

**Bankruptcy Circuit Update**  
*Featuring cases from January 2017*

**First Circuit**

***Rosado v. Banco Popular de Puerto Rico*, Case No. 11-02825-bk, 561 B.R. 598  
(1st Cir. B.A.P. January 4, 2017)**

Chapter 7 debtors appealed a bankruptcy court’s order denying their contempt motion against Banco Popular de Puerto Rico (“Banco Popular”) under 11 USC § 105, on account of an alleged violation of the discharge injunction. After Banco Popular obtained relief from the automatic stay and after the debtors obtained a discharge under § 727, Banco Popular reinitiated foreclosure proceedings that had previously been stayed. The debtors alleged that Banco Popular’s continued efforts to foreclose using the “ordinary foreclosure” method, an *Ipsonam* remedy constituted a violation of the § 524(a)(2) discharge injunction. The debtors asserted that Banco Popular should have employed the statute governing *in rem* proceedings. The Bankruptcy Appellate Panel affirmed the bankruptcy court’s holding, finding that the record was devoid of any facts showing “impermissible coercion or harassment,” an element essential to establish a claim under § 524(a)(2). The record revealed that Banco Popular disavowed any intent to pursue the debtors personally. Moreover, “the very damning evidence” needed to find in favor of the debtors was missing.

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**Second Circuit**

***Marblegate Asset Mgmt., LLC v. Educ. Mgmt. Fin. Corp.*, 15-2124  
(2d Cir., January 17, 2017)**

The Second Circuit held that Section 316(b) of the Trust Indenture Act (“TIA”) prohibits only non-consensual amendments to an indenture’s core payment terms, such as the amount of principal, interest, and term, and does not guarantee that non-core payment terms, such as covenants and guarantees, cannot be modified or removed. In so holding, the Second Circuit overturned the broad interpretation of the TIA set forth by the United States District Court for the Southern District of New York, which previously interpreted the TIA as protecting a noteholder’s “practical ability” to be repaid.

Section 316(b) of the TIA provides that “the right of any holder of an indenture security to receive payment of the principal of and interest on such indenture security ... shall not be impaired or affected

without the consent of such holder.” Prior to the District Court’s decision in this case and a similar ruling by the district court in the *Caesars* restructuring, issuers, bondholders, and practitioners had largely understood § 316(b) to protect only a holder’s *legal* rights to payment under the indenture, not the holder’s *practical* ability to recover such payment.

The facts of this case are as follows: Education Management Corp. (“EDMC”) is a for-profit education provider which in 2014 derived revenue primarily from federal student aid programs under Title IV of the Higher Education Act of 1965. EDMC owed in excess of \$1.3 billion, consisting primarily of \$1.085 billion in secured term loans and \$217 million in unsecured notes. The unsecured notes were issued by a subsidiary of EDMC under an indenture qualified under the TIA. The indenture included a provision restating §316(b) of the TIA, specifically providing that, notwithstanding any other provision of the indenture, “the right of any Holder of a Note to receive payment . . . shall not be impaired or affected without the consent of such Holder.” The notes were guaranteed by EDMC (as parent of the issuer). However, the indenture provided that this parent guarantee could be removed (1) by consent of a majority of the holders of the notes and/or (2) automatically if the company’s secured creditors released EDMC’s guarantee of their secured debt (which, at time of issuance of the notes, was not subject to such a parent guarantee).

In Spring 2014, EDMC informed investors and creditors that it was in significant financial distress, and that by the end of June 2014, it would not be in compliance with its secured facility’s financial covenants. EDMC’s secured creditors ultimately waived those financial covenants until September 2014 to allow for the development of a comprehensive restructuring plan. EDMC obtained an amendment of its secured credit facility to eliminate, alter, or delay many payment obligations, and in exchange EDMC guaranteed the secured debt. EDMC likewise began restructuring negotiations with an ad hoc committee of term lenders.

EDMC’s restructuring options were complicated and limited: EDMC could not restructure under the bankruptcy code without losing eligibility for Title IV funds under the Higher Education Act, which was the company’s primary source of revenue. As such, EDMC had to restructure out of court. The company and the ad hoc committee therefore entered into a restructuring support agreement that provided a two-path restructuring: first, if 100% creditor consent was received, EDMC’s secured and unsecured debt would be converted into a smaller amount of debt and equity (with ratios varying based on type of debt), and second, if less than 100% creditor consent was received, the exchange would not occur and instead an “intercompany sale” would be undertaken, as described further below.

EDMC launched an exchange offer for the unsecured notes on October 1, 2014 in accordance with the restructuring support agreement, pursuant to which holders of more than 90% of the notes, but less than 100%, agreed to exchange their notes. EDMC therefore sought to consummate the intercompany sale, pursuant to which: (1) the secured lenders would release the EDMC parent guarantee, thereby causing an automatic release of the parent guarantee of the notes under the terms of the notes indenture, (2) the secured lenders would foreclose on their collateral, which was substantially all of the assets of the company, and (3) the secured lenders would immediately sell those assets to a newly-created subsidiary of EDMC, which new subsidiary would distribute new debt and equity to the signatories of the restructuring support agreement. The impact of the intercompany sale on the holders of notes was explicit in the exchange offer documents: while the holders would maintain their claims against certain

of EDMC's issuer and guarantee subsidiaries, those entities would have no assets from which to satisfy the noteholders' claims. EDMC's guarantee of the notes would be released.

Two investment funds holding collectively \$20.3 million of the unsecured notes (together, "Marblegate") commenced a preliminary injunction action in the Southern District of New York to block EDMC's proposed restructuring, arguing that the intercompany sale would violate the TIA. While recognizing that two aspects of the intercompany sale, the asset foreclosure and release of parent guarantee, had a contractual basis in the notes indenture, the district court evaluated whether such aspects of the intercompany sale, and the release of the parent guarantee in particular, would impermissibly impair or affect the right to receive payment on the notes. The district court framed the issue as a dispute over the scope of the TIA and whether it is "a broad protection against nonconsensual debt restructurings, or a narrow protection against majority amendment of certain 'core terms,'" ultimately finding the former interpretation "more persuasive."

In reaching this conclusion, the district court considered the legislative history surrounding the TIA which, in the district court's view, confirmed a broad reading of the TIA's provisions regarding right to payment. Initially, the district court found that if the TIA protected only the rights set forth in a notes indenture (as may be limited in that indenture), preemptive limitations on the ability to receive payments set forth in an indenture, including by majority vote, would be permissible. Such a result, in the district court's view, would render the TIA meaningless. To support its reading of §316(b) of the TIA, the district court looked to the legislative history's statement of purpose: to prevent "evasion of judicial scrutiny of the fairness of debt-readjustment plans". From this, the district court reasoned that "Section 316(b) [of the TIA] was intended to force bond restructurings into bankruptcy where unanimous consent could not be obtained." Applying this reasoning to the proposed restructuring, the court indicated that the intercompany sale was "precisely" the type of restructuring that the TIA precludes.

EDMC appealed on the grounds that the district court misinterpreted and misapplied §316(b), and that its intercompany "friendly foreclosure" sale and concomitant release of the parent guaranty complied with §316(b) as it did not "formally amend" the indenture's express payment terms. The Second Circuit agreed with EDMC. While the Second Circuit agreed with the district court that the text of §316(b) is ambiguous, the Second Circuit concluded, based on the statute's legislative history, that Congress did not intend the broad reading of §316(b) that the district court adopted. Instead, the Second Circuit found that Congress "sought to prohibit formal modifications to indentures without the consent of all bondholders, but did not intend to go further in banning other well-known forms of reorganization like foreclosures." The Second Circuit added that its holding leaves frustrated noteholders with some recourse, namely, pursuing state and federal law remedies, including fraudulent transfer actions. In addition, the Second Circuit noted that sophisticated creditors can insist on provisions in debt instruments that prohibit transactions like the intercompany sale at issue in this case.

***Collins v. J&N Rest. Assocs., Inc.*, 16-1362, 2017 WL 219085 (2d Cir., January 17 2017)**

The Second Circuit affirmed the judgment of the district court affirming the bankruptcy court's dismissal of the fraudulent transfer claim asserted by James C. Collins, in his capacity as trustee of the Mendolia bankruptcy estate (the "Trustee") against J&N Restaurant Associates Inc. and other associated defendants, who had separately filed for bankruptcy. The bankruptcy court held that the Trustee's claim

was discharged by the defendants' chapter 11 reorganization, and the district court agreed on appeal, further concluding that the Trustee's claim was barred by the defendants' plan of reorganization's disposition of all administrative expense claims.

In both the bankruptcy and district court proceedings, all parties agreed that the alleged fraudulent transfer, which related to the use of proceeds from the sale of the Mendolias' second home to satisfy indebtedness owed to one of defendants' suppliers shortly before the two bankruptcies commenced, should be viewed as a post-petition administrative expense of the defendants' estate. The Trustee conceded that (1) he reviewed the defendants' plan; (2) the plan stated that all administrative claims would be paid on its effective date; (3) his claim was not "specifically provided for" in the plan, and (4) he nonetheless did not raise his administrative expense claim until nearly one year after plan confirmation. The Trustee nevertheless contended that he was not precluded from seeking such recovery because the defendants' chapter 11 plan did not explicitly say that administrative expenses must be submitted by a date certain.

The Second Circuit began its analysis by noting that while Bankruptcy Code section 503 sets no clear timeline for the submission of administrative expense requests, it does state that untimely submissions are authorized only if "permitted by the court for cause." In other words, this provision allows a court to set a claims bar date. Conversely, a reorganization plan may provide that unaccounted-for administrative expenses will not be discharged at the bar date, but assumed as liabilities of the reorganized debtor. In this case, the Trustee contended that defendants' plan was of the latter variety.

The Second Circuit was not persuaded by this argument, as the defendants' plan expressly "discharge[d], and release[d] . . . all Claims of any nature whatsoever . . . and . . . all rights and interests of all Creditors against the Debtor or any of its assets or property." The plan thereafter states that it is the "final, complete and exclusive statement of the obligations and duties of the Debtors to the Creditors," including the "enforceability of the Claims and Administrative Expense Claims." Accordingly, the Second Circuit held that while chapter 11 plans may permit later recovery of unaccounted-for administrative expenses generally, the quoted language makes it clear that defendants' plan did not. The Second Circuit therefore affirmed the judgment of the district court.

***Trikona Advisers Ltd. v. Chugh*, 14-975, 846 F.3d 22 (2d Cir., January 18, 2017)**

The Second Circuit affirmed the judgment of the district court granting summary judgment in favor of Rakshitt Chugh ("Chugh"), ARC Capital LLC, and other related corporate entities (the "Chugh Defendants") in an action brought by plaintiff Trikona Advisers, Ltd. ("TAL") for alleged breaches of fiduciary duty by Chugh, a former partner and fifty-percent owner of TAL, and the other defendants. The district court held that TAL's claims had previously been determined in Chugh's favor in a proceeding in the Cayman Islands, and that TAL was collaterally estopped from asserting them in the U.S. action.

On appeal, TAL argued that the district court incorrectly applied the doctrine of collateral estoppel and further argued that Chapter 15 of the United States Bankruptcy Code prevented the district court from giving preclusive effect to the Cayman court's factual findings.

TAL was an investment advisory company formed in 2006 by beneficial owners Chugh and Aashish Kalra (“Kalra”) as a vehicle for helping foreign investors invest in Indian real estate and infrastructure. Each man held a fifty percent equity stake in TAL through entities controlled by them. Chugh’s shares were owned by ARC Capital LLC (“ARC”) and Haida Investments (“Haida”), and Kalra’s shares were owned by Asia Pacific Investments, Ltd. (“Asia Pacific”). At the same time, the two men formed Trinity Capital Plc. (“Trinity”), a closed-end fund listed on the London Stock Exchange, through which they solicited investments. Kalra and Chugh managed Trinity through TAL. Trinity paid TAL a fee for its management services, calculated at two percent of Trinity’s net asset value plus a performance fee.

The 2008 economic crisis significantly impacted TAL and soured the relationship between Chugh and Kalra. Trinity’s shareholders began pressuring the Trinity board to sell the company’s assets and distribute capital, which would reduce TAL’s management fees by lowering Trinity’s net asset value. TAL tried to prevent the sell-off by engaging in a series of ill-fated transactions. The wide-ranging financial and legal fallout from the unsuccessful deals further tainted the relationship between TAL and Trinity, and TAL essentially ceased to function as a going concern. The souring of Kalra and Chugh’s relationship culminated on January 11, 2012, when, TAL’s board of directors voted to remove Chugh as a director.

TAL’s collapse spawned a number of legal proceedings in the United States and abroad, two of which are relevant to this case: a wind-up proceeding in the Cayman Islands and the federal civil suit in Connecticut that was the subject of this appeal. In 2012, ARC and Haida, which held Chugh’s TAL shares and were controlled by Chugh, filed a petition in the Grand Court of the Cayman Islands, seeking to “wind up” TAL, a Cayman corporation. The suit sought to liquidate the business and divide its assets between Chugh and Kalra. Kalra opposed Chugh’s petition, asserting the affirmative defense that Chugh had breached his fiduciary duty to TAL in several ways, and that his removal from the board was therefore justified. Kalra framed each of his arguments as jurisdictional defenses, arguing that if any one of these allegations were true, Chugh would be precluded from invoking the Cayman court’s equitable jurisdiction under the doctrine of unclean hands.

The Cayman court eventually granted Chugh’s petition, finding that “each of” Chugh’s allegations was supported by evidence, and that these allegations “taken together” supported a finding that it was just and equitable to wind up TAL. It also rejected each of Kalra’s affirmative defenses, concluding that there was “no merit whatsoever in the allegations made against Mr. Chugh.”

Meanwhile, in the U.S., Kalra, through Asia Pacific, sued the Chugh Defendants in the district court in Connecticut. After TAL’s board removed Chugh, TAL was substituted as plaintiff. TAL’s operative complaint asserted eleven causes of action against the Chugh Defendants sounding in breach of fiduciary duty, aiding and abetting breach of fiduciary duty, unfair competition, theft of trade secrets, civil conspiracy, conversion, statutory theft, unjust enrichment, and abuse of process. These claims substantially reprised the allegations Kalra asserted as affirmative defenses to Chugh’s wind-up petition in the Caymans.

Following the ruling of the Cayman court in the wind-up proceeding in January of 2013, the Chugh Defendants moved for summary judgment in the district court based on collateral estoppel. They argued that in deciding the wind-up petition, the Cayman court had already made findings of fact in Chugh’s favor on all of Chugh’s assertions regarding TAL’s collapse, and that Kalra was therefore collaterally

estopped from relitigating those factual disputes. The district court agreed and granted the Chugh Defendants' motion for summary judgment.

On appeal in the Second Circuit, TAL asserted five separate arguments, including an assertion that the district court was precluded by Chapter 15 of the Bankruptcy Code from applying collateral estoppel to the findings of fact from the wind-up proceeding. The Second Circuit began its analysis by noting that Chapter 15 of the Bankruptcy Code requires that under certain circumstances, before foreign liquidation proceedings may be recognized in United States courts, a bankruptcy court in the United States must approve an application for recognition from a "foreign representative" appointed in connection with that foreign proceeding. TAL argued that because no application for recognition was ever made in connection with the Cayman Island wind-up proceeding, that judgment could not have been recognized in the district court. As a result, TAL argued that the findings of fact made by the Cayman court in the wind-up proceeding cannot be given preclusive effect and therefore cannot support the district court's granting of summary judgment in favor of the defendants on collateral estoppel grounds.

The Second Circuit agreed with the district court that the requirements of Chapter 15 did not apply here. Chapter 15, enacted by Congress in 2005, incorporated into United States law the Model Law on Cross-Border Insolvency drafted by the United Nations Commission on International Trade. The statute's primary purpose was to facilitate the consolidation of multinational bankruptcies into one single proceeding. Chapter 15 addressed a persistent problem in cross-border liquidations: creditors would initiate multiple bankruptcy proceedings to recover assets from a debtor in jurisdictions other than the site of the principal liquidation. This caused administrative inefficiency and also allowed creditors to bypass the priority restraints of the main bankruptcy proceeding and attempt to recover more than their fair share of the debtor's assets. In the interests of uniformity and efficiency, Chapter 15 provides for the coordination of domestic and foreign proceedings into a single bankruptcy and, with specific relevance to the issue raised by TAL, allows foreign representatives appointed in connection with foreign proceedings to seek recognition of those proceedings in United States courts as a means of requesting United States assistance in administering the main liquidation.

Consistent with its limited purpose, Bankruptcy Code section 1501(b) specifies four circumstances in which Chapter 15 applies. These are cases in which: (1) assistance is sought in the United States by a foreign court or a foreign representative in connection with a foreign proceeding; (2) assistance is sought in a foreign country in connection with a case under this title; (3) a foreign proceeding and a case under this title with respect to the same debtor are pending concurrently; or (4) creditors or other interested persons in a foreign country have an interest in requesting the commencement of, or participating in, a case or proceeding under this title. These scenarios assume that (1) a United States court is being asked either to assist in the administration of a foreign liquidation proceeding or to administer a liquidation proceeding itself, or (2) a foreign court is being asked to assist in administering a liquidation proceeding in the United States.

Moreover, Bankruptcy Code section 1515 does not apply generally to parties, but, by its terms, requires only "foreign representatives" to apply for recognition of a foreign judgment in bankruptcy. A "foreign representative" is defined in Bankruptcy Code section 101(24) as "a person or body... authorized in a foreign proceeding to administer the reorganization or the liquidation of the debtor's assets or affairs or to act as a representative of such foreign proceeding."

Applying this law to the case at hand, the Second Circuit noted that no party to the district court proceeding is a “representative” of a “foreign proceeding,” as those terms are defined in Bankruptcy Code sections 101(24) and (23). Moreover, no party to the district court proceeding sought the assistance of the district court in enforcing or administering a foreign liquidation proceeding, nor was any party seeking the assistance of a foreign country. Furthermore, the case did not involve a proceeding under the Bankruptcy Code pending concurrently with a foreign liquidation proceeding, nor were foreign creditors seeking to commence an action under the Bankruptcy Code. The Second Circuit also stated that even if one assumes that that the wind-up proceeding is the type of case that Chapter 15 would ordinarily cover, Chapter 15 does not apply when a court in the United States simply gives preclusive effect to factual findings from an otherwise unrelated foreign liquidation proceeding, as was done here. Accordingly, the Second Circuit held that the instant non-bankruptcy action, brought in the District of Connecticut and governed by Connecticut law, is unconnected to any foreign or United States bankruptcy proceeding.

The Second Circuit then considered TAL’s remaining arguments (regarding collateral estoppel, the preclusive effect of in rem proceedings, privity, and comity) and found them meritless.

***Mack v. Rescap Borrower Claims Tr.*, 16-304 (2d Cir., January 31, 2017)**

The Second Circuit affirmed the judgment of the district court affirming two orders of the bankruptcy court: (1) an order sustaining ResCap Borrower Claims Trust’s (the “Trust”) objection to the proof of claim alleging malicious prosecution filed by Barry F. Mack (“Mack”); and (2) an order sustaining the Trust’s objection to Mack’s proof of claim alleging a violation of the Real Estate Settlement Procedures Act (“RESPA”), 12 U.S.C. § 2605(e).

In 2000, Mack realized he could no longer afford the mortgage payments on his home and contacted his loan servicer, GMAC Mortgage LLC (“GMACM”), to obtain a loan modification. GMACM did not provide Mack with relief from his mortgage, but instead initiated a foreclosure action against Mack in Florida state court on behalf of Deutsche Bank, which owned the mortgage at that time. Mack, however, was not in default on his mortgage. When GMACM realized that it had brought the foreclosure action in error, it contacted local counsel to withdraw the lawsuit. For reasons unknown, local counsel did not move to dismiss the action until three months later.

While the foreclosure action remained pending in Florida state court, Mack and his wife filed counterclaims against Deutsche Bank, seeking damages for slander of title and a violation of RESPA based on a transfer of title without notifying the Macks. Deutsche Bank never responded to the counterclaims (allegedly because of the continued ineptitude of the same local counsel) and the Macks received a default judgment. After the state court issued its default judgment, Deutsche Bank became aware of the counterclaims and moved to set aside the judgment. Ultimately, in February 2013, the state court granted Deutsche Bank’s motion to vacate the judgment as to the Macks’ RESPA claim, but confirmed the judgment with respect to the Macks’ slander of title claim. The Macks received approximately \$320,000 in damages.

About a month after GMACM brought its foreclosure action, the Macks wrote a letter to GMACM querying why the foreclosure action remained pending even though GMACM had notified them that

they were not in default (the “Qualified Written Request”). The Macks did not send their Qualified Written Request to the address designated by GMACM for receipt of such requests. Instead, they sent it to the address designated by GMACM for “General Inquiries.” GMACM never responded to or acknowledged receipt of the Macks’ Qualified Written Request.

In May 2012, the Trust filed for bankruptcy. Several months later, the Macks timely filed a proof of claim against GMACM for money damages, alleging that the loan servicer was liable to them for malicious prosecution and RESPA violations arising out of the 2009 foreclosure action. This RESPA claim, which was based on GMACM’s alleged failure to respond to the Qualified Written Request, was distinct from the RESPA claim brought in the earlier Florida action. The Trust objected to both proofs of claim. In 2014, the bankruptcy court sustained the Trust’s objection to the Macks’ malicious prosecution claim on the ground that it was barred by res judicata because of the state court judgment rendered against Deutsche Bank, but overruled the Trust’s objection to Mack’s RESPA claim against GMACM for failure to respond to their Qualified Written Request. In 2015, after conducting a trial on the Macks’ RESPA claim, the Bankruptcy Court sustained GMACM’s objection on the ground that the Macks had failed to mail the Qualified Written Request to the correct address.

The Second Circuit began its analysis by first addressing Mack’s malicious prosecution claim, which Mack argued was not barred due to res judicata. To determine whether the Florida state court’s judgment against Deutsche Bank for slander of title bars Mack’s malicious prosecution claim against GMACM, the Second Circuit looked to Florida state law. Under Florida law, in order for res judicata to apply, four conditions must be met: (1) identity of the thing sued for; (2) identity of the cause of action; (3) identity of persons and parties; and (4) identity of the quality or capacity of the persons for or against whom the claim is made.

The Second Circuit found that all four of those conditions were satisfied here. First, there was “identity of the thing sued for” because in the bankruptcy court Mack sought monetary damages on his malicious prosecution claim and he previously sought (and received) monetary damages on his slander of title claim. Second, because both claims required proof of nearly identical facts, i.e., that there were no legitimate grounds for bringing the 2009 foreclosure action, there was “identity of cause of action.”

The third condition, identity of parties, requires that “the same parties or their privies participated in prior litigation that eventuated in a judgment by which they are mutually bound.” To that end, privity may exist where a third party must indemnify and so is vicariously liable for the acts of the party to the lawsuit.” Here, the bankruptcy court found that GMACM owed indemnification obligations to Deutsche Bank because it was the sub-servicer of the Macks’ mortgage. It also observed that GMACM initiated the foreclosure action on behalf of Deutsche Bank, entered a notice of appearance in the action, and submitted evidence at the hearing seeking to vacate the default judgment entered against Deutsche Bank. Based on those findings, the Second Circuit agreed with the bankruptcy court that there was “identity of parties.”

The Second Circuit also held that the fourth and final condition of res judicata was also met. Because Deutsche Bank’s potential liability in the slander of title action derived from GMACM’s filing of the 2009 foreclosure action, Deutsche Bank had the same incentive to litigate the relevant issues then as GMACM would now. Accordingly, the Second Circuit held that the judgment against Deutsche Bank

for slander of title entered by the Florida state court barred Mack's claim for malicious prosecution against GMACM.

The Second Circuit then addressed Mack's contention that the bankruptcy court erred by sustaining the Trust's objection to his claim that GMACM violated its duties under RESPA by failing to respond to his Qualified Written Request. Under RESPA, a Qualified Written Request is correspondence that identifies a borrower's account and includes a statement of the reasons why the borrower believes the account is in error or provides sufficient detail to the servicer regarding other information sought by the borrower. The statute requires a mortgage servicer to respond to a borrower's Qualified Written Request within certain time limits, but it also allows a mortgage servicer to establish a designated address for Qualified Written Requests. If a mortgage servicer designates a specific address for receipt of Qualified Written Request, then the borrower must deliver the papers to such address in order for the inquiry to be deemed a Qualified Written Request.

Here, the Second Circuit held that GMACM's statutory duty to respond to the Macks' letter was never triggered, and thus never violated, because the Macks failed to mail their letter to GMACM's designated Qualified Written Request address, despite having notice of that address. Accordingly, the Second Circuit affirmed the judgment of the district court in its entirety.

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## **Fifth Circuit**

***In re Bandi*, 16-30633, 2017 WL 344286 (5th Cir. Jan. 23, 2017).**

In this case, Chapter 7 debtors Stephen and Charles Bandi filed a slew of pleadings regarding the bankruptcy court's and Fifth Circuit's determinations that one of their debts was non-dischargeable. First, the Bandis sought a panel rehearing and a rehearing en banc of the Fifth Circuit's decision. While those petitions were pending, they also filed a motion in the bankruptcy court for an indicative ruling pursuant to Federal Rule of Civil Procedure 62.1. After the bankruptcy court summarily denied that motion, the Bandis filed a motion for writ with the Fifth Circuit to compel the bankruptcy court to hold a hearing on their Rule 62.1 motion. Because the Fifth Circuit ultimately denied the Bandis' petitions for a panel rehearing and a rehearing en banc, the Bandis were told that no further relief was available and no action would be taken on their writ.

Two years later, the Bandis unsuccessfully moved to compel the Fifth Circuit to resolve the motion for writ. They then moved to reopen the case in the bankruptcy court, arguing the writ was actually a notice

of appeal. Shortly thereafter, the Bandis filed an independent action in equity for relief from judgment with the bankruptcy court. All requested relief was denied, and the Bandis appealed.

The Fifth Circuit affirmed the denial of the motion to reopen, rejecting the notion that the writ could be characterized as a notice of appeal. Specifically, the Court found it did not clearly evidence the Bandis' intent to appeal, particularly given that they had previously filed four notices of appeal. Further, even if the Bandis intended to appeal, the Fifth Circuit explained there was "no relief" an appeal could provide. The Bandis were seeking review of the bankruptcy court's refusal to hold a hearing on their Rule 62.1 motion. The purpose of a Rule 62.1 motion, the Court explained, is to permit remand of a case from the Fifth Circuit to allow the bankruptcy court to decide a particular issue before appeal. Here, the issue of dischargeability had been decided, and there was no case to remand. Therefore the motion was moot.

Finally, the Fifth Circuit also affirmed the dismissal of the Bandis' independent action because they were improperly attempting to relitigate already-decided issues.

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***In re Dallas Roadster, 15-41396, 846 F.3d 112 (5th Cir. 2017).***

The parties, Dallas Roadster, Limited (Roadster) and Texas Capital Bank N.A. (TCB), both appealed a district court ruling that entered judgment in favor of TCB on counterclaims, but denied TCB's request for attorney's fees. The parties had an extended business relationship with Roadster executing several loan agreements with TCB. Specifically, Roadster and TCB executed notes and loan and security agreements for purchasing inventory (Floor Plan Note) and for refinancing Roadster's real estate (Real Estate Note).<sup>1</sup>

The business relationship ended when TCB declared that default had been triggered through violations by Roadster and accelerated the notes and sought a receivership in state court. TCB sent notice of default to Roadster claiming that default had been triggered because Roadster had sought financing from Auto Finance Corporation (AFC). At the time, TCB was aware that the DEA was investigating Roadster for IRS filing violations and therefore, began taking steps to protect its interests.

Following a raid by the DEA, TCB filed its Original Petition and Emergency Application for Appointment of a Receiver in Texas state court. The state court granted the application and Roadster did

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<sup>1</sup> This case summary focuses only on the litigation between the entities TCB and Roadster. Bahman Hafezamini, CEO of Roadster and guarantor on its notes, also filed various counterclaims against TCB that were all dismissed at the trial court level. The Fifth Circuit affirmed.

not appeal, opting instead, to file for bankruptcy. As a result, the state court action was removed to the bankruptcy court, which commenced an adversary proceeding. Eventually, a confirmed plan was approved that settled all disputes over the remaining loan balance, but carved out TCB's post-petition litigation fees and expenses and specifically stated that TCB was free to pursue these fees.

TCB sought its fees in district court, and pursued a claim for breach of contract against Roadster and its guarantors. Roadster also brought various counterclaims, including breach of contract. Both parties moved for summary judgment, which resulted in dismissal of most of the claims except for TCB's breach of contract and attorney's fees claims, and Roadster's breach of contract claim. The district court then conducted a bench trial and entered take nothing judgments on all remaining claims. Both sides appealed.

The Fifth Circuit reviewed the district court's holding that Roadster could not recover on its breach of contract claim because it had materially breached the contract before TCB's alleged breaches. The district court had previously held that two breaches of the floor plan agreement were material because Roadster had breached a section of the agreement that provided that Roadster would not incur other loans. Specifically, TCB alleged that Roadster had provided false certificates of compliance showing that there had not been a change in ownership. The second material breach came from a violation in the loan agreement because the agreement provided that there would not be a change in ownership of borrower (Roadster).

Roadster argued that the district court had erred in finding that its breaches were material. The Fifth Circuit however, determined that the district court had accurately applied the five factors for material breach as set out in the *Mustang* case. *Mustang Pipeline Co. v. Driver Pipeline Co.*, 134 S.W.3d 195, 199 (Tex. 2004). The Fifth Circuit determined that all factors had been accurately applied in the case and that the breaches were material. The court specifically rejected Roadster's argument that the district court erred by not addressing each individual factor for each of the alleged breaches by citing to *Benoit v Bordelon*, 596 Fed. Appx. 264, 268 (5th Cir. 2015). This case held that the magistrate judge had not erred by failing to discuss all five factors under *Mustang*. Finally, the Fifth Circuit rejected Roadster's argument that there was no evidence to support a materiality finding regarding the false certificates of compliance. The court held that there was sufficient evidence supporting the district court's finding that this breach was material.

Turning finally to TCB's appeal of the take nothing judgment on its claim for attorney's fees, the Fifth circuit vacated and remanded the district court's ruling. The Court went through a lengthy explanation of the claim for attorney's fees and determined that TCB was only looking to recover its fees incurred by defending against Roadster's counterclaims. The court next reviewed the district court's finding that the floor plan loan agreement provided for recovery of TCB's attorney's fees, but that the claim for fees was unenforceable due to the Texas Supreme Court's ruling in *Zachry Construction Corp. v. Port of Houston Authority*, 449 S.W.3d 98 (Tex. 2014). The district court conducted an *Erie* analysis and applied the principles in the *Zachry* case and determined that TCB's claim for fees was unenforceable because of TCB's wrongdoing in applying for receivership.

The Fifth Circuit, however, disagreed with this application of *Zachry*, holding that the case does not apply to the loan provisions in this case and refused to extend *Zachry's* holding in a way that would override the loan provisions. The Fifth Circuit also rejected Roadster's argument that TCB could not

recover fees because it had breached the loan agreements. The court, did however remand the case to determine if the district court had used its inherent power to sanction TCB.

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***Janvey v. Alguire*, 14-10857, 2017 WL 430078 (5th Cir. Jan. 31, 2017).**

In this matter (hereinafter referred to as *Alguire IV*) the Fifth Circuit considered whether a receiver appointed to recover corporate assets that had been transferred in fraudulent conveyances could avoid arbitration by suing on behalf of only one of several entities he had been appointed to represent. Janvey was appointed as Receiver for several entities after the collapse of a massive Ponzi scheme perpetrated by Allen Stanford. Stanford used various entities, including Stanford International Bank, Ltd. (“Bank”), the Stanford Group Company (“Company”), and Stanford Group Holdings, Inc. (“Holdings”) (collectively, the “Stanford Entities”) to perpetrate the Ponzi scheme. The Receiver sued former employees of the Stanford Entities to recover monies in the form of salaries, commissions, bonuses, and later-forgiven loans paid as fraudulent transfers under the Texas Uniform Fraudulent Transfer Act. The employees moved to compel arbitration, based on various agreements they had with Company and Holdings, which contained arbitration clauses. However, Bank was not party to any arbitration agreement (except as to one employee, Giusti, whose motion to compel arbitration is discussed later in this summary). A number of related appeals followed, a brief understanding of which is necessary to understand the issues in *Alguire IV*.

While the motions to compel arbitration were pending, the district court issued a preliminary injunction preventing the employees from accessing frozen assets. The injunction was appealed, and although the Fifth Circuit initially upheld the injunction and further held that the Receiver’s claims were not subject to the arbitration agreement, *see Janvey v. Alguire (Alguire I)*, 628 F.3d 164, 185 (5th Cir. 2010), it later withdrew and replaced the opinion, instead upholding the injunction but concluding it lacked jurisdiction over the still-pending motions to compel arbitration. *Janvey v. Alguire (Alguire II)*, 647 F.3d 585, 605 (5th Cir. 2011). Thereafter, the district court agreed with the reasoning in *Alguire I*, and denied the motions to compel arbitration on the basis that the Receiver’s claims were brought not on behalf of the Stanford Entities, but on behalf of third-party creditors who were not parties to the arbitration agreement. The employees appealed the district court’s denial of the motions to compel arbitration.

While the appeal was pending, the Fifth Circuit held in another Stanford scheme appeal that the Receiver represented the creditors, not the Stanford Entities. *Janvey v. Democratic Senatorial Campaign Comm., Inc. (DSCC I)*, 699 F.3d 848 (5th Cir. 2012). However, the Fifth Circuit once again withdrew its opinion and replaced it with another, in which it concluded that:

[A] federal equity receiver has standing to assert only the claims of the entities in receivership, and not the claims of the entities' investor-creditors, but the knowledge and effects of the fraud of the principal of a Ponzi scheme in making fraudulent conveyances of the funds of the corporations under his evil coercion are not imputed to his captive corporations. Thus, once freed of his coercion by the court's appointment of a receiver, the corporations in receivership, through the receiver, may recover assets or funds that the principal fraudulently diverted to third parties without receiving reasonably equivalent value.

*Janvey v. Democratic Senatorial Campaign Comm., Inc. (DSCC II)*, 712 F.3d 185, 190 (5th Cir. 2013). Because the reasoning of *DSCC II* invalidated the reasoning underlying the district court's denial of the motions to compel arbitration, the Fifth Circuit vacated the denial and remanded for the district court to reconsider the motions in light of *DSCC II*. *Janvey v. Alguire (Alguire III)*, 539 Fed. App'x 478, 480-81 (5th Cir. 2013).

On remand, the district court once again denied the motions to compel arbitration, on the following bases: (1) the Receiver could not choose the Stanford entity on whose behalf he sued, but must instead sue on behalf of the Company, which was party to the arbitration agreements; (2) however, the Receiver had permissibly rejected the arbitration agreements because, like a bankruptcy trustee, an equity receiver has the power to assume or reject any executory contract and need not do so affirmatively; and (3) in the alternative, the Receiver's claims would conflict with the central purposes and objectives of the federal equity receivership statutory scheme, and therefore, the district court exercised its discretion to deny the motions to compel. The district court's order denying the motions to compel is the subject of this matter, *Alguire IV*.

The Fifth Circuit, relying on its decision in *DSCC II*, determined that the Receiver has standing to assert the claims of the Bank and any other Stanford Entities in receivership. *DSCC II* relied on *Scholes v. Lehmann*, in which the Seventh Circuit held that corporations involved in a fraudulent scheme, although the "robotic tools" of the defrauder, were "nevertheless in the eyes of the law separate legal entities with rights and duties." 56 F.3d 750, 754 (7th Cir. 1995). The Fifth Circuit reasoned that "[i]f corporations retain identities distinct from Stanford himself, as 'separate legal entities with rights and duties,' it logically follows that they are distinct from one another." *Alguire IV*, 2017 WL 430078, at \*4. Because Stanford no longer controls Bank and Company for the benefit of an integrated criminal scheme, Bank and Company are separate actors, and the Receiver "may bring his claim on behalf of whichever of the entities he chooses, provided that the entity has a claim against the defendant in question." *Id.* Thus, because the Receiver brought his claims only on behalf of Bank, and Bank was not party to any of the arbitration agreements (other than Giusti's), the Bank had not consented to arbitration and it could not be compelled to arbitrate with the employee defendants.

The Court further held that the equitable doctrines of alter ego, equitable estoppel, and the third-party beneficiary – doctrines which permit a court to impose a contract on a non-signatory to the contract – could not bind the Bank to the arbitrate agreements. While the equitable estoppel and third-party beneficiary doctrines were inapplicable because the elements for each doctrine were not met, the alter ego theory did not apply because of the reasoning set forth in *DSCC II*. Thus, "blurring of corporate boundaries and the wrongful actions taken by Stanford no longer equitably affect the hostage corporations now that they are under the control of the Receiver. Just as Stanford's removal from the

scene vitiated the defendants' defense of *in pari delicto*, so it vitiates their defense of alter ego." *Alquire IV*, 2017 WL 430078, at \*5 (internal citations omitted).

The Court explicitly refused to address the Receiver's argument that the arbitration agreements were also unenforceable because they were "instruments of the fraud" and enforcement of them would "give effect to the very fraud the Receiver is charged with unwinding by diminishing his ability to return fraudulently transferred assets to the creditors." *Id.* at \*7. Nor the did Court address the Receiver's policy argument that the underlying purpose of the federal equity receivership statutes is at odds with the Federal Arbitration Act's mandate in favor of arbitration. Finally, the Fifth Circuit held that the Receiver could not be compelled to arbitrate Bank's claims against Giusti, because Giusti had waived its right to arbitrate by engaging in litigation for three years before moving to compel arbitration, which caused prejudice to Bank.

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## **Seventh Circuit**

***In re Margaret Kempff*, No. 15-3200, 2017 WL 396590, (7<sup>th</sup> Cir. Jan. 30, 2017) (Sykes, J.).**

On January 30, 2017, the Seventh Circuit affirmed the decisions of the Bankruptcy and District Courts, holding that it would not disturb the Bankruptcy Court's credibility determination that the debtor had not "knowingly and fraudulently" made false statements in her petition. Specifically, prior to filing bankruptcy, the debtor's husband forged her signature on a third mortgage for \$400,000 on their home without her knowledge or consent in an attempt to cover up his embezzlement at work. He was found out, filed for bankruptcy, and the holder of the third mortgage – an individual who also was an attorney – sought to prevent his claim against the wife (debtor) from being discharged in bankruptcy.

First, the lender argued that the debtor should be denied discharge because she "fraudulently permitted her accountant to transfer [approximately \$7,200] to the Illinois Department of Revenue for unpaid taxes." (Slip Op. 5). The bankruptcy court disagreed, crediting the debtor's testimony that she did not know that her accountant was taking that action. The lender did not challenge the factual finding but instead argued that 11 U.S.C. § 727(a)(2) "contains no requirement that the complaining creditor actually suffer harm." (*Id.* at 6). The Seventh Circuit rejected that argument as tangential and unavailing, noting that discharge is denied only where the debtor "actually intended to hinder, delay or defraud a creditor . . . [and] intent to defraud must be actual and cannot be constructive." (*Id.* (quoting *Village of San Jose v. McWilliams*, 284 F.3d 785, 790 (7<sup>th</sup> Cir. 2002)).

Second, the lender argued that discharge should have been denied because the debtor (a) failed to include in her schedule her own claim against her husband; (b) listed her parents as creditors for \$1.4 million even though her parents did not have legal authority to collect on that particular debt; (c)

reported the value of her clothing and jewelry as only \$500; (d) underreported the financial assistance she was receiving from her parents; and (e) reported a \$3,275.35 payment to her parents as \$275.35. Again the bankruptcy court believed the debtor that this was not intentional, finding that (a) the claims against the husband were (understandably) valued at zero in an amended schedule; (b) the parental claim was included as a result of “inexplicable” and “incompetent” advice of her bankruptcy attorney; (c) the only evidence about the value of her belongings came from her fraudster husband; (d) the difference in parental assistance was in the form of charges to her parents’ credit cards rather than cash received and would not have affected her ability to receive a discharge; and (e) the “missing” \$3,000 was a typo. Under the applicable “clearly erroneous standard,” the Seventh Circuit saw no reason to undo the Bankruptcy Court’s credibility determination that the debtor had not intended to defraud anyone here, either.

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## **Ninth Circuit**

***In Schoenfeld v. Hugler (In re Schoenfeld), Nos. 15-56871 and 56872, 2017 WL 491160 (9<sup>th</sup> Cir. Feb. 7, 2017)***

The Ninth Circuit affirmed a district court’s order permanently enjoining the debtor-appellant from serving as a fiduciary to any ERISA-covered employee benefit plan in the future. This ruling was made after a remand by the Ninth Circuit to determine if certain debts owed by the debtor were non-dischargeable under Code section 523(a)(4). The Ninth Circuit held that the district court did not abuse its discretion by concluding that the law of the case doctrine precluded the debtor from relitigating the district court’s prior ruling that he had breached his fiduciary duties under ERISA. The Ninth Circuit explained that the debtor-appellant waived his opportunity to challenge the prior ruling in his initial appeal. In that appeal, the Ninth Circuit vacated and remanded to the district court to reconsider the unrelated issue of whether the debtor’s debt was non-dischargeable under section 523(a)(4), but it did not disturb that court’s order to the extent it held that the debtor violated ERISA. Finally, the Ninth Circuit rejected the debtor’s contention that satisfaction of the underlying debt rendered moot the prospective, injunctive relief ordered by the district court which was designed to protect against future violations of ERISA.

***In Seydan v. Beauty Illusions, Inc. et al. (In re Kanaan), No. 1:16-ap-1077-GM, 2016 WL 8138979 (Bankr. S. D. Cal. Feb. 1, 2017),***

The bankruptcy court granted the debtor-defendant’s motion to dismiss a Section 523 nondischargeability adversary proceeding because the plaintiff filed her complaint after the deadline set forth in Bankruptcy Rule 4007(c) and failed to establish “unique,” “extraordinary” or “exceptional” circumstances justifying the late filing. The court noted that “[c]ourts are split as to whether a court loses

jurisdiction to hear a nondischargeability complaint filed after the deadline,” while noting that “[c]ourts within the Ninth Circuit have held that the rule is subject to doctrines of waiver, equitable tolling, and estoppel....” The court held, in part, that Rule 60, Fed. R. Civ. P., is unavailable to excuse a litigant’s failure to meet Rule 4007(c)’s deadline, and noted that the Ninth Circuit BAP has held that the concept of “excusable neglect” contemplated by Rule 60(b) is unavailable to extend the Rule 4007(c) deadline, citing several cases including Schunk v. Santos (In re Santos), 112 B.R. 1001 (9th Cir. BAP 1990). The court explained that a motion seeking an extension of the Rule 4007(c) deadline must be filed in advance of that deadline. The court concluded that the complaint, filed 2 days after the Rule 4007(c) deadline, was time-barred, reasoning that because plaintiff (and her counsel) had actual notice of the debtor’s chapter 7 case in time to file a nondischargeability complaint, the fact that the plaintiff’s counsel had experienced “life and death matters” did not excuse the late filing, i.e., did not constitute “unique,” “extraordinary” or “exceptional” circumstances.

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***Tomkaw v. Barton (In re Khan), 2017 WL 279505 (9th Cir. Jan. 23, 2017)***

In *Tomkaw v. Barton*, the Ninth Circuit affirmed the bankruptcy court’s decision on appeal from the Bankruptcy Appellate Panel that a creditor’s claim was not subordinated under 11 U.S.C. § 510(b) and converted the debtors’ chapter 13 bankruptcy proceedings to chapter 7 proceedings. Section 510(b) requires that claims for damages “arising from the purchase or sale” of a “security of the debtor or of an affiliate of the debtor” must be subordinated to particular other claims or interest.

In this case, a creditor obtained a state judgment against two debtors for their alleged fraudulent conversion of the creditor’s common stock shares. The debtors thereafter separately filed for bankruptcy relief under chapter 13. The debtors, however, failed to provide “meaningful information” regarding their companies’ stock valuation at their 341 meeting and accurately report both the value of the company’s stock and state court judgment. The creditor in turn filed (a) a proof of claim in each case to which the debtors objected arguing subordination under section 510(b) and (b) motion to convert each case to a chapter 7 as a result of the debtors’ bad faith. The bankruptcy court ultimately held that the creditor’s claim was not subject to subordination because they were not for damages arising from the purchase or sale of a security and granted the creditor’s motion to convert. The debtors appealed but the bankruptcy appellate court affirmed the subordination determination, albeit on different grounds (i.e., section 510(b) does not apply to individual debtors), and held that the bankruptcy court did not abuse its discretion when it found bad faith and converted the cases from Chapter 13 proceedings to Chapter 7 proceedings.

The Ninth Circuit agreed with the lower courts that section 510(b) did not apply because the claim did not arise from the purchase and sale of a security but rather from a judgment entered against the debtors on account of their actions. In particular, even though the creditor’s damage award for conversion was based on the value of the securities at the time of conversion, his actions did not arise out of the

purchase of the securities and the risks that the purchase might entail. Instead, it arose out of the debtors' conversion of the securities many years later. According to the panel, the value of the securities at the date of conversion was the measuring stick. The Ninth Circuit, however, disagreed with the bankruptcy appellate panel by holding that section 510(b) also applied to individual debtor. Lastly, the Ninth Circuit did not find an abuse of discretion with respect to conversion. The bankruptcy court was required and did consider the totality of the circumstances.

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***In re Zenovic*, SC-15-1204-FYJu, 2017 WL 431400 (9th Cir. Jan. 31, 2017)**

In *In re Zenovic*, the Ninth Circuit BAP affirmed in part and reversed in part a nondischargeable judgment of the bankruptcy court under §§523(a)(2)(A) and (a)(6). In 2008, Creditors paid Debtor \$641,000 pursuant to a contract for the purchase of vacant land and construction of an elder care facility. Debtor did not perform any construction and instead used Creditors' funds for unrelated personal and business debts. In 2010, Creditors discovered that Debtor was not a licensed contractor and that it was nearly impossible to obtain necessary permits to construct an elder care facility on the land. As a result, the value of the land was substantially less than Creditors had paid. Creditors filed a state court suit for fraud against Debtor and a third-party broker. In 2013, Creditors settled with the broker for \$498,000, and Debtor filed a chapter 7 petition.

The bankruptcy court entered a nondischargeable judgment for actual fraud in the amount of \$68,925 and awarded prejudgment interest at the state rate of 7%. The damage calculation was based on the difference in the amount paid under the contract and the value of the property as of the date of trial, which was about 6 years after the Creditors obtained titled to the property.

The BAP reversed the damage amount and reasoned that although fraud damages were limited under CA law to the difference between what was bargained for and what was actually received, the difference should be measured at the time the Creditors became aware of the fraud. The BAP held that using an unduly late valuation date could subject the Debtor to liability for losses that were not caused by the Debtor. The BAP affirmed the bankruptcy court's decision to apply prejudgment interest at the state rate because the "debt" was entirely a creature of state law and its dischargeability was also dependent on state law fraud. Applying the prejudgment interest to the damage and then crediting the settlement amount to the principal first, the BAP concluded that the correct amount was \$164,047.82 and remanded for entry of judgment.

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## **Eleventh Circuit**

### ***Wortley v. Bakst*, Case Nos. 15-11923 and 15-90007, 844 F.3d 1313 (11th Cir. 2017).**

The plaintiffs brought a state court action against counsel for the chapter 7 trustee—Bakst and Fender for allegedly attempting to influence the bankruptcy judge (Judge Olson) assigned to the Trafford bankruptcy case. While the Chapter 7 Trustee was litigating three adversary proceedings in the Trafford bankruptcy against a group of Wortley defendants, Bakst’s law firm hired Fender who was Judge Olson’s fiancé. The adversary proceedings against the Wortley defendants were tried together at a bench trial before Judge Olson, resulting in a \$2.5 million judgment in favor of the chapter 7 trustee against the Wortley defendants. During the course of the adversary proceedings the Wortley defendants filed motions to have Judge Olson recuse himself, which were denied. The state court action was removed to bankruptcy court and assigned to Judge Cristol who dismissed the action and certified his decision for direct appeal to the Court of Appeals.

The Eleventh Circuit held that it did not have appellate jurisdiction to review the bankruptcy court’s order dismissing the action. The Court determined that since the bankruptcy court had only “related to” jurisdiction over the Wortley claims asserted against the chapter 7 that the bankruptcy court did not have the authority to enter a final dismissal order. With “related to” jurisdiction, the bankruptcy court was only authorized to submit a report containing proposed findings of fact and/or conclusions of law. §158(d)(2)(A) only permits the Court to consider “judgment[s], order[s], or decree[s]— rulings which have adjudicative consequences— of the bankruptcy court.” Thus permitting a direct appeal in a non-core proceeding would ignore the Court’s fundamental function as the appellate court and put the Court in the position of making findings of fact.

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