

Bankruptcy Circuit Update
Featuring cases from December 2016

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 on **Friday, January 27, 2016, at 3:30 E.S.T./12:30 P.S.T.** to present and discuss notable cases from the past few 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.

First Circuit

Bates v. CitiMortgage, Inc.
No. 16-1228, 844 F.3d 300 (1st Cir., December 14, 2016)

Chapter 7 debtors executed a loan modification agreement with the lender on their residential property subsequent to their chapter 7 discharge. Ultimately, the debtors defaulted on the terms of the agreement and the lender foreclosed. The debtors received 1099-A tax forms which incorrectly indicated that they were personally liable for the loan (they did not reaffirm the loan). The debtors filed an adversary proceeding claiming the lender violated the discharge injunction pursuant to 11 U.S.C. § 524(a) by issuing the forms, among other things. The First Circuit affirmed the decisions of the bankruptcy and district courts that the debtors failed to demonstrate that the 1099-A forms were objectively coercive which is required to prove a discharge injunction violation.

HSBC Bank USA, N.A. v. Lassman (In re Demore)
No. 16-1150, 844 F.3d 292 (1st Cir., December 13, 2016)

Chapter 7 trustee of the consolidated bankruptcy estates of a husband and wife filed an adversary proceeding to avoid a mortgage lien pursuant to 11 U.S.C. § 544(a)(3). The First Circuit affirmed the decision of the district court reversing the bankruptcy court’s summary judgment in favor of the trustee. In doing so, the Court rejected the trustee’s argument that the certificate of acknowledgement attached to the mortgage was “materially defective” because it failed to state the debtors executed the mortgage as their free act and deed. The Court found that the execution of the certificate of acknowledgement which stated that the execution was voluntary by the debtors’ attorney-in-fact before a notary and filed with the Power of Attorney was sufficient to satisfy the requirements of the applicable Massachusetts statute.

Submitted by:
Sabrina C. Beavens, Esquire
Upton & Hatfield LLP
10 Centre Street
Concord, NH 03302
Email: sbeavens@uptonhatfield.com

Second Circuit

Yagman v. Kittay, 16-57, 2016 WL 7018353 (2d Cir., December 1, 2016)

The Second Circuit affirmed the judgment of the district court dismissing the appeal filed by chapter 7 debtor Stephen Yagman ("Yagman") to the bankruptcy court order overruling his objections and directing the trustee to distribute the bankruptcy estate.

The Second Circuit held that the district court properly dismissed Yagman's appeal for lack of subject matter jurisdiction. The bankruptcy court had approved a settlement agreement under which Yagman withdrew his objection to the claims of certain creditors and waived his right to object to the distribution of the bankruptcy estate. Yagman failed to object to the bankruptcy trustee's motion for settlement approval, and did not appeal from the bankruptcy court's order approving the settlement. As such, the Second Circuit held that Yagman was barred from challenging the distribution of the bankruptcy estate.

Additionally, the Second Circuit agreed with the district court's holding that Yagman lacked standing to challenge the bankruptcy court's order because he had no direct financial interest in the bankruptcy estate's funds.

Metro. Estates, Inc. v. Emmons-Sheepshead Bay Dev., LLC (In re Emmons-Sheepshead Bay Dev., LLC), 15-3844-bk, 2016 WL 7107981 (2d Cir., December 6, 2016)

The Second Circuit affirmed the district court's judgment affirming the bankruptcy court's dismissal of the amended complaint in an adversary proceeding filed by Metropolitan Estates, Inc. ("Metropolitan") against debtor Emmons-Sheepshead Bay Development, LLC ("Emmons"). The bankruptcy court had dismissed the amended complaint with prejudice for failure to state a claim under Federal Rule of Civil Procedure 12(b)(6) and denied Metropolitan's motion to vacate, alter, or reconsider the dismissal.

This dispute centered on Metropolitan's investment in a condominium development known as "The Breakers at Sheepshead Bay Condominium" (the "Property"), which was conveyed to Emmons in 2007. In August 2012, one of Emmons's principals filed for bankruptcy on behalf of Emmons and, according to Metropolitan, undervalued the Property at \$14 million when it was actually worth more than \$30 million.

Through its adversary proceeding complaint, Metropolitan sought to revoke the confirmation order and rescind the discharge of the Property under 11 U.S.C. § 1144 on the grounds that (1) the order was procured by fraud, (2) the Property was fraudulently conveyed and held in a constructive trust, (3) the plan of reorganization benefitted Emmons but not the unsecured creditors, and also facilitated the secret sale of the Property to a sham purchaser, and (4) Metropolitan was denied due process because the bankruptcy court issued the confirmation order despite their lack of access to certain material discovery.

The Second Circuit began its analysis of the complaint's dismissal by noting that to revoke a confirmation order under Bankruptcy Code section 1144, a plaintiff must show the order was procured by fraud. Additionally, Federal Rule of Civil Procedure 9(b) requires that a plaintiff alleging fraud state with particularity the circumstances constituting fraud or mistake, and to allege facts that give rise to a strong inference of fraudulent intent.

Here, the Second Circuit held that the bankruptcy court properly dismissed the amended complaint because Metropolitan failed to sufficiently allege that the confirmation order was procured by fraud. The amended complaint presented only conclusory allegations that Emmons fraudulently and intentionally misled the bankruptcy court by underreporting the value of the Property, obscuring the ownership history of the Property, and manufacturing a false sense of urgency in the bankruptcy proceedings. There were no factual allegations to substantiate those claims or to support any inference of fraudulent intent. The Second Circuit also found that Metropolitan's claims as to incomplete discovery, the parties' unsuccessful settlement negotiations, the priority of creditors, the post-order sale of the Property, and the lack of due process were inapposite because Bankruptcy Code section 1144 expressly limits the basis for revocation to procurement by fraud. The Second Circuit thus affirmed the district court's holding that the amended complaint failed to state a claim under Bankruptcy Code section 1144.

The Second Circuit then considered the denial of Metropolitan's motion to vacate, alter, or reconsider the bankruptcy court's decision, noting that such motions are governed by Federal Rules of Civil Procedure 52(b), 59(e), and 60(b), which apply to adversary proceedings through Federal Rules of Bankruptcy Procedure 7052, 9023, and 9024, respectively. Rule 52(b) allows a court to make amended or additional findings that are supported by the record and to amend the judgment accordingly. Rule 59(e) permits a court to "alter or amend judgment to correct a clear error of law or prevent manifest injustice." Rule 60(b) authorizes a court to grant relief from a judgment on specific grounds such as mistake, inadvertence, surprise, or excusable neglect; newly discovered evidence that could not have been discovered earlier with reasonable diligence; fraud, misrepresentation, or misconduct by the opposing party; and a void, satisfied, released, or discharged judgment.

Here, the Second Circuit reviewed hearing transcripts and Metropolitan's filings and found that they merely rehashed the arguments that Metropolitan raised at the motion to dismiss stage without establishing a basis under Rules 52(b), 59(e), or 60(b) for amending or altering the findings or judgment of the bankruptcy court. Accordingly, the Second Circuit held that bankruptcy court did not abuse its discretion in denying their motion to vacate, alter, or reconsider.

Flaxer v. Gifford (In re Lehr Constr. Corp.), 16-350, 2016 WL 7177759 (2d Cir., December 9, 2016)

The Second Circuit affirmed the judgment of the district court affirming the bankruptcy court's denial of a faithless servant claim asserted by Jonathan Flaxer, as Chapter 11 trustee (the "Trustee") of debtor Lehr Construction Corp. ("Lehr"), against Peter Gifford ("Gifford"), one of Lehr's purchasing agents.

In 2010, the Manhattan District Attorney's Office discovered that Lehr was systematically overbilling its clients. Lehr filed for Chapter 11 bankruptcy in February 2011, after the investigation was publicly disclosed. In May 2011, a grand jury indicted Lehr and several of its employees, and Lehr was subsequently convicted on thirteen counts, including enterprise corruption, a scheme to defraud, and grand larceny. Gifford was not indicted, though he entered into a cooperation agreement with the Manhattan District Attorney's Office.

In February 2013, the Trustee brought a faithless servant claim against Gifford under New York common law, seeking to disgorge more than \$1.2 million in compensation and legal fees based on Gifford's participation in the fraud. Gifford filed a motion for judgment on the pleadings pursuant to Federal Rule of Civil Procedure 12(c), asserting the affirmative defense of *in pari delicto*. The bankruptcy court granted the motion on the basis that the Trustee was *in pari delicto* with Gifford, and the district court affirmed on the same ground. On appeal, the Trustee contended that an employee may not impute his conduct to his principal to defend against the principal's claims and thus may not assert *in pari delicto* as a defense against his employer. Instead, according to the Trustee, only third parties may invoke principles of imputation and the defense of *in pari delicto* to defend against claims brought by a principal.

The Second Circuit began its analysis by noting that the Trustee's argument that *in pari delicto* and imputation arise only in the context of a principal's claim against a third party is belied by New York law. A narrow exception to the presumption that acts of agents are presumptively imputed to their principals is the adverse interest exception, where the principal is actually the victim of a scheme undertaken by the agent to benefit himself or a third party personally, which is therefore adverse to the principal's own interests. The Second Circuit also noted that binding precedent in the Second Circuit requires that the defense of *in pari delicto*, which mandates that the courts will not intercede to resolve a dispute between two wrongdoers, applies even in difficult cases and should not be weakened by exceptions.

Turning to New York case law, the Second Circuit held that, contrary to the Trustee's position, New York courts have dismissed employers' claims against their employees on the basis of an *in pari delicto* defense. Accordingly, the Second Circuit rejected the Trustee's contention that employees are categorically barred from asserting an *in pari delicto* defense against their employers. The Second Circuit also noted that the adverse interest exception does not avail the Trustee, because the fraud in which Gifford participated was committed on behalf of Lehr and not against it. The Second Circuit was also not persuaded by the Trustee's contention that allowing an employee to assert an *in pari delicto* defense against his employer would inherently conflict with the faithless servant doctrine, as such conflict would appear to arise only where the

basis for the *in pari delicto* defense is the imputation of the defendant's misconduct; the Second Circuit held that this was not the case here where the basis for the *in pari delicto* defense was Lehr's conviction on thirteen felony counts for a scheme that was overseen by Gifford's superiors and for which Gifford was not convicted.

Guthrie v. 11 E. 36th, LLC, 16-1233, 2016 WL 7323983 (In re 11 E. 36th, LLC) (2d Cir., December 16, 2016)

The Second Circuit affirmed the judgment of the district court expunging the claim and constructive trust argument asserted by Victoria Guthrie ("Guthrie").

In 2007, Guthrie mortgaged a condominium and loaned the proceeds to the Morgan Investment Fund, LLC (the "Morgan Fund"). When the loan was about to mature, Guthrie agreed to extend it if she received additional security. The Morgan Fund manager arranged for several other entities controlled by his family to sign pledge agreements putting up collateral in exchange for the loan extension. One entity that signed a pledge agreement was 11 East 36th, LLC ("11 East"), which had a 100% interest in an entity called Morgan Lofts, LLC ("Morgan Lofts") which owned several apartments. 11 East pledged its ownership interest in Morgan Lofts as security for the Morgan Fund's debt to Guthrie, and the Morgan Fund manager filed a UCC financing statement for the pledge on Guthrie's behalf. 11 East received no benefit from the transaction.

A few years later, 11 East and Morgan Lofts both filed for bankruptcy, and Guthrie filed a proof of claim. However, the bankruptcy court discovered that the financing statement was inconsistent with the pledge: the financing statement described the collateral as the apartments Morgan Lofts owned, but the collateral pledged was actually 11 East's ownership interest in the Morgan Lofts entity itself. The bankruptcy court found that the financing statement was "seriously misleading," that it was therefore ineffective to perfect Guthrie's security interest, and that Guthrie's resulting unperfected claim was avoided under Bankruptcy Code section 544(a). She was left with no claim whatsoever, and the district court affirmed.

On appeal, Guthrie did not contest the prior holdings that the UCC statement was materially misleading, that her claim was therefore unperfected, or that it was properly avoided under the Bankruptcy Code. Instead, she argued that her claim should have been allowed to persist as an unsecured claim, rather than being expunged.

The Second Circuit began its analysis of the expunging of Guthrie's claim by noting that, as Guthrie herself conceded, she never had a right to sue 11 East in personam for the debt owed to her by the Morgan Fund. Furthermore, the bankruptcy court avoided her right to proceed in rem against the collateral (11 East's interest in Morgan Lofts). As such, the Second Circuit was not persuaded that Guthrie had any other claim remaining against the bankruptcy estate. Because 11 East received no benefit from its pledge to Guthrie, the Second Circuit found that, in the absence of a clear right to a claim, Guthrie failed to show why she should share, *pari passu*, with the other unsecured creditors of 11 East.

The Second Circuit then turned to Guthrie's constructive trust argument, noting that the district court had discretion to address this claim despite Guthrie's failure to raise it before the bankruptcy court. The Second Circuit held that the bankruptcy court did not abuse its discretion by declining to do so because the factual predicates for a constructive trust claim were disputed, and there was no manifest injustice in holding that Guthrie had waived her claim. Accordingly, the Second Circuit affirmed the holdings of the district court.

Ring v. First Niagara Bank, N.A., Case No. 15-4131-bk, 2016 WL 7436608 (In re Sterling United, Inc.) (2d Cir., December 22, 2016)

The Second Circuit affirmed the district court's judgment affirming the bankruptcy court's dismissal of the claims that John H. Ring, III, the Chapter 7 bankruptcy trustee (the "Trustee") for the estate of Sterling United, Inc. ("Sterling"), asserted seeking to avoid the security interest of First Niagara Bank ("First Niagara") in Sterling's assets under Bankruptcy Code section 547.

First Niagara had loaned over one million dollars to Sterling and was granted a blanket security interest in all of Sterling's assets. Between 2005 and 2007, First Niagara filed three financing statements, pursuant to N.Y. U.C.C. § 9-502, to perfect those interests. The collateral indication in the initial U.C.C. filing stated that it covered "All assets of the Debtor including, but not limited to, any and all equipment, fixtures, inventory, accounts, chattel paper, documents, instruments, investment property, general intangibles, letter-of-credit rights and deposit accounts now owned and hereafter acquired by Debtor and located at or relating to the operation of the premises at 100 River Rock Drive, Suite 304, Buffalo, New York, together with any products and proceeds thereof." After Sterling changed its address, First Niagara filed a new statement with substantially similar language and the updated address.

The Second Circuit began its analysis by setting forth an overview of the applicable law. Bankruptcy Code section 547(b)(4)(A) allows a bankruptcy trustee to avoid any "transfer of an interest of the debtor in property . . . made . . . on or within 90 days before the date of the filing of the petition" for bankruptcy, provided that those interests are not perfected security interests. In New York, a financing statement perfects a security interest if it (a) states the name of the debtor and the name of the secured party or a representative of the secured party, and (b) "indicates the collateral covered by the financing statement." The collateral requirement may be satisfied by "an indication that the financing statement covers all assets or all personal property," which is the minimum necessary to "provide notice that a person may have a security interest in the collateral claimed."

The Trustee argued that First Niagara inadequately perfected its interests in Sterling's assets under New York law and maintained that, rather than dismiss his claim, the bankruptcy court should have awarded the estate the value of any property interests transferred to, or liquidation proceeds collected by, First Niagara within 90 days of the May 17, 2013 bankruptcy petition date. The parties agreed that the most recent collateral amendments, which were filed within 90 days of the bankruptcy petition, did not and could not have perfected First Niagara's security interests. The only dispute, therefore, was whether the initial collateral description was sufficient to perfect First Niagara's security interests, or whether, as the Trustee argued, the indication was

restricted to the initially stated address, and therefore a nullity with respect to Sterling's assets at the new address.

The Second Circuit held that the description was sufficient because it unambiguously refers to "[a]ll assets of the Debtor" irrespective of their location. The phrase "including, but not limited to" introduces a subset of, and does not function as a limitation on, the phrase "all assets of the Debtor." The Second Circuit found that the Trustee offered no reason for departing from this general principle of interpretation, and instead argued that the address modifies "[a]ll assets" or, at least, makes the collateral indication "seriously misleading" under N.Y. U.C.C. § 9-506. The Second Circuit found neither argument persuasive because the location restriction is the second half of a conjunctive phrase identifying assets included in but not exhaustive of those covered by the collateral specification.

The Second Circuit was also not persuaded by the cases cited by the Trustee in support of his argument that the specific location here makes the collateral indication "seriously misleading" because none of those cases involved an explicit and unambiguously broad term (e.g. "all assets") paired with language disclaiming any limitation on the contents of that category (e.g. "including, but not limited to"). Accordingly, because the geographic reference in the initial collateral indication was merely illustrative and because the indication clearly reached all of Sterling's assets, the Second Circuit affirmed the judgement of the district court.

Submitted by:

Bram A, Strohlic

Skadden, Arps, Slate, Meagher & Flom LLP

Four Times Square

New York, New York, 10036-6522

bstrochl@skadden.com

Third Circuit

In re Millennium Lab Holdings, II, LLC, Case No. 15-12284 (LSS) (Bankr. D. Del. Dec. 2, 2016).

In the most recent opinion in *Millennium*, the court examined its power to exercise jurisdiction over a post-confirmation Rule 2004 motion seeking authority to conduct discovery.

A trustee of two claims trusts created pursuant to the debtors' plan filed a Rule 2004 motion seeking discovery from third parties relating to the cause of the debtors' financial collapse. The third parties, each of whom were involved in an purportedly harmful pre-petition credit agreement with the debtors, claimed that the court lacked subject matter jurisdiction over the motion.

The court first rejected the notion that a post-confirmation Rule 2004 motion should be analyzed pursuant to the court's "related to" jurisdiction under 28 U.S.C. §§ 1334 and 157. Rather, the court established that because Rule 2004 can only be asserted within the context of a bankruptcy case, it "arises in" chapter 11 and is thus a core proceeding over which the bankruptcy court has

jurisdiction, notwithstanding the fact that the motion was filed after plan confirmation. See op. at 11 (citing *In re Seven Fields Dev. Corp.*, 505 F.3d 237, 260 (3d Cir. 2007)).

In further challenge to jurisdiction, the third parties argued that the court should look not to Rule 2004 when deciphering its jurisdiction, but instead consider whether the potential causes of action contemplated by the Rule 2004 motion would fall within the court's purview. The court spurned this idea, claiming that "[s]uch a contention endows the Court with prophetic powers it does not, and cannot, have. . . . 'there is no way to determine where the investigations will lead, what claims may be revealed, and what issues are core and non-core.'" Op. at 10. (quoting *In re Friedman's Inc.*, 356 B.R. 779, 784 (Bankr. S.D. Ga. 2005)). Additionally, the court distinguished the cases relied on by third parties because they did not examine the court's jurisdiction to hear the Rule 2004 motion, but rather whether there was good cause for discovery pursuant to Rule 2004.

Lastly, the court rejected the third parties' technical dispute against jurisdiction. The third parties argued that because the confirmed plan lacked "reservation of jurisdiction" language, the court was stripped of its jurisdiction to hear the Rule 2004 motion. The court reminded the parties that such "reservation of jurisdiction" language is only required for courts to retain "related to" jurisdiction after plan confirmation. Thus, the court found this argument irrelevant because it had already established that the motion should be analyzed as a core proceeding though "arises in" jurisdiction. See Op. at 13 (analogizing *In re Insilco Techs., Inc.*, 330 B.R. 512 (Bankr. D. Del. 2005), *aff'd*, 394 B.R. 747 (D. Del. 2008)).

Submitted by:

Meghan Byrnes
Skadden, Arps, Slate, Meagher & Flom LLP
920 North King Street, One Rodney Square
P.O. Box 636
Wilmington, DE 19899-0636
Meghan.byrnes@skadden.com

Fourth Circuit

***Lovegrove v. Ocwen Home Loans Servicing, L.L.C.*, No. 15-2158, 2015 WL 5042913 (4th Cir. Dec. 20, 2016):**

On December 20, 2016, the Fourth Circuit affirmed the decision of the U.S. District Court for the Western District of Virginia (the "District Court"), which granted summary judgment in favor of Ocwen Home Loans Servicing ("Ocwen") on FDCPA and FCRA claims by a former chapter 7 debtor.

In a separate Chapter 7 proceeding, the debtor received a discharge in 2011 as to his mortgage loan. In 2012, Ocwen became the servicer of that mortgage loan and proceeded to send several letters and account statements to the debtor providing the principal balance due, payment due dates, payment coupons, and the total amount due. Each communication included disclaimers in accordance with FDCPA regulations, including information relevant to bankruptcy debtors and

debts that may have been discharged in bankruptcy. Also, Ocwen improperly reported to credit bureaus that the debtor did still owe the mortgage debt, and in 2014 Ocwen notified the credit bureaus to remove any reporting concerning the discharged mortgage debt.

In 2014, the debtor filed suit with the District Court alleging that Ocwen violated the FDCPA for attempting to collect a discharged debt and that Ocwen violated the FCRA by misreporting the status of that debt. The District Court granted summary judgment in favor of Ocwen, holding that it was not attempting to collect a debt within the meaning of the FDCPA and that the FDCPA claims were precluded by the Bankruptcy Code. As to the FCRA claims, the District Court held that the debtor could not maintain those claims either.

On appeal, the Fourth Circuit affirmed the District Court's decision in relatively short order. As to the FDCPA claims, the Court held that the relevant "communications were for informational purposes only, were non-threatening in nature, and contained clear and unequivocal disclaimers to establish that they were not in connection with the collection of a debt under [the debtor's] circumstances." Notably, the Court applied a standard known as a "commonsense inquiry" to evaluate objectively the parties' relationship, in lieu of the "least sophisticated consumer" test applied by some courts in the FDCPA context. Here, the debtor's original mortgage note exceeded \$1.2 million, he continued to live in the million dollar home, and he received communications with clear disclaimers. The Court concluded that the communications were not attempts to collect a debt, and thus, it was "not necessary to address whether the Bankruptcy Code precludes the FDCPA under these facts." On the FCRA claims, the Court affirmed the District Court based on Ocwen's compliance with relevant statutes requiring Ocwen to investigate disputed credit reporting information and report the results of that investigation to the credit bureaus.

Submitted by:

Jed Donaldson

Spotts Fain PC

411 E. Franklin Street, Suite 600

Richmond, VA 23219

Email: jdonaldson@spottsfain.com

Fifth Circuit

Delta Produce, L.P. v. Stokes Law Office (In re Delta Produce, L.P.), Case No. 14-51079, Consolidated with 14-51080, --- F.3d ---, 2016 WL 7404679 (5th Cir. Dec. 21, 2016).

This attorney's fee dispute concerns whether special counsel appointed by the bankruptcy court pursuant to 11 U.S.C. § 327 to recover funds under the Perishable Agricultural Commodities Act ("PACA") could collect fees and expenses from the PACA trust assets, which are kept separate from the bankruptcy estate, or must seek recovery of fees through 11 U.S.C. § 327(e). In deciding the matter, the Fifth Circuit also examined whether, in light of *Stern v. Marshall*, 564 U.S. 462 (2011), a bankruptcy court had jurisdiction over the PACA case transferred from the

district court, and if so, whether the district court had appellate jurisdiction over two interim fee applications made by the PACA special counsel.

PACA protects suppliers of fruits and vegetables by requiring buyers—often brokers that purchase the produce from farmers and sell it to grocery stores or restaurants—to hold either the produce or all proceeds or accounts receivable from sale of the produce in trust for the benefit of unpaid suppliers under “full payment of the sums owing in connection with such transactions has been received by” the supplier. 7. U.S.C. § 499e(c)(2). Because suppliers retain an equitable interest in assets of the “nonsegregated ‘floating’ trust” created by PACA, the trust assets are thus insulated from the buyer/debtor’s bankruptcy estate. Seller therefore have a “superpriority” right that trumps the rights of the buyer’s other secured and unsecured creditors.” Debtors were “repackers” who purchased produce from farmers and then sold it to grocers. Shortly before debtors filed their voluntary Chapter 11 bankruptcy petition, certain produce suppliers brought suit under PACA against the debtors. Although PACA trust assets were insulated from the bankruptcy estate, the initial PACA claimants explicitly consented to consolidation of their case in the bankruptcy court. Kingdom Fresh Produce, Inc. subsequently joined as a PACA claimant in the consolidated case.

The bankruptcy court appointed attorney Craig Stokes as “Special PACA Counsel” and, under 11 U.S.C. § 327(e), as “PACA litigation counsel.” Stokes was charged with preserving, collecting, and facilitating distribution of the collected PACA trust assets. During the pendency of the PACA litigation, Stokes filed three fee applications, to which Kingdom Fresh objected. The bankruptcy court approved each of the interim fee applications and the final fee application, and Kingdom Fresh appealed each fee award.

On appeal, the Fifth Circuit first examined issue of whether the bankruptcy court had the constitutional authority to decide the PACA claims in light of the Supreme Court’s decision in *Stern v. Marshall*, which held that although a bankruptcy court had statutory authority to enter final judgment on a state law counterclaim, it lacked constitutional authority to do so. Relying on *Wellness Int’l Network, Ltd. v. Sharif*, 135 S. Ct. 1932, 1944-46, 1948 (2015), for the proposition that a bankruptcy litigant can impliedly waive its right to Article III adjudication of *Stern* claims, the Fifth Circuit held that there was consent for the bankruptcy court to act. The original PACA claimants consented to adjudication of their claims in the bankruptcy court, and claimants such as Kingdom Fresh, who filed their PACA claims after consolidation in the bankruptcy court, were put on notice by the docket sheet that the original claimants had consented; by failing to raise constitutional objections when joining the case, Kingdom Fresh impliedly gave its consent, too. The Fifth Circuit held that express and implied consent from all PACA claimants “thus vested the bankruptcy court with jurisdiction to preside over the PACA claims even if doing so posed a *Stern* problem.”

Next, the Court examined whether the district court lacked appellate jurisdiction to review the bankruptcy court’s two interim fee awards because they were not final orders. Although “the concept of finality applied to appeals in bankruptcy is broader and more flexible than the concept applied in ordinary civil litigation,” the Court had previously held that interim fee awards are interlocutory awards not subject to review. *See In re Tex. Extrusion Corp.*, 844 F.2d 1142, 1155 (5th Cir. 1988). Kingdom Fresh had not included a motion for leave in its appeal, but argued

that the district court had impliedly granted leave to appeal pursuant to 28 U.S.C. § 158(a)(3) and Fed. R. Bankr. Pro. 8004(d), since it issued a lengthy order on the merits. The Circuit Court held that although Fed. R. Bankr. Pro. 8004(d) allows a court to treat a notice of appeal as a request for leave to appeal, the district court must nonetheless indicate its intent to exercise its discretion by either granting or denying leave. Because there was no indication that the district court realized the interim fee awards were interlocutory orders or that it believed there was a benefit to hearing them in a “piecemeal” manner, the district court lacked jurisdiction to review the interim fee awards.

Third, the Fifth Circuit examined whether Kingdom Fresh had standing to challenge the entire fee awards. Relying on the “person aggrieved” test, the Court reasoned that because the PACA disbursements and fee charges were made on a pro rata basis, Kingdom Fresh lacked standing to dispute the percentage of Stokes’ fees allocable to the non-objecting parties.

Finally, the Court addressed the issue of whether Stokes’s fees allocable to Kingdom Fresh could be deducted from the PACA trust assets before all claimants were made whole. PACA’s trust provision contains no exceptions to its requirement that buyers must hold receivables or proceeds in trust for the benefit of all unpaid sellers “until full payment of the sums owing in connection with such transactions has been received by the sellers.” 7 U.S.C. § 499e(c)(2). However, the Fifth Circuit highlighted other cases’ distinction between “individuals who are PACA trustees or their functional equivalents—who owe fiduciary duties to the PACA claimants and are thus aware of the trust provision—and those whose primary role is outside the PACA trustee framework and do not owe duties to the claimants.” Thus, the Court held that PACA trustees and their functional equivalents—such as Stokes—may not be paid from PACA trust assets until full payment of the sums owing is paid to all claimants. Although this decision “gives rise to a free rider concern,” the Court reasoned that there were other options available to ensure PACA trustees could recover their fees, including appointment pursuant to 11 U.S.C. § 327.

Submitted by:

Rebecca A. Muff
Diamond McCarthy LLP
909 Fannin, 15th Floor
Houston, Texas 77010
Email: rmuff@diamondmccarthy.com

Ninth Circuit

In re Molasky, Case No. 14-60080, 843 F.3d 1179 (9th Cir. 2016)

In *In re Molasky*, the Ninth Circuit reversed the bankruptcy court’s dismissal of a §523 adversary proceeding and held that an intervenor who adopted an original party’s complaint as his own can continue litigation after the original party has been dismissed.

Creditor OneCap timely filed an adversary proceeding contesting the dischargeability of a \$17 million debt. Augustine Bustos was an investor in the debt instrument serviced by OneCap. As part of a settlement in the administrative case involving a separate group of debts indirectly related to Bustos, the parties stipulated that Bustos would be allowed to intervene in the §523 action.

The bankruptcy court permitted Bustos to intervene but did not allow Bustos to file his own §523 action. OneCap was later dismissed for failure to prosecute and the bankruptcy court dismissed Bustos on the basis that without its own §523 action, there was no independent basis for jurisdiction. This determination was ultimately reversed by the Ninth Circuit in *Molasky I* in which the Circuit directed the bankruptcy court to evaluate equitable factors that might justify extending the §523 deadline or otherwise allow Bustos to pursue the OneCap complaint. The bankruptcy court dismissed the adversary because of intervening precedent which held that a bankruptcy court cannot retroactively extend the deadline to file a §523 action, and the BAP affirmed.

The Ninth Circuit held that the bankruptcy court had an independent basis for jurisdiction because Bustos adopted the OneCap complaint as his own and the claim was not adjudicated when OneCap was procedurally dismissed. The Panel also noted that allowing intervenors to continue would promote judicial economy because all individual creditors in fractionalized debt instruments would otherwise be incentivized to file separate §523 actions in case the representative might later fail to prosecute adequately.

Submitted by:

Jeffrey J. Coe

Mesch Clark Rothschild

259 N. Meyer Avenue

Tucson, AZ 85701-1090

Email: jcoe@mcrazelaw.com

In re Sadlowski v. Michaels Stores Inc., Case No. 14-56654, 2016 WL 7448760 (9th Cir. Dec. 28, 2016)

In *Sadlowski v. Michaels Stores, Inc.*, No. 14-56654, 2016 WL 7448760 (9th Cir. Dec. 28, 2016), the Ninth Circuit reversed a decision by a district court granting summary judgment barring her wage and hours claim against Michaels Stores, Inc. based on the doctrine of judicial estoppel. The decision of the district court was premised on the non-disclosure of Ms. Sadlowski's claims in her chapter 13 bankruptcy case. The Ninth Circuit explained that the general rule in which failure to disclose a claim by a debtor generally bars prosecution of such a claim on judicial estoppel grounds, did not apply where the bankruptcy filing pre-dated the lawsuit. The Ninth Circuit further explained that "[t]here was no basis in the record for a finding that Sadlowski was aware of enough facts to know that she had a legal claim against Michaels until she retained legal counsel for the wage-and-hour case in September 2011, about a month before her bankruptcy case was dismissed in October 2011." Continuing, the Ninth Circuit explained that "the bankruptcy court never 'accepted' or relied upon Sadlowski's nondisclosure of her wage and hour claim. She did not receive a discharge, a favorable ruling, or any other benefit [that

might warrant application of the doctrine of judicial estoppel]; rather, her bankruptcy case was dismissed due to noncompliance with the Chapter 13 payment plan.” The Ninth Circuit further explained that the district court’s ruling was tantamount to a determination that dismissal based on nondisclosure of a “potential” claim during a bankruptcy proceeding, in itself, estopped the bankrupt from prosecuting that claim in a civil action. The Ninth Circuit concluded that that determination was premised on an incorrect legal standard as it effectively reduced the multi-factor test for application of judicial estoppel set forth in *New Hampshire v. Maine*, 532 U.S. 742, 750-51 (2001), to one factor, that is, whether the party took inconsistent positions, and that no Ninth Circuit decision supported such an approach.

Submitted by:

Paul A. Avron
Berger Singerman
One Town Center Road, Suite 301
Boca Raton, FL 33486
PAvron@bergersingerman.com

Eleventh Circuit

Two creditors sought election of a chapter 7 trustee through Section 702 of the Bankruptcy Code. Another creditor and the interim chapter 7 trustee objected, arguing the instigating creditors’ disputed claim status rendered them unable to seek election of a chapter 7 trustee. The bankruptcy court agreed and sustained their objection; the district court affirmed.

On appeal, the Eleventh Circuit primarily addressed the issue of appellate jurisdiction—whether the order denying the request to elect a chapter 7 trustee was a “final order.” The appellate court concluded that an order resolving a disputed chapter 7 trustee election is a final order over which the Eleventh Circuit has appellate jurisdiction. The court then summarily affirmed the lower court’s judgment based on its decision.

Submitted by:

Matthew B. Hale
Sticher, Riedel, Blain & Postler, P.A.
110 East Madison Street, Suite 200
Tampa, Florida 33602