

Bankruptcy Circuit Update
Featuring cases from July 2017

First Circuit

Goldsmith v. Marci Assoc., Inc. (In re E & G Waterworks LLC),
Adv. No. 16-4106, Case No. 15-40816,
--- B.R. ----, 2017 WL 3442541 (Bankr. C. D. Mass. July, 27, 2017)

In *E & G Waterworks LLC*, the defendant sought to compel the chapter 7 trustee to arbitrate the trustee's claim for turnover under §542(b) of the Bankruptcy Code. Pre-petition the debtor and the defendant had entered into an agreement whereby the debtor was to be paid for services performed and materials provided to the defendant. As of the petition date, the debtor had not been paid, and the trustee brought a complaint primarily for turnover of the receivable. The defendant asserted that the arbitration clause in the agreement should be enforced and the matter should be submitted to arbitration. The trustee refused.

In its analysis, the court stated that whether to compel arbitration is a two-part inquiry. First, a court must determine whether the dispute falls within the scope of the arbitration clause. This is an issue of state contract law; but, a court must apply due regard to the federal policy favoring arbitration. In *E & G Waterworks LLC*, the arbitration clause used broad language, indicating that "all" disputes were to be subject to arbitration. The court held that because the turnover action arose out of the debtor's performance under the agreement, the matter fell within the scope of the arbitration clause.

Second, a court must determine whether the arbitration clause should be enforced in the present situation. To start, a court must decide whether the dispute involves a core or non-core matter. There is a general agreement that bankruptcy courts must compel arbitration of non-core proceedings. But with respect to core proceedings, there is a divergence of approach. The Fifth Circuit has rejected the binary distinction between core and non-core matters. Rather, courts in the Fifth Circuit have the discretion to refuse to enforce an arbitration clause when: the underlying nature of a proceeding derives exclusively from the Bankruptcy Code and arbitration would conflict with the purpose of the Code. In its analysis, the court in *E & G Waterworks LLC* stated that the trustee's collection of receivables was a core proceeding under §542(b) and this power does not exist independent of the Code. The court then went on to hold that arbitration inherently conflicts with the trustee's right to demand turnover pursuant to §542(b). The court stated that turnover actions are an integral part of the bankruptcy administration process and to require arbitration would de-centralize the bankruptcy process where, as in the present case, there was no question as to liability or amount of the debt. Requiring arbitration would undermine the trustee's power to seek quick and inexpensive resolution of routine bankruptcy matters. Thus, the court denied the motion to compel arbitration.

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Second Circuit

Abraham v. Stuart (In re Abraham), 16-2968,
--- Fed.Appx. ---, 2017 WL 3016695, (2d Cir., July 17, 2017)

The Second Circuit affirmed the district court's order affirming the bankruptcy court's denial of discharge in the chapter 7 bankruptcy case of Stanley Abraham ("Abraham").

Creditor Janet Stuart ("Stuart") objected to Abraham's discharge with respect to a \$75,000 debt she sought to collect from Abraham and his father-in-law in a state court proceeding. All parties agreed that Stuart transferred a total of \$75,000 to Abraham in 2009, and that Abraham had not repaid the money, either before or after his 2013 bankruptcy filing. Abraham contended, however, that the money was intended as a loan for his father-in-law and argued that Stuart lacked Article III and statutory standing to bring a claim against him. The bankruptcy court found, following a bench trial, that Abraham had knowingly and fraudulently made materially false statements on his bankruptcy filings, in violation of 11 U.S.C. § 727(a)(4)(A), and that a general denial of discharge was warranted.

On appeal, the Second Circuit found Abraham's arguments regarding Stuart's standing to be unpersuasive. First, the Second Circuit noted that Stuart had alleged an injury, caused by Abraham through his failure to repay her, that would be redressed by a favorable court ruling in the bankruptcy court that would allow her to pursue her state court claim against Abraham. Next, the Second Circuit stated that Stuart had standing under the Bankruptcy Code to object to discharge pursuant to section 727(a)(4)(A), because she was a creditor of Abraham's estate, even if her claim was disputed.

Abraham also argued that the bankruptcy court improperly allowed Stuart to amend her complaint. However, the Second Circuit noted that because Abraham did not object to Stuart's motion to amend and instead raised this argument for the first time on appeal to the district court, he accordingly waived such argument.

Finally, the Second Circuit was not persuaded by Abraham's argument regarding the merits of the bankruptcy court's decision denying the discharge. Abraham asserted that both lower courts had erred in denying the discharge because any misstatements or omissions in his bankruptcy filings were innocent or immaterial. The Second Circuit noted that to deny a discharge under Bankruptcy Code section 727(a)(4)(A), one must show that (1) the debtor made a statement under oath; (2) the statement was false; (3) the debtor knew the statement was false; (4) the debtor made the statement with fraudulent intent; and (5) the statement related materially to the bankruptcy case. Here, the bankruptcy court found that Abraham violated Bankruptcy Code section 727(a)(4)(A) because (1) he signed the bankruptcy petition and underlying

documents under oath; (2) the bankruptcy schedules and statements did not fully disclose his interests in several companies, did not disclose the name of his accountant in response to questions on the forms, and did not accurately disclose his gross income; (3) these disclosures were material because they related to his financial condition and business dealings; (4) the repeated inaccuracies and inability to explain the omissions exhibited a reckless disregard for the truth; and (5) Abraham should have known that the answers provided to these basic questions were false.

After reviewing the record, the Second Circuit found no error in the lower courts' conclusions that the misstatements warranted a denial of discharge, noting that the inaccuracies and omissions, particularly with respect to income, were material to Abraham's bankruptcy filing and financial condition. Additionally, the Second Circuit found Abraham's excuses of negligence and reliance on his attorney unconvincing. As an example, the Second Circuit noted that Abraham reported no income for 2011, whereas his tax returns showed that he and his wife had a combined adjusted gross income of \$34,037 for that year, which was "hardly a small or excusable omission." Accordingly, the Second Circuit affirmed the judgment of the district court affirming the bankruptcy court order denying the discharge.

IEE LLC v. Giddens (In re Lehman Bros. Holdings Inc.),
16-2737, 16-2788, 2017 WL 3180718 (2d Cir., July 27, 2017)

In this case, which derived from two consolidated appeals, the Second Circuit affirmed in part and reversed in part a judgment by the district court relating to claims brought by two former employees of Lehman Brothers Inc. ("LBI"): Jonathan Hoffman ("Hoffman") and Wayne Judkins ("Judkins"). The district court's earlier judgment (i) affirmed the portion of the bankruptcy court's order that disallowed Judkins's claim and most of Hoffman's claim and (ii) reversed the portion of the bankruptcy court order that allowed a portion of Hoffman's claim.

In 2008, LBI's parent company, Lehman Brothers Holdings Inc. ("LBHI"), filed for bankruptcy. The following day, LBHI, LBI, and LB 745 LLC (another Lehman entity) entered into an Asset Purchase Agreement (the "APA") with Barclays Capital Inc. ("Barclays") pursuant to which Barclays purchased the bulk of LBI's North American capital markets and investment banking businesses. Under the APA, Barclays agreed to offer employment to former LBI employees who worked in the acquired businesses, and to accept certain compensation obligations with respect to such transferred employees. Specifically, Article IX of the APA provided that Barclays would pay each transferred employee an annual bonus for 2008. After the bankruptcy court approved the APA, Hoffman and Judkins accepted the offer to transfer and began working at Barclays in the fall of 2008.

Hoffman had been a highly successful trader at LBI whose compensation was governed by a series of annually negotiated contracts. In 2007 and 2008, his contracts provided for a base salary of \$200,000 plus an annual bonus based on a percentage of net profit he generated: 12% of the first \$25 million and 14% of anything beyond that, less his base salary. His bonus each year was to be paid in two installments: 75% in cash and equity awards early the following year, with

the remaining 25% in cash early the year after that, subject to “clawback” if he lost money for LBI during the previous year.

The bankruptcy court calculated that, under these contracts with LBI, Hoffman was owed: (1) approximately \$7.7 million in cash in early 2009 as the second installment of his 2007 bonus; (2) approximately \$62.3 million in some combination (at LBI’s discretion) of cash and equity awards in early 2009 as the first installment of his 2008 bonus; and (3) assuming he traded profitably in 2009, approximately \$18.9 million in cash in early 2010 as the second installment of his 2008 bonus. Thus, the parties agreed that when LBI entered liquidation, Hoffman was owed a total of approximately \$83 million in bonuses.

Accordingly, Barclays’s employment contract with Hoffman provided for payment of \$83 million on top of the same general compensation package he had with LBI. Of the \$83 million, \$70 million was to be paid in three installments between February 2009 and February 2011, and \$13 million was to be paid through increased performance incentives in 2009 and 2010. Hoffman ultimately received the \$83 million, plus an additional \$100 million in compensation for his trading performance at Barclays in 2008 to 2010.

Unlike Hoffman, Judkins’s time at LBI was brief. He was hired as a trader in January 2008 under a contract that entitled him to an annual salary of \$200,000 plus a minimum bonus of \$800,000 (to be paid in early 2009 in a combination of cash and equity awards). Judkins also claimed that his managers at LBI orally promised to pay him a performance bonus. When Barclays hired Judkins in October 2008, it agreed to pay him the same \$200,000 base salary plus his guaranteed 2008 bonus of \$800,000. Judkins received the \$800,000 bonus, in cash, in February 2009.

In 2009, Hoffman and Judkins both filed claims against LBI for their bonuses, and the trustee for the liquidation of LBI objected. After a hearing on the merits, the bankruptcy court found that Barclays ultimately paid appellants the full value of the outstanding bonuses they were owed. However, it concluded that because the \$7.7 million paid to Hoffman for his 2007 bonus was outside the scope of the obligations delegated to Barclays under the APA, Hoffman could pursue a \$7.7 million claim in the bankruptcy. On appeal, the district court affirmed in part and reversed in part, ruling that, regardless of the scope of the delegation in the APA, Hoffman and Judkins could not claim any part of their bonuses because they accepted payment of those bonuses from Barclays.

In the Second Circuit, Hoffman and Judkins both argued that LBI still owed them their bonuses. The Second Circuit was not persuaded by this argument, except with respect to Hoffman’s \$7.7 million bonus for 2007. The Second Circuit noted that the bankruptcy court had found that Hoffman, Judkins, and Barclays understood that Barclays would pay the bonuses LBI owed Hoffman and Judkins. Moreover, the Second Circuit stated that it was undisputed that Barclays paid the \$83 million and \$800,000 that LBI owed Hoffman and Judkins, respectively. The entire payment to Judkins and all but \$7.7 million of the payment to Hoffman were annual bonuses from 2008, and accordingly were obligations delegated to Barclays under the APA. The Second Circuit stated that although the delegation did not extinguish LBI’s obligation to pay these bonuses, Barclays’s performance (i.e., its payment of the bonuses) did.

However, the Second Circuit did not extend its holding to the \$7.7 million owed to Hoffman for his 2007 bonus. The bankruptcy court found that this amount lay outside the scope of the delegation in the APA (meaning Barclays had no obligation to pay it), and the Second Circuit found no error in that determination. Relying on the law governing unjust enrichment, the trustee contended that, although the APA had been understood not to cover 2007 bonuses, it would be inequitable to allow Hoffman's claim to the extent of his 2007 bonus in light of all Hoffman was paid under his agreement with Barclays. However, the Second Circuit noted that Hoffman's employment agreement with Barclays required him to generate substantial profits for Barclays before earning the full amount promised under that agreement, and the Second Circuit therefore found nothing inequitable in allowing him to pursue his liquidated and unpaid 2007 bonus claim against LBI in bankruptcy.

The Second Circuit then addressed Hoffman and Judkins' remaining arguments, finding none convincing. First, the Second Circuit disagreed that Barclays was required to pay additional sums to Judkins pursuant to an oral promise from his LBI managers because LBI's bonus policy explicitly stated that employees had no entitlement to bonuses unless guaranteed in writing. Second, the Second Circuit disagreed with Hoffman's assertion that LBI should have been judicially estopped from arguing that Barclays satisfied LBI's 2008 bonus obligation to him because LBHI took a contrary position in prior litigation. The Second Circuit held that judicial estoppel did not apply because this contrary position was taken by LBHI rather than by LBI, and because it was not adopted by a court.

Accordingly, the Second Circuit affirmed the judgment of the district court with respect to the disallowance of Judkins's claim and Hoffman's claim for his 2008 LBI bonus, and reversed the district court's judgment with respect to the disallowance of Hoffman's claim for his 2007 LBI bonus.

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Third Circuit

***In re SemCrude LP et al.; Arrow Oil & Gas Inc. et al. v. J. Aron & Co. et al.;
BP Oil Supply Co. v. SemGroup LP et al.; J. Aron & Co. v. SemGroup LP et al.,
Case Nos. 15-3094, 15-3095, 15-3096, 15-3097, 15-3121, 15-3123 and 15-3124
864 F.3d 280 (3rd Cir. July 19, 2017)***

The Third Circuit upheld a 2015 district court ruling that rejected unsecured oil producers' contentions that "a lien or trust follows oil from their wells to the gas pump" in claims against purchasers of the producers' oil from a bankrupt intermediary that resold the oil to large

distributors. SemGroup and its subsidiaries, including SemCrude LP, filed for Chapter 11 protection in 2008 after speculation led to SemCrude losing bets on future oil prices going down – which it traded with BP and J. Aron – resulting in balances due to BP and J. Aron, cash collateral requirements for SemCrude, and SemCrude’s default in the futures contracts. After the bankruptcy was filed, over 1,000 oil producers were left unpaid, prompting adversary proceedings by oil producers, purchasers, and banks demanding full payment. The U.S. Bankruptcy Court for the District of Delaware consolidated the cases by state and determined that the banks’ security interests had priority over other parties’ lien or trust rights.

J. Aron and BP brought separate adversary proceedings seeking to tender amounts they owed to the bankruptcy estate as a condition for their release from liability. Two dozen suits filed by oil producers against J. Aron and BP in various courts asserted security interests under state law and common law fraud, but the claims were transferred to the bankruptcy court. A Chapter 11 plan was confirmed in 2009 through which funds turned over by J. Aron and BP were to pay for oil produced in the weeks prior to the bankruptcy filing. In 2013, the bankruptcy court recommended summary judgment in favor of J. Aron and BP, failing to find fraud, and concluding they purchased the oil as buyers for value in the ordinary course of business under U.C.C. § 9-317(b), thus taking the oil free of any security interests.

Producers in Texas, Kansas and Oklahoma challenged the bankruptcy court’s ruling and the District Court’s subsequent adoption of the recommendation, arguing that U.C.C. provisions in Texas and Kansas automatically granted a perfected security interest in oil sold even after it was resold, while asserting that Oklahoma provided coverage by an implied trust that created an ownership interest in oil that BP and J. Aron took to settle of SemCrude’s options debts. However, as the Third Circuit pointed out, Delaware and Oklahoma – where SemGroup and its affiliates are registered – require filing of financing statements to perfect liens. None of the producers perfected security interests by filing financing statements in accordance with U.C.C. § 9-310(a), leaving them unprotected in case of SemGroup's insolvency (in contrast to the purchasers, who took steps to protect themselves). The Third Circuit also noted that neither BP nor J. Aron acquired the oil as “collateral for the options trades” but rather on credit, hence, “neither had knowledge of the producers’ security interests in oil” as required by U.C.C. § 1-202(b). Finally, the court rejected the Oklahoma producers’ assertion that oil and gas revenues create an implied trust in favor of unpaid producers against all “downstream” purchasers under Oklahoma statute, since this oil is then combined with “myriad other producers’ oil and is resold many times” before consumers purchase it at the pump. The industry relies on the warranty that the oil is sold free and clear of any liens, a reliance the court proffered as fortunate for “anyone who has unwittingly filled a gas tank with Oklahoma-produced oil.” Summary judgment affirmed in favor of oil purchasers.

In re Fayson, Case No. 16-10013,
2017 WL 2992474 (3rd Cir. July 13, 2017)

The U.S. Bankruptcy Court for the District of Delaware held, in a case of first impression for the District, that a Chapter 13 plan modification that proposes surrendering collateral securing a 910 Claim and treating any deficiency as an unsecured claim is permissible under §

1329 of the Bankruptcy Code. However, any proposed modification under § 1329 must be made in good faith pursuant to § 1325(a)(3). Debtor bought a used Mercedes on credit, then filed a petition under Chapter 13. Six months after the court allowed her to keep the Mercedes in exchange for paying the full debt, Debtor returned the vehicle to the secured Creditor and moved to modify the confirmed Chapter 13 plan, claiming mechanical issues and an undelivered warranty. The vehicle was securing a 910 Claim, in which a claim is secured by a motor vehicle purchased by a debtor within two-and-a-half years of the petition date. In surrendering the vehicle, Debtor sought to convert any deficiency into an unsecured claim, which would result in reclassifying the claim under § 1329. Creditor objected to Debtor's Modification on grounds that § 1329 does not allow a Debtor to modify a confirmed Chapter 13 plan in which a motor vehicle secures a 910 Claim to surrender the vehicle and reclassify the deficiency as an unsecured claim, since a 910 Claim must be treated as fully secured and paid in full under a Chapter 13 plan. Even if such modification was allowed, Creditor argued that the modification could not be confirmed because Debtor submitted it in bad faith. Debtor countered that she was proceeding in good faith per the requirements of § 1325(a)(3). A Chapter 13 debtor is prevented by § 1325(a)(3) from bifurcating a secured creditor's claim in a recently-purchased vehicle by treating the claim as secured only up to the present value of the car, then transferring the remaining debt on the vehicle as unsecured. When collateral is surrendered, a creditor is deemed to receive full payment of its secured claim, and any deficiency is treated as unsecured under the plan, unless a debtor chooses to surrender the vehicle to a creditor under § 1325(a)(5)(C), which allows surrender of collateral securing a claim. Debtor's loan fell within the protections of § 1325(a), since she purchased her vehicle 24 months before the petition date, thus preventing her from forcing a "cramdown" to keep the vehicle over Creditor's objection by paying Creditor the replacement value of the collateral. This necessitated Debtor's attempt to modify the Chapter 13 plan.

The bankruptcy court noted the general agreement among courts that "§ 1329(a)(1) does not prohibit anything," but permits certain types of modifications. The court reasoned that 1329(a) permits a debtor to alter, reduce, or reclassify a previously allowed secured claim, and § 502(j) provides a court broad authority to reconsider an allowed or disallowed claim for "cause according to the equities of the case." The court stated that § 1325(a)(5)(B) does not bar Debtor's proposed modification but that § 1329(b)(1) requires that modifications under § 1329(a) meet the standards for plan confirmation set out in 1325(a), so as to not allow Debtor to do in a modified plan what could not have been done first under a confirmed plan. Here, surrendering the collateral would have been available to Debtor under § 1325(a)(5)(C). The court also did not find that Debtor's modification unfairly prejudiced Creditor, since the Code adequately protects secured creditors by preventing a Chapter 13 debtor from bifurcating a secured creditor's claim in a recently-purchased vehicle. The court concluded that Debtor's modification was permitted if made in good faith. Accordingly, the court determined that a further evidentiary hearing is required to determine whether the Debtor has proceeded in good faith.

***In re World Imports, Ltd.*, No. 16-1357,
862 F.3d 338 (3rd Cir. July 10, 2017)**

The Third Circuit reversed the District Court’s and bankruptcy court’s decision in an international supply chain case, holding that receipt of goods as used in 11 U.S.C. § 503(b)(9) requires physical possession by a buyer or agent. In a case with “important ramifications for a creditor that sells goods to a debtor soon before the debtor files a Chapter 11 bankruptcy petition,” the court was asked to consider whether to allow the suppliers of goods priority claims when the claims were filed within 20 days before the purchaser filed bankruptcy. To answer this, the court analyzed the meaning of the word “received” in the context of a vendor’s right to administrative expense claims filed before a debtor’s Chapter 11 petition. Previously, the Third Circuit had interpreted a related provision of the Bankruptcy Code, § 546(c), to mean that “receipt” occurs when the buyer takes physical possession of the goods. In the present case, two Chinese vendors sold furniture and other goods to Debtor, World Imports, in the ordinary course of business. The goods were shipped to the United States “free on board” (FOB) at the port of origin, so Debtor assumed the risk of loss or damage upon transfer at the port. The goods were shipped in May and early June 2013. Debtor took possession of a shipment from one of the vendors in June 2013. Three shipments of goods were accepted into the U.S. from the other vendor within 20 days of the Debtor’s Chapter 11 filing in July 2013.

Both vendors filed Motions for Allowance and Payment of Administrative Expense Claims under 11 U.S.C. § 503(b)(9), which allows a creditor to recover as a priority administrative expense the value of goods sold in the ordinary course of business and “received by the debtor within 20 days before” the bankruptcy petition is filed. Section 503(b)(9) acts as an exception to § 546(c), which requires notice for reclamation to be made within 45 days after goods are received. The parties disagreed as to whether shipment or physical acceptance constituted receipt, forcing the U.S. Bankruptcy Court for the Eastern District of Pennsylvania to evaluate the word “received,” which was not defined in § 503(b)(9). Rejecting the vendors’ argument that the U.C.C. should act as a gap filler for the federal statute, the bankruptcy court instead turned to international contract conventions, from which it concluded that the goods were “constructively received” when they were shipped from China. The bankruptcy court thus denied the vendors’ motions, and the District Court affirmed.

On appeal, the Third Circuit disagreed with the bankruptcy court’s construction rationale, opting instead to view the legislative context of the Bankruptcy Code and prior decisions as indications that Congress meant to use the U.C.C. definitions for this particular Code amendment. Examining the Code, the court suggested it was “quite implausible” that Congress meant for the date of receipt to be different between § 503(b)(9) and § 546(c). Then, citing its 1984 definition in *In re Marin Motor Oil*, in which the Third Circuit determined that the word “receipt” in § 546(c) means “taking physical possession” as it does in the U.C.C., the court reasoned that the seller’s remedy only converts to a “different right” of reclamation (governed in bankruptcy cases by § 546(c)) upon the buyer’s physical possession. This is due to the seller’s right to stop delivery of the goods while the common carrier remains in possession, regardless of which party bears the risk of loss or is deemed to have title to the goods while they are in the carrier’s possession. Consequently, under the U.C.C. and Chapter 11, receipt does not occur until after the seller’s ability to stop delivery ends, which is upon the buyer’s physical possession,

regardless of FOB status. Establishing that receipt under § 503(b)(9) requires physical possession by the buyer or his agent, the court next determined that the common carrier did not act as the Debtor's agent, since goods received by a common carrier are deemed to be in possession of the common carrier, not in constructive possession of the buyer. Here, because the goods were received only when Debtor took physical possession of them, and Debtor took physical possession within 20 days prior to commencing its bankruptcy case, vendors' claims are entitled to "the highest priority." Order of the District Court reversed and case remanded for proceedings consistent with Third Circuit's opinion.

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Fifth Circuit

Matter of Cowin,
864 F.3d 344, 2017 WL 3032158 (5th Cir. July 18, 2017)

In this case, debtor Charles Cowin ("Cowin") appealed a finding that debts arising from his scheme to deprive mortgage holders of proceeds due from foreclosure sales were non-dischargeable under 11 U.S.C. §§ 523 (a)(4) and (6). In May 2010, Cowin filed for Chapter 11 bankruptcy, and several banks brought an adversary proceeding seeking to have the debts arising from Cowin's scheme deemed non-dischargeable (the "Countrywide Adversary Proceeding"). Cowin's Chapter 11 case ultimately was dismissed, but the bankruptcy court retained jurisdiction of the Countrywide Adversary Proceeding by agreement of the parties.

More than two years later, in February 2013, Cowin filed Chapter 7 bankruptcy. The Chapter 7 case was assigned to the same judge presiding over the ongoing Countrywide Adversary Proceeding. In April 2013, the bankruptcy court issued a memorandum opinion in the Countrywide Adversary Proceeding finding that (i) Cowin was liable for the debts resulting from his scheme and (2) those debts were non-dischargeable. Before the bankruptcy court entered final judgment, however, Cowin filed a suggestion of bankruptcy, formally notifying the court of his Chapter 7 proceeding. The bankruptcy court nevertheless entered final judgment in the Countrywide Adversary Proceeding, extending its finding of non-dischargeability to Cowin's Chapter 7 case.

On appeal, Cowin argued that the bankruptcy court (i) erred in finding his debts non-dischargeable based on the actions and intent of his co-conspirators in the mortgage scheme and (ii) violated the automatic stay in his Chapter 7 case by entering judgment in the Countrywide Adversary Proceeding. With respect to the first issue, the Fifth Circuit found there was sufficient evidence of Cowin's individual intent and conduct to support a finding of dischargeability. Further, the Court concluded in the alternative that Cowin's co-conspirators' conduct also rendered Cowin's debts non-dischargeable. Specifically, the Court explained the only relevant consideration under § 523(a)(4) was the character of the debt—i.e. whether the debt

arose from larceny—rather than the character of the debtor. Here, because Cowin did not challenge the bankruptcy court’s finding that his scheme constituted “larceny,” his debts were non-dischargeable under the statute.

The Fifth Circuit, assuming but not deciding it was error for the bankruptcy court to enter the Countrywide Adversary Proceeding judgment, also held that error was harmless for several reasons. First, everything in the record indicated the bankruptcy court would have lifted the stay if requested by the Countrywide plaintiffs. Second, if the court had lifted the stay, the outcome would have remained the same; in other words, a remand to permit the stay to be lifted would leave Cowin in the same position. Third, Cowin was not prejudiced by the failure to lift the stay because he had agreed to the bankruptcy court’s continued jurisdiction in the Countrywide Adversary Proceeding, and the adversary would have been no different if it was refiled in his Chapter 7 case. Fourth, the Court also noted that Cowin’s delay in filing his suggestion of bankruptcy until after the bankruptcy court issued its memorandum opinion illustrated that his sole motive was to avoid the adverse judgment.

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In re Hawk,
864 F.3d 364, 2017 WL 3048605 (5th Cir. July 19, 2017).

This appeal stems from a chapter 7 filing by Gregory and Marcie Hawk. After filing, the Hawks claimed an exemption for particular funds held in an individual retirement account (“IRA”) pursuant to Texas Property Code § 42.0021. The reasoning behind the sought exemption was that tax-exempt or tax-deferred assets held in a qualifying retirement account are usually exempt under Texas law. As such, the Hawks reasoned that the IRA funds were excluded from the property of the estate under 11 U.S.C. § 522(b). The Hawks withdrew the funds from their IRA but failed to roll them over into another IRA. Both the bankruptcy and district courts held that the funds lost their exemption status when the Hawks did not roll the funds over because Texas law dictates that funds withdrawn from a retirement account must be rolled into a different retirement account within sixty days of the withdraw. The Fifth Circuit Affirmed.

This was a matter of first impression for the Fifth Circuit as the court had not previously ruled on a Texas debtor’s entitlement to an exemption when funds are withdrawn from a retirement account and not subsequently placed into another retirement account within sixty days. As a preliminary matter, the court noted the similarities between the Texas statutes that address retirement account exemptions and those addressing homestead exemptions. Indeed, Texas Property Code § 42.001(a) and 42.0021(c) allow the exemption of a homestead and IRA

respectively. The Code further states that a homestead must be rolled over within 60 months of the sale and an IRA must be rolled over within 60 days of withdraw. The court then turned its attention to the Hawks' two primary arguments: (1) The snapshot rule was improperly applied by the lower courts; and (2) The facts in this case were distinguishable from *In re Frost*, 744 F.3d 384 (5th Cir. 2014), and therefore, should not be applied. Specifically, the Hawks argued that *Frost* applies only in chapter 13 cases, not chapter 7 cases.

Turning to the first argument, the snapshot rule states that exemption are determined based on the state law that is in effect when the petition for bankruptcy is filed. The Hawks argued their exemptions were permanently fixed no later than the deadline for filing objections. In responding to this argument, the court turned to its opinion in *In re Zibman*, 268 F.3d 298, (5th Cir. 2001). In *Zibman*, the court held that when the debtors "failed to reinvest the proceeds in another Texas homestead within the statutory time period, those proceeds lost their exemption, freeing the Trustee to reach the proceeds as part of the bankruptcy estate." *Id.* at 305. The Fifth Circuit applied the principles in *Zibman* to homesteads sold during the pendency of bankruptcy. In *In re Frost*, 744 F.3d 384, 389 (5th Cir. 2014), the court held that the debtor's home was unconditionally exempt and would have remained that way if it had remained his home. Once the debtor sold his homestead, the exemption changed from unconditional to conditional interest in the proceeds from the sale of the property. Therefore, "[o]nce the conditional exemption expired ... Frost lost his right to withhold the sale proceeds from the estate." *Id.* Similarly, the Hawks changed their interest in their IRA funds from unconditional to conditional when the funds were withdrawn from the IRA and not rolled over into another IRA as it is a Texas law requirement to roll over the funds within 60 days of withdraw. If the proceeds that were exempt on the petition date were allowed to be exempt indefinitely, the reinvestment aspect of 42.0021(c) would be lost and a limited exemption would suddenly become indefinite.

Turning to the Hawks' second argument, the court began its analysis by stating that the argument that *Frost* is inapplicable because it is a chapter 13 case is unconvincing as *Frost* heavily relied on *Zibman*, which is a Chapter 7 case. The court further opined that *Frost* did not limit its applicability to Chapter 13 cases nor does the opinion mention that the case was brought under chapter 13.

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Sixth Circuit

***Jahn v. Burke (In re Burke)*, No. 16-6603,
863 F.3d 521 (6th Cir. July 14, 2017).**

The Sixth Circuit held that Debtors, as parties who would likely benefit from a trustee's abandonment of residential mortgage property, are therefore "parties in interest" with Article III standing to request abandonment after refusing a trustee's check in the amount of the homestead exemption. Furthermore, such request is to be granted when there is inconsequential equity in the property that could benefit unsecured creditors after the property's liquidation. After Debtors Philip and Nekolia Burke filed for Chapter 7 bankruptcy, the trustee sought to evict them from their residence in order to facilitate its sale. Debtors moved to compel the trustee to abandon the property, claiming that its fair market value after the balance due on the mortgage loan left no net equity for the estate to benefit creditors. The U.S. Bankruptcy Court for the Eastern District of Tennessee granted the Debtors' request to compel abandonment, and, on appeal by the trustee, the District Court affirmed the request. The Sixth Circuit, reviewing de novo the bankruptcy court's legal conclusions, determined the key issue was whether their residence should be in the estate at all, especially when Debtors were not requesting the homestead exemption. After weighing the valuations offered by the trustee using testimonies of a real estate agent and home inspector, the Sixth Circuit agreed with the bankruptcy court that the valuations offered by the Debtors through two licensed appraisers were more accurate in valuing the property around \$108,000 – the potential sale price minus required mold and other repairs – than the trustee's estimate approaching \$200,000. The court concluded that a Chapter 7 trustee must generally abandon property that does not possess substantial equity. Here, no substantial equity existed when the \$108,000 value weighed against the mortgage loan balance of \$91,581. The court also reasoned that the trustee is not entitled to evict debtors from their residential property merely by tendering a check in the amount of \$7,500 – the Debtors' homestead exemption – when Debtors disputed whether there was any substantial equity in the property that would benefit unsecured creditors upon its sale. On the other hand, the sale of the Debtors' residence and eviction sought by the trustee would constitute an injury-in-fact, which would be redressable by a favorable ruling. Hence, Debtors had standing as parties-in-interest to compel the trustee to abandon their residence. Affirmed.

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Ninth Circuit

***Pinnacle Restaurant at Big Sky, LLC v. CH SP Acquisitions, LLC* *(In Re Spanish Peaks Holdings II),* 862 F.3d 1148 (9th Cir. 2017)**

In *In Re Spanish Peaks*, the Ninth Circuit affirmed the district court's affirmance of the bankruptcy court's order allowing a Chapter 7 trustee to sell real property free and clear of two commercial leases.

Spanish Peaks was a large resort in Big Sky Montana which was owned and managed by a collection of interrelated entities. The Debtor leased restaurant space on a 99-year lease to Pinnacle Restaurant at Big Sky, LLC ("Pinnacle") for annual rent of \$1,000. The Debtor also leased a separate parcel of commercial real estate to Montana Opticom, LLC ("Opticom") on a 60 year term with annual rent of \$1,285. Both lessees were related to the Debtor.

Debtor filed under Chapter 7 and the trustee moved for authorization to sell substantially all of the estate assets "free and clear of any and all liens, claims, encumbrances and interests." The court granted the motion over the objection of Pinnacle and Opticom. The district court affirmed on the basis that the sale extinguished the leases because under Montana law, a foreclosure would terminate junior leasehold interests.

The Ninth Circuit noted the apparent tension between §363(f) and §365(h) and further noted that the majority of courts that have addressed the issue have held that the more specific provision in §365(h), that permits a lessee to retain its rights in a lease which has been rejected by the debtor, trumps the provision in §363(f) that allows the property to be sold free and clear.

The Ninth Circuit instead joined the Seventh Circuit in holding that §363(f) does not conflict with §365(h) and that a sale under §363(f) can be free and clear of leasehold interests when the leases have not been rejected. The Circuit reasoned that a sale is not equivalent to a "rejection" which is necessary to trigger a lessee's rights under §365(h). The Circuit noted that lessees are protected by the adequate protection requirement of §363(e) and by the conditions of §363(f) required to sell property free and clear of liens and interests.

Partida v. U.S. Dep't of Justice (In re Partida), 862 F.3d 909 (9th Cir. 2017)

In *In re Partida*, the Ninth Circuit affirmed the BAP's decision that the government's collection of criminal restitution under the Mandatory Victims Restitution Act ("MVRA") is not stayed by §362(a).

The facts were undisputed that the Debtor agreed to pay criminal restitution of \$193,337 after pleading guilty to embezzlement and theft in 2002. The Debtor failed to pay the restitution and at the time of her Chapter 13 filing in 2013, Debtor owed \$218,500. During the case, the government offset Debtor's income. Debtor filed a motion for contempt against the government for violating the stay which was denied by the bankruptcy court. The BAP affirmed on the basis

that the MRVA provision that provides the government with broad powers to enforce civil judgments “notwithstanding any other federal law” overrides the automatic stay.

The Ninth Circuit joined the Sixth and Second Circuits in holding that collection of criminal restitution does not violate the automatic stay. Although the Circuit recognized that the stay exception for ongoing criminal actions or proceedings could well apply to criminal restitution collection *per se*, it based the decision on the statutory language of the MVRA. The MVRA was enacted after the Bankruptcy Code and because Congress referenced another bankruptcy provision in the MVRA, it “had the potential effects of the Bankruptcy Code in mind when it drafted” the MVRA.

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In re Mainline Equipment, Inc.,
2017 WL 3223009, --- F.3d ---- (July 31, 2017)

In *Los Angeles County Treasurer & Tax Collector v. Mainline Equipment, Inc.*, Mainline Equipment, Inc. (“Mainline” or “Debtor”) failed to pay property taxes assessed by the County of Los Angeles (“County”) on its personal or non-real estate property. In turn, the County recorded tax delinquency certificates with the Los Angeles County Recorder creating a blanket lien on Mainline’s personal property (Mainline possessed no real property) in the county under section 2191.4 of the California Revenue and Taxation Code. The County, however, failed to record any of its liens with the Secretary of State of California. In 2012, Mainline filed a voluntary Chapter 11 bankruptcy petition and administered its estate as a “debtor-in-possession.” Shortly after, the Debtor initiated an adversary proceeding to set aside the County’s liens on its personal property under section 545(2) of the Bankruptcy Code. The bankruptcy court granted summary judgment in favor of the debtor because the liens were (i) statutory in nature and (ii) had not been perfected against a hypothetical bona fide purchaser of personal property under California law. The Bankruptcy Appellate Panel’s (“BAP”) affirmed the lower court’s judgment and the County appealed.

The Ninth Circuit affirmed BAP’s affirmance of the bankruptcy court’s summary judgment and held that the County could not enforce a lien on the personal property of the Chapter 11 debtor-in-possession, when the County failed to perfect the lien against a bona fide purchaser. Although section 545(2) of the Bankruptcy Code expressly applies to a trustee, a debtor-in-possession has the same powers as a trustee and thus, able to set aside liens against its estate, if the lien is (i) a statutory lien and (ii) fail the “hypothetical bona fide purchase test.” First, the County’s liens are statutory because they arose “solely by force of statute” under section 101(53) defining “statutory lien.” Second, the County’s liens are invalid against a bona fide purchase according to a prior decision, *County of Humboldt v. Grover (In re Cummins)*, and

the plain language of section 2191.4 of the California Revenue and Taxation Code, which in relevant parts, provides that filing the certificate constitutes a lien upon all personal and real property in the county except that the lien upon unsecured property shall not be valid against a purchase for value of encumbrancer without actual knowledge of the lien when he or she acquires his or her interest in the property.

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10th Circuit

United States v. Yurek, No. 15-cr-394-WJM,
2017 WL 3190399 (D. Colo. July 27, 2017)

The matter before the court was defendants' motion to strike material from a criminal indictment, Count II of which charged defendants with bankruptcy fraud in violation of 18 U.S.C. § 157(1). The court rejected defendant's contention that the indictment's incorporation of many factual allegations in Count I, a charge of tax evasion, were due to be stricken. The elements of the bankruptcy fraud claim are (i) a specific intent to defraud; (ii) a scheme to defraud; and (iii) the filing of a bankruptcy petition to conceal or execute the scheme. Defendants argued that allegations concerning the corporation's payment of their personal expenses could not be part of a scheme to defraud the IRS or the bankruptcy court and should, therefore, be stricken. The court rejected that argument, reasoning that the allegations, if proven, could tend to support a finding of intent to defraud by concealment of income or, at least materially altered the investigation and collection efforts of the IRS and trustee in bankruptcy. The court also rejected defendants' contention that no acts undertaken after their bankruptcy filing were due to be stricken because the filing of the petition constituted the alleged violation of Section 157(1). The court explained that the allegations, if proven, would be relevant as they would tend to establish the elements necessary for conviction as relating to the existence of an overall scheme or artifice to defraud. Finally, as a result of its rulings, the court found that there was no basis to strike the subject allegations incorporated into Count II on the basis of prejudice.

In re Holman, No. 11-13418,
2017 WL 3025929 (Bankr. D. Kan. July 14, 2017)

In this case the bankruptcy court considered a motion for stay pending appeal of an interlocutory order denying motions to dismiss the debtor's Chapter 13 case "for cause" under Section 1307(c) filed by the Chapter 13 Trustee and the United States. The bankruptcy court's order found that debtors' misconduct warranted dismissal, but that by the time of the trial on the motions to dismiss, the debtors had made all plan payments and, upon request, they would be

entitled to a discharge under Section 1328(a). Subsequent to entry of the order, the debtors moved for their discharge, certifying that they had made all plan payments. That same day, the debtors moved for leave to appeal, and for stay pending appeal; in both motions confirming debtors had made all plan payments. Specifically, the trustee sought a stay of entry of a discharge and closing their Chapter 13 case pending adjudication of the appeal. Despite the fact that the District Court granted the trustee's request to take his interlocutory appeal, the bankruptcy court denied the trustee's motion for a stay pending appeal, concluding in part that he could not show a substantial likelihood of success on the merits. The bankruptcy court reasoned that Section 1328(a)'s plain language that it "shall" grant a discharge "as soon as practicable" after completion of plan payments was mandatory, as opposed to the permissive dismissal for cause under Section 1307(c).

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11th Circuit

June:

In Re: Caribbean Fuels America, Inc.,

--- Fed.Appx --- 2017 WL 2703541 (11th Cir. June 22, 2017).

The Eleventh Circuit reversed the district court since the proper standard was not applied in a fraudulent transfer proceeding. While the opinion is not published, the Eleventh Circuit holds that the outcome is governed by *In Re: Financial Federated Title & Trust, Inc.*, 309 F.3d 1325, 1331–33 (11th Cir. 2002), thus creating a circuit split with the Fifth Circuit's in *Janvey v. Golf Channel Inc.*, 834 F. 3d. 570 (5th Cir. Aug. 22, 2016). The Eleventh Circuit stated that the proper standard under §548, in "assessing the "value" of property, goods, or services rendered directly to a debtor, the question is not whether the debtor subjectively benefited from the property it receives; the operative question is whether the property, goods, or services provided had objective value."

In *Caribbean Fuels*, the company and its owner leased a large home for \$8,500 a month. The lease provided that the house could only be used as a residence. However, the non-debtor lessee worked from his leased home and otherwise made himself available 24/7 to Caribbean Fuels' customers. Caribbean Fuels paid 100% of the rent with the owner reimbursing Caribbean Fuels for 75% of the rent. The Chapter 7 trustee sought to recover amount paid by Caribbean Fuels on the basis that the debtor did not receive reasonably equivalent value because the debtor operated a separate commercial location and the lease limited the use of the home to residential purposes. Thus, the debtor did not receive value from the house that was reasonably equivalent

to the payments it made to the non-debtor owner of the debtor, which the bankruptcy court agreed. The Eleventh Circuit found error since the bankruptcy court focused exclusively on the impact that the goods and services had on the debtor instead of assessing whether the property leased had objective value reasonably equivalent to what the debtor paid the landlord.

Pollitzer v. Gebhardt, 16-11506 (11th Cir. June 27, 2017)

In affirming the district court, the Eleventh Circuit concluded that §707(b) applies to a petition that was initially filed under Chapter 13 but later converted to Chapter 7.

The debtor made plan payments under his Chapter 13 plan for two years and then exercised his right to convert to Chapter 7 as set forth in §1307. Upon conversion, the U.S. Trustee moved to dismiss debtor's case as abusive under §707(b). The debtor argued that §707(b) was limited to "a case filed by an individual debtor under this chapter" and since the debtor filed a chapter 13 first, §707(b) did not apply when he converted his case. The Eleventh Circuit turned to the "history and statutory evolution" stating that §707(b) was "a potent tool for bankruptcy courts to expeditiously dismiss Chapter 7 petitions filed by debtors with income sufficient to pay their creditors" and concluded that §707(b) "would be eviscerated" if the Court adopted the debtor's reading of the statute. Simply stated, §707(b) would serve no purpose if a debtor could file Chapter 13 today and then the next day convert to Chapter 7

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July:

***In re Kurzban*,**

2017 WL 3141915 (Bankr. S.D. Fla. July 24, 2017)

In re Kurzban is one of the first bankruptcy court opinions to interpret the Eleventh Circuit's 2016 opinion *Failla v. Citibank, N.A. (In re Failla)*, 838 F.3d 1170 (11th Cir. 2016), which resolved an intra-circuit conflict on the obligations implicated by a debtor's decision to "surrender" under § 521(a)(2) of the Bankruptcy Code.

The bank in *Kurzban* initiated a foreclosure on the debtors' residence in 2008, prompting the debtors to file a bankruptcy petition in 2009. In their schedules, the debtors indicated an intent to surrender the real property subject to the bank's mortgage. They received their discharge in 2010, but did not surrender the property. Post-discharge, the debtors engaged in modification discussion and the bank voluntarily dismissed its foreclosure case in 2011. Five years later, in 2016, the bank filed another foreclosure case and subsequently filed a motion with the bankruptcy court seeking to reopen the case to compel the debtors to surrender the property.

Although *Failla* held that "surrender" means a debtor must effectively stand down and not interfere with a secured creditor's foreclosure efforts, Judge Isicoff ruled that this obligation does not last in perpetuity. In the present case, where the creditor voluntarily dismissed the

foreclosure case following the bankruptcy, entered into modification negotiations with the debtor, and the present foreclosure relates to defaults which occurred after the “surrender” decision, the debtor’s seven-year-old “surrender” decision did not bind the debtor.

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