important.

The court found that the representations pertained to the overall financial strength and stability of McKinney—that McKinney was overall financially sound. Accordingly, the court held that oral statements fell under the exception in section 523(a)(2)(A) and therefore did not render the debt non-dischargeable.

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Sixth Circuit Summary

In re Shefa LLC,
No. 14-42812, 2017 WL 6550492 (Bankr. E.D. Mich. Dec. 22, 2017)

The Bankruptcy Court for the Eastern District of Michigan denied a motion by the City of Southfield, Michigan, to compel a bankrupt hotel owner to transfer the deed to the city. Finding that Debtor had not violated a court order requiring him to renovate the hotel, the court

concluded there had been no "Event of Default" under the confirmed Plan that would trigger the city's right to exercise either the Escrow Deed remedy or the Power of Attorney Deed remedy.

Debtor had acquired the hotel in 2009, but the hotel closed in 2010. Debtor filed a Chapter 11 petition in 2014 and won confirmation in 2016 of a reorganization plan, after litigation and mediation. The plan required Debtor to spend at least $2.1 million to renovate and reopen the hotel. While the plan did not set a deadline or milestones for this requirement, Debtor had to obtain site plan approval from the city 180 days after the plan's effective date. The plan also provided that, if Debtor defaulted and failed to cure within a specified period after receiving notice from the city, this event of default would trigger specific remedies by the city. One of the remedies, the "Escrow Deed" remedy, would allow the city to obtain the deed from the title company in which Debtor had placed an executed deed in favor of the city. Similarly, under the "Power of Attorney Deed" remedy, Debtor executed a power of attorney authorizing the mayor and city clerk to execute a deed in favor of the city triggered by an event of default.

In 2017, the city alleged that Debtor's failure to make required renovations constituted an "event of default." Upon learning that the title company would not issue title insurance if the city used the escrow deed or power-of-attorney deed remedy, the city moved to compel Debtor to deed or directly transfer the hotel to it. The city also issued letters of default to Debtor but acknowledged that Debtor cured the default each time. This led the court to find no events of default that would entitle the city to exercise the remedies specified in the plan. The court went further to note that, even if there was an event of default by Debtor, an order requiring Debtor to transfer the hotel to the city directly by executing and delivering another deed was not a remedy the confirmed plan provided. Instead, the plan limited the city's remedies to the Escrow Deed and Power of Attorney Deed remedies. Denying the city's motion, the court determined that the city was effectively seeking a modification of the confirmed plan. This would go against Section 1127(b) which permits the debtor alone to propose a post-confirmation modification.

In re Ibrahim (Almasudi v. Ibrahim),
No. 16-32406, 2017 WL 6498026 (Bankr. E.D. Tenn. Dec. 15, 2017)

The Bankruptcy Court for the Eastern District of Tennessee determined that the owner of a Knoxville hookah lounge could not discharge an $84,000 judgment for debt owed to Plaintiff, a college student from Saudi Arabia. Debtor had met Plaintiff in 2014 at Debtor's then-business, the Dubai Hookah Lounge. After befriending Plaintiff, Debtor convinced Plaintiff to invest $28,000 in the business by falsely telling the student the money was for kitchen renovations, and that Plaintiff would receive a share of the business's profits. Instead, Debtor used the money to support what the court described as a "lavish lifestyle." Following unsuccessful attempts to get his money back, Plaintiff learned through the newspaper that the business was having financial difficulties.

In late 2015, Plaintiff sued Debtor for repayment of $28,000, punitive damages, and attorney's fees, but those proceedings were stayed when Debtor filed a Chapter 7 petition in 2016. Plaintiff then filed a proof of claim for $28,000 and initiated an adversary proceeding, contending that Debtor (1) obtained the money by false pretenses, false representations, or actual fraud, rendering the debt non-dischargeable under Section 523(a)(2)(A); and (2) willfully and maliciously converted the money, rendering the debt non-dischargeable under Section 523(a)(6).

Plaintiff also sought statutory damages, alleging Debtor's violation of the Tennessee Consumer Protection Act (TCPA), but the bankruptcy court declined to extend this claim to "casual, non-commercial transactions between two individuals," as this was not the intent of the statute's protection.

With respect to the other two claims, the bankruptcy court found evidence for conversion under Tennessee law, since Debtor clearly "took plaintiff's $28,000 with the intention of spending it on whatever he wanted to spend it on, that he never had any intention of using the money for the business or to renovate or install a kitchen, and that he never had any intention of paying anything back to plaintiff." Even under Section 523(a)'s requirement to construe liberally in a defendant's favor, the conversion of Plaintiff's $28,000 was "willful and done with malice and an intent to harm," as Debtor schemed to convince Plaintiff to "invest" money in a business that Debtor knew was struggling when in fact Debtor intended to use the money for personal enjoyment. Since Debtor's actions met the "willful and malicious" requirement of Section 523(a)(6), and Debtor's promises to Plaintiff also constituted false representations under Section 523(a)(2)(A), the court found that Plaintiff was entitled to a non-dischargeable judgment of $28,000 in actual damages. Additionally, the court called the Debtor's conduct "particularly egregious, callous and intentional," ordering him to pay $56,000 in punitive damages.

In re Mountain Glacier LLC
(Nestlé Waters North America Inc. v. Mountain Glacier LLC),
877 F.3d 246 (6th Cir. Dec. 11, 2017)

The Sixth Circuit held that language in a Chapter 11 disclosure statement that described the debtor's counterclaim in a pending arbitration and indicated it would be transferred to the reorganized debtor was sufficient to identify and thus reserve the claim. The description, which stated that the counterclaim remained unliquidated and of uncertain value, specified that this claim would be transferred to the reorganized Debtor for future prosecution upon entry of order confirming the plan. Affirming the motion for summary judgment granted by the Bankruptcy Court for the Middle District of Tennessee in favor of Mountain Glacier, the Sixth Circuit rejected Nestlé Waters North America's argument that Debtor Mountain Glacier's Chapter 11 plan and disclosure statement did not clearly state that the reorganized Debtor would retain the arbitration claim.

Nestle and Glacier had been involved in arbitration when Mountain Glacier filed for bankruptcy. The bankruptcy automatically stayed the arbitration, which remained stayed until the bankruptcy court confirmed Mountain Glacier's reorganization plan and the bankruptcy proceedings concluded. When Mountain Glacier tried to resume arbitration, Nestlé objected, arguing that Mountain Glacier did not properly reserve the arbitration claim in its reorganization plan. In Mountain Glacier's Chapter 11 disclosure statement, it detailed its assets and liabilities, as well as a plan of reorganization outlining how it intended to pay its creditors. One of its assets – its stayed claim against Nestlé Waters – was described as "a counterclaim asserted by the Debtor against Nestlé Waters North America, Inc. in arbitration pending in Chicago, IL," which "remain[ed] unliquidated and ha[d] unknown value." The plan indicated that this arbitration claim would be transferred to the "Reorganized Debtor" upon plan confirmation.

The bankruptcy court ruled in favor of Mountain Glacier. Addressing Nestlé's appeal, the Sixth Circuit clarified that a Chapter 11 plan's reservation of preexisting claims for post-bankruptcy litigation is sufficient if it enables creditors to identify the actual or potential claims at issue, and allows them to evaluate whether those claims might provide additional assets for distribution. Reasoning that "If creditors wanted more information, they could have objected to the reservation (or plan) and asked the bankruptcy court to require a more fulsome description," the court determined that nothing more was required to retain the claim.

Nestlé contended that Browning v. Levy, 283 F.3d 761 (6th Cir. 2002), set a stricter standard for preserving a claim than the Bankruptcy Code, hence, res judicata barred Mountain Glacier's attempt to resume arbitration. Rejecting Nestlé's reasoning, the Sixth Circuit interpreted Browning to mean that res judicata does not apply if the debtor "expressly retained an existing claim for post-bankruptcy litigation." Instead, Section 1123(b)(3) allows a debtor's plan to provide for "the retention and enforcement by the debtor" of "any claim or interest," even where a claim includes a right to payment that is disputed.

In re Webster,
No. 17-43099, 2017 WL 5989170 (Bankr. E.D. Mich. Dec. 1, 2017)

The Bankruptcy Court for the Eastern District of Michigan held that the most appropriate valuation of a debtor's ownership interest in a hair salon for a Chapter 13 liquidation analysis is the forced-sale value of the business as a going concern. Rejecting both Debtor's request to use a non-going-concern liquidation valuation and Creditors' preference for using a going-concern fair market value, the court concluded that the hair salon's value in a forced sale was the most accurate method by which to ensure that Debtor's Chapter 13 plan satisfied the Section 1325(a)(4) requirement that a proposed plan pay creditors at least what they would receive in a hypothetical Chapter 7 liquidation. The Debtor's purchase of the hair salon in 2016 had resulted in a breach of contract suit in state court by the previous owners, necessitating Debtor's obtaining a valuation for the business. At that time, the going-concern value was found to be $239,000 and the non-going-concern liquidation value was found to be $29,000.

When Debtor filed a Chapter 13 petition in 2017, the bankruptcy court considered as part of the liquidation analysis what a hypothetical Chapter 7 trustee would earn for the estate by liquidating Debtor's property. This requirement of Section 704(a)(1) enables the trustee to close a case "as expeditiously as is compatible with the best interests of parties in interest." However, Section 721 allows the trustee to operate a debtor's business for a limited time if doing so is in the best interest of the estate while not interfering with its orderly liquidation. Thus, a trustee may attempt to sell a viable business as a going concern with the prospect that this "may well yield more than the sale of its constituent parts." But since the requirement to sell the business expeditiously reduces the opportunity to market the business, the court explained that Chapter 7 trustees typically obtain less than the fair market value for a debtor's assets.

In the present case, the court reasoned it was "unlikely that a hypothetical Chapter 7 trustee would engage in the piecemeal sale of the business's assets" for the $29,000 proposed by Debtor, since the salon had been in business for over 30 years and realized a five-year average gross income of $660,000. Instead, the court theorized that a trustee would try to sell the business quickly as a going concern through such methods as an auction. Recognizing that

forced sales have less favorable market conditions than fair market value sales, the bankruptcy court thus elected to determine the forced-sale value of Debtor's business following an evidentiary hearing.

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Ninth Circuit Summary

Carruth v. Eutsler (In re Eutsler)
— B.R. — (9th Cir. BAP 2017)

In Eutsler, the Ninth Circuit BAP affirmed the bankruptcy court's order denying a motion for stay relief and a motion for reconsideration filed by two minority shareholders of a closely held corporation of which Debtor was the president and a shareholder.

The two minority shareholders acquired 49% of the corporation in 1998 and entered into a Stock Restriction/Buy Sell Agreement ("Buy-Sell") with Debtor and a fourth shareholder. The Buy-Sell provided that shareholders were required to provide notice to the other shareholders upon filing for bankruptcy and the corporation was entitled to purchase that shareholder's shares according to a formula. The Buy-Sell also provided that if the corporation did not purchase the shares within a specified time, the other shareholders could make the purchase.

Debtor filed a chapter 13 petition on March 12, 2015. He did not schedule the Buy-Sell as an executory contract and did not provide notice of the bankruptcy to the shareholders. After Debtor's plan was confirmed, the minority shareholders filed a motion for stay relief and argued that the Buy-Sell was executory, the ipso facto clause was enforceable, and because the Debtor did not assume or reject the Buy-Sell, it rode through confirmation.

The bankruptcy court denied the motion and held that the Buy-Sell was not executory under the "Countryman" definition because applying state law, no breach of any of the parties' obligations would have constituted a material breach. The bankruptcy court also held that the bankruptcy code barred application of the ipso facto clause and Debtor's plan would be in jeopardy if he was forced to sell his shares.

The BAP affirmed and held that under In re Robert L. Helms Constr. & Dev. Co., 139 F.3d 702 (9th Cir. 1998), which adopted the Countryman test, an option is not executory unless the optionee has chosen to exercise his option and has thereby created performance due on the petition date.

Interestingly, the BAP explained in several footnotes that it believes the Ninth Circuit should revisit the Countryman definition of executory contract in part because it "turns on factors

that have little if anything to do with the underlying policies of bankruptcy law and produce anomalous results in some cases."

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Tenth Circuit Summary

In Wagner v. Lankford (In re The Vaughan Company, Realtors),
Adv. Pro. No. 12-1139, 2017 WL 6372463 (Bankr. D. N.M. Dec. 12, 2017),

In this matter the court denied a motion to vacate certain judgments under Rule 60(b)(4) filed by Mr. and Mrs. Lankford, pro se, which the court characterized as "another in a series of efforts the Lankfords have undertaken to overturn a summary judgment this Court entered against them in this adversary proceeding." The Lankfords assertd that "1) the chapter 11 trustee and her counsel acted improperly in [t]he [Debtor's] Chapter 11 bankruptcy case by deliberately and fraudulently miscalculating the Trustee's claims against them; and 2) this Court acted improperly in connection with a discovery issue and by granting summary judgment." The court recounted how it had denied a prior motion filed by the Lankfords which sought to reopen the adversary and vacating the order granting summary judgment. Factually, the Lankfords unwittingly invested in a Ponzi scheme perpetrated by Douglas Vaughan and the Debtor. The Chapter 11 trustee sued several investors in the Ponzi scheme, including the Lankfords, seeking to clawback funds paid them. The Langfords did not appeal the adverse summary judgment ruling. The Langfords sought other related relief from the bankruptcy court and the District Court all of which was denied. The bankruptcy court explained that a judgment is "void" per Rule 60(b)(4) "only if the court that rendered it lacked jurisdiction of the subject matter, or of the parties, or if it acted in a manner inconsistent with due process of law." The bankruptcy court recounted various arguments it and/or the District Court rejected that had been advanced by the Langfords including alleged falsification of the minutes from a critical hearing, alleged bias and corruption by the Court and by the Trustee and her counsel, and alleged willful and fraudulent errors by the Trustee in the calculation of the Lankfords' net winnings. The bankruptcy court declined to to revisit the same issues the Lankfords raised in their prior motion to vacate and again concluded that the Langfords' arguments were without merit.

Finally, the bankruptcy court rejected the Lankfords' claim that it lost jurisdiction based on its alleged bias and should have recused itself prior to entering summary judgment against them, explaining that "[a]dverse rulings alone are insufficient to show improper bias," citing Green v. Branson, 108 F.3d 1296, 1305 (10th Cir. 1997)

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11th Circuit

***In re Northington*, 876 F.3d 1302 (11th Cir 2017)**

In a narrow split, the Court reversed the district court, which had affirmed the bankruptcy court's denial of stay relief. The creditor—pawnbroker moved for relief from automatic stay to exercise its rights in motor vehicle that Chapter 13 debtor had pawned prepetition.

The debtor entered into a pawn transaction in which he pledged his car in exchange for a loan, the debtor failed to make payments on time, thus defaulted on the loan. Shortly before the expiration of the redemption period—during which he could pay off his debt and regain title to his car— the debtor filed a Chapter 13 bankruptcy petition—all agreed that the initial redemption period had not expired before the bankruptcy filing. Under Georgia law the debtor was required to redeem his car within a statutory 30-day period grace period otherwise it was automatically forfeited to the pawn broker by operation of law. While the pawnbroker's motion for stay relief was still pending, the bankruptcy court confirmed the chapter 13 plan, which treated the pawnbroker's claim as secured debt with monthly payments. The pawnshop did not object to confirmation of the chapter 13 plan or its proposed to treatment. After confirmation the parties continued to litigate the stay motion.

The issue for the Court was whether the filing of the bankruptcy petition necessarily froze the assets in the estate just as they were, such that at confirmation the pawnbroker remained a mere "holder[ ] of [a] secured claim" whose "rights" the bankruptcy court could "modify" under Section 1322(b)(2) or did Georgia's pawn statute continue to operate in the background, so to speak, such that upon the expiration of the redemption period, the car was "automatically forfeited to the pawnbroker by operation of [law]." The Court held that forfeiture occurs if the debtor does not timely redeem the property. While admitting that this was a tough case, the Court appreciated the dissent's opinion that the decision was sidestepping the preclusive effects of a confirmed bankruptcy plan especially in view of the fact that the pawnshop had not filed an objection to confirmation.

***In re Horne*, 876 F.3d 1079 (11th Cir. 2017)**

The Court affirmed the district court's award of attorney's fees on the basis that §362(k)(1) specifically departs from the American Rule and authorizes costs and attorney's fees for willful violation of the automatic stay, prosecuting a damage violation, and defending these judgments on appeal, as well granting attorney's fees for this appeal.

Attorney for creditor filed a civil action in state court against the debtor despite being informed of the stay and refused to dismiss the case. The debtor then filed as a motion in bankruptcy court for violation of the stay and the bankruptcy court awarded damages and attorney's fees of $41,714.31. The creditor's attorney appeal that decision, which affirmed and also awarded additional attorney's fees of $34,551.28. The attorney then filed motions seeking recusal of the bankruptcy judge, which the bankruptcy court denied and the district court

affirmed but denied the debtor's motion for attorney's fees. The Court affirmed the denial of the recusal motion and remanded to the district court to award attorney's fees under §362(k) or explain why the recusal motion did not involve litigation over the stay violation.

The creditor argued that debtor was not entitled to attorney's fees for pursuing a damages award nor fees incurred in defending that award on appeal by relying on the U.S. Supreme Court's case in *Baker Botts LLP v ASARCO, LLC*— courts should not depart from the American Rule. In contrast to *Baker Botts* this case differs in so much as §362(k)(1) contemplates departure from the American Rule by providing for the recovery of "actual damages, *including* costs and attorneys' fees for willful violations of the stay. The creditor argued that §362(k)(1) should be read narrowly so that once the conduct ending the stay violation occurred the right to attorneys' fees ended. In affirming, the Court looked at the word *including* as Congress' intention to serve as a word of enlargement.

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