Bankruptcy Circuit Update
Featuring cases from July 2018

Second Circuit

Hoti Enters., L.P. v. Rattet (In re Hoti Enters., L.P.),
17-1415, 729 Fed.Appx. 110 (2nd Cir., July 2, 2018)

The Second Circuit affirmed the judgment of the district court affirming the bankruptcy court's order granting a motion to dismiss for lack of standing filed by GECMC 2007-C1 Burnett Street, LLC ("GECMC") against chapter 11 debtor Hoti Enterprises, L.P. ("Hoti").

Hoti previously owned a residential apartment complex in Brooklyn and defaulted on its mortgage loan in 2008. In 2009, GECMC, the purported assignee of the mortgage loan, filed a state court action foreclosing on the apartment complex, and sought the appointment of a receiver. Hoti retained Rattet, Pasternak & Gordon-Oliver, LLP (collectively, "Rattet"), to represent it in out-of-court negotiations with creditors and to file for bankruptcy if necessary, which eventually occurred in 2010.

In an adversary proceeding in the bankruptcy case, Hoti asserted various claims against twelve defendants, all of them law firms or individual lawyers who represented Hoti in the state court foreclosure action and/or the chapter 11 proceedings. Hoti alleged that GECMC was never properly in the chain of title to the original lender and that GECMC therefore had no standing to sue or bring the state foreclosure action. Accordingly, Hoti argued that Rattet should not have advised Hoti to file for bankruptcy. Hoti also alleged that Rattet executed a cash collateral order in the bankruptcy court proceeding without Hoti's consent and that Rattet failed to challenge the underlying mortgage loan documents so that Hoti's right to challenge GECMC's claim was lost. The bankruptcy court held that Hoti was asserting claims that belonged to GECMC pursuant to Hoti's confirmed plan, and accordingly granted the defendants' motion to dismiss Hoti's claims for lack of standing, and the district court affirmed.

On appeal in the Second Circuit, the Court began its analysis by noting that standing includes both constitutional limitations on federal-court jurisdiction and prudential limitations on its exercise. The "prudential standing" rule serves to bar litigants from asserting the rights or legal interests of others in order to obtain relief from injury to themselves. The Second Circuit then turned to section 4.2 of Hoti's confirmed chapter 11 plan, which provided that GECMC was entitled to receive all rights, title, and interest in all "Non-Avoidance Causes of Action" that the debtors or their estates may have. Section 1.12 of the confirmed plan defined "Non-Avoidance Causes of Action" broadly and included the claims asserted in this appeal.

The Second Circuit noted that Hoti had advanced a single argument on appeal in the district court, alleging that because Rattet entered into the cash collateral order without Hoti's consent and failed to challenge GECMC's foreclosure action after the bankruptcy filing, any claims resulting from such conduct belong to Hoti and not the bankruptcy estate. However, the district court determined that because Hoti failed to raise this argument in the bankruptcy court,

it was waived. On appeal in the Second Circuit, Hoti offered no argument disputing the district court's conclusion. Accordingly, the Second Circuit declined to consider this argument on appeal, and affirmed the judgment of the district court.

Beckford v. Bayview Loan Servicing, LLC (In re Beckford),
17-2865 (2nd Cir., July 6, 2018)

The Second Circuit affirmed the judgment of the district court affirming the dismissal of the adversary proceeding brought by pro se debtor Alman Beckford ("Beckford") against Bayview Loan Services, LLC ("Bayview") for lack of standing.

After Beckford filed for bankruptcy in 2013, Bayview moved to lift the automatic stay to continue foreclosure proceedings against real property owned by Beckford. In response, Beckford initiated an adversarial proceeding, asserting claims under the federal mortgage statutes, as well as state law tort, contract, and property claims. The bankruptcy court dismissed Beckford's amended complaint for failure to state a claim. The district court affirmed the dismissal on an alternative ground, reasoning that Beckford lacked standing to assert the claims.

The Second Circuit held that the district court correctly determined that Beckford lacked standing to bring claims against Bayview. The Second Circuit noted that, pursuant to Bankruptcy Code section 541(a)(1), the filing of a bankruptcy petition creates a bankruptcy estate that is comprised of all legal or equitable interests of the debtor as of the commencement of the case, which includes any causes of action that the debtor possesses. Only a bankruptcy trustee has standing to bring claims owned by the bankruptcy estate.

The Second Circuit's reasoning centered on when the claims at issue accrued, which required separate analyses depending on the nature of the claims. Here, Beckford raised claims under the Truth in Lending Act, Home Ownership and Equity Protection Act, Real Estate Settlement Procedures Act, Fair Credit Reporting Act, Racketeer Influenced and Corrupt Organizations Act, and state law claims sounding in tort (breach of fiduciary duty, fraudulent misrepresentation) and contract law (unjust enrichment). Beckford also asserted claims for usury and quiet title. The Second Circuit noted that (i) Beckford's federal, tort, and contract claims accrued when either the defendant committed a violation of the federal laws, committed the acts or omissions complained of, or breached an implied contract, or when Beckford's injuries occurred; (ii) Beckford's quiet title action accrued when he became aware that Bayview had a competing interest in the real property at issue; and (iii) the usury claim accrued when Beckford took out his mortgage at a usurious rate.

The Second Circuit then analyzed when such claims accrued, noting that the complaint demonstrated that Beckford's injuries accrued long before he filed his bankruptcy petition in April 2013. Specifically, Beckford's claims accrued when: (1) he purchased his property in 2003 and his mortgage lender allegedly failed to make the proper disclosures and charged usurious rates; (2) he made payments on his mortgage and the mortgage servicer allegedly failed to properly apply payments, resulting in overpayments and inaccurate accounting; and (3) an allegedly void mortgage note was assigned to Bayview. The Second Circuit also noted that the

quiet title claim accrued when Bayview began foreclosure proceedings in May 2012. Therefore, the Second Circuit found that Beckford's claims were part of his bankruptcy estate and could only have been asserted by the bankruptcy trustee.

The Second Circuit was not persuaded by Beckford's argument that Bayview's postpetition actions in the bankruptcy court, including moving to lift the automatic stay and failing to challenge the dischargeability of its lien, removed Beckford's claims from the bankruptcy estate and permitted him to assert them. The Second Circuit noted that Bayview's action or lack thereof did not affect the date of accrual of Beckford's claims, all of which accrued prior to the bankruptcy filing. Bayview's actions during the bankruptcy case did not affect the timing of those events, and accordingly the Second Circuit held that the district court properly determined that Beckford lacked standing.

Shinhan Bank v. Lehman Bros. Holdings Inc. (In re Lehman Bros. Holdings Inc.), 17-2700 (2nd Cir., July 18, 2018)

The Second Circuit affirmed the judgement of the district court affirming a bankruptcy court order enforcing a clawback settlement agreement between Shinhan Bank ("Shinhan") and Lehman Brothers Holdings Inc. ("LBHI," and together with Lehman Brothers Special Financing Inc., "Lehman"). On appeal, Shinhan renewed its argument that the bankruptcy court misapplied the so-called Winston factors, and thus erred in concluding that Shinhan reached a binding and enforceable settlement agreement with Lehman.

Shinhan was one of hundreds of defendants in a $1 billion clawback adversary proceeding that Lehman's bankruptcy administrator began in 2010, and the settlement at issue in this appeal was one of many that were entered into in connection with that adversary proceeding. Specifically, Shinhan and Lehman reached a settlement agreement with the help of a mediator on April 20, 2016, while motions to dismiss were pending. The settlement agreement, however, was never signed by the parties, and while Lehman sought to enforce it, Shinhan argued that it was not valid.

Both the district court and the bankruptcy court recognized that the analysis set forth in Winston v. Mediafare Entm't Corp., 777 F.2d 78 (2d Cir. 1985), governs the resolution of the question whether Shinhan bound itself to a settlement. Under the Winston framework, a court determines whether parties intended to be bound to a settlement in the absence of a mutually executed document by considering:

(1) whether there has been an express reservation of the right not to be bound in the absence of a writing; (2) whether there has been partial performance of the contract; (3) whether all of the terms of the alleged contract have been agreed upon; and (4) whether the agreement at issue is the type of contract that is usually committed to writing.

Accordingly, the Second Circuit evaluated each of the Winston factors separately, starting with the first factor, the express reservation of the right not to be bound absent a writing. Here, Shinhan did not dispute that it did not expressly reserve the right not to be bound in the

absence of a writing when its counsel informed the mediator that Shinhan agreed to the proposed settlement amount. Instead, Shinhan urged the Second Circuit to look past its April 20, 2016 email to a later-circulated draft "Release Agreement," in which various terms were addressed. The Second Circuit declined to do so, noting that in the cases in which the Second Circuit looked to the terms of a draft written settlement agreement for the purposes of evaluating the Winston factors, the draft was circulated before the parties purportedly reached an agreement to settle. Here, by contrast, the parties agreed to settle on April 20, if at all, before any draft written settlement agreement was circulated. Accordingly, the Second Circuit concluded that the first factor weighed in favor of finding an intention to be bound.

Next, the Second Circuit addressed the second Winston factor, partial performance. Shinhan endorsed the district court's finding that this factor weighed against finding an intent to be bound. The Second Circuit likewise could not identify any partial performance by Lehman of the putative agreement, as Lehman neither provided Shinhan a release nor sought to voluntarily dismiss its claims before the bankruptcy court, which were its two primary obligations under a settlement. The Second Circuit therefore held that the second Winston factor weighed against finding an intention to be bound.

The Second Circuit then turned to the third prong of the Winston framework, which focuses on whether all of the settlement terms had been agreed upon. Shinhan identified a handful of contractual terms that it argued were material and remained open on April 20. The Second Circuit noted that in an ordinary case, it might have found this argument persuasive, but due to the circumstances of the Lehman bankruptcy, the Second Circuit believed that the parties had agreed to the material terms of a settlement agreement on April 20. Specifically, Shinhan did not identify any outstanding issues in its April 20 email assenting to the settlement, nor did Shinhan raise any concerns to a follow-up email confirming the settlement subject to "routine settlement documentation." The Second Circuit found that Shinhan's failure to identify any material issue at that time provided strong evidence that the parties had agreed to all of the material terms of the agreement on April 20. Accordingly, the Second Circuit held that the third Winston factor weighed in favor of finding an intent to be bound.

Finally, the Second Circuit addressed the final Winston prong, the regularity with which this type of agreement is committed to writing. Although the bankruptcy court characterized the putative settlement here as "super simple," Lehman was not able to identify any precedential opinion in which the Second Circuit relied on the Winston factors to recognize and enforce a putative settlement without either a written draft agreement or assent to the terms in open court before an attempt to renege. Moreover, during oral argument in the Second Circuit, Lehman acknowledged that it did not effectuate a single settlement during the entire Lehman bankruptcy without a written agreement. Given this consistent practice, and despite the apparent simplicity of the putative settlement, the Second Circuit found that the fourth Winston factor weighed in Shinhan's favor and against finding an intention to be bound.

The Second Circuit then weighed the various factors, noting that this was a close case because the first and third Winston factors weighed in favor of finding an intention to be bound, while the second and fourth factors weighed against such a finding. Ultimately, however, the Second Circuit concluded that as of April 20, the parties intended to be bound and the settlement

agreement was enforceable. The Second Circuit reasoned that the action contemplated under the settlement agreement here was simple and would have been rapidly achieved, rendering the second Winston factor—the absence of partial performance—only minimally probative of any intent not to be bound. By contrast, the absence of an express reservation of rights and of outstanding material terms to be negotiated weighed heavily in favor of finding an intention to be bound, especially in view of the parties' conduct (the lack of any meaningful disagreement beyond the settlement amount) and the broader context of the Lehman bankruptcy. In these circumstances, the Second Circuit concluded that the balance tipped in favor of finding an intention to be bound and therefore affirmed the district court's order holding Shinhan to the settlement.

Nath v. Select Portfolio Servicing, Inc. (In re Nath),
17-1921 (2nd Cir., July 24, 2018)

The Second Circuit affirmed two judgments of the district court, one affirming a pair of rulings by the bankruptcy court in the third bankruptcy filed by Prem Nath ("Nath") and one affirming a ruling by the bankruptcy court in Nath's fourth bankruptcy, all of which centered on attempts to modify the automatic stay to permit a foreclosure sale of Nath's property.

Nath had defaulted on a home mortgage, and, after years of litigation, a state court issued a foreclosure judgment in favor of U.S. Bank, N.A. ("U.S. Bank") and its servicer, Select Portfolio Servicing, Inc. ("SPS"). Nath then filed his third bankruptcy and moved to extend the automatic stay to stave off foreclosure. He also moved for sanctions against U.S. Bank, SPS, and their attorneys. The bankruptcy court denied both motions. On the eve of the foreclosure sale, Nath filed his fourth bankruptcy. U.S. Bank and SPS then successfully moved for relief from the automatic stay, and Nath's home was later sold in foreclosure. Nath then moved to set aside the sale as violative of the automatic stay. The bankruptcy court denied this motion as well.

The Second Circuit affirmed the judgements of the district court affirming all of the bankruptcy court's denials of Nath's motions. Specifically, the Second Circuit reasoned that because Nath was actively challenging the foreclosure judgment against him on multiple fronts, the bankruptcy court's finding that his third bankruptcy was not filed in good faith, as required for extension of the automatic stay under Bankruptcy Code section 362(c)(3)(B), was not clearly erroneous, and the bankruptcy court properly denied the extension motion. Moreover, the Second Circuit noted that Nath had forfeited any challenge to the bankruptcy court's denial of his motion for sanctions by failing to address one of the independent bases in support of that denial in his appellate brief: his lack of standing. Finally, the Second Circuit noted that it was undisputed that in Nath's fourth bankruptcy, the bankruptcy court lifted the automatic stay with respect to the state foreclosure proceeding, and there was therefore no basis to set aside the foreclosure sale. Accordingly, the Second Circuit affirmed the judgments of the district court.

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Fifth Circuit

Bennett v. Lindsey (In re Lindsey),
2018 WL 3409995 (5th Cir. July 11, 2018)

On appeal was whether (1) the bankruptcy court properly dismissed a dischargeability complaint under 11 U.S.C. § 523(a)(2); and (2) whether the bankruptcy court abused its discretion by denying leave to amend the complaint.

Plaintiff and Debtor entered into an agreement whereby Plaintiff would release Debtor from claims arising from a formal contractual agreement in exchange for $15,000. Debtor never paid Plaintiff the $15,000 debt. In February 2016, Debtor filed chapter 7 bankruptcy and listed the $15,000 debt on his schedules. Plaintiff filed an adversary proceeding against Debtor alleging non-dischargeability of a debt under 11 U.S.C. § 523(a)(2)(A).[1] Specifically, Plaintiff alleged Debtor fraudulently induced the release by asserting misrepresentations. Debtor moved to dismiss the complaint pursuant to Federal Rule of Civil Procedure 12(b)(6) and Federal Rule of Bankruptcy Procedure 7012(b)(6) because the complaint failed to meet the heightened pleading requirements of Rule 9(b) and Bankruptcy Rule 7009. The bankruptcy court set the matter for hearing.

At the hearing, the bankruptcy court generously permitted extensive arguments from both parties and repeatedly expressed concern that Plaintiff's complaint was conclusory. In response, Plaintiff expressed a desire to re-plead in the event the bankruptcy court was persuaded by Debtor's motion to dismiss, but did not formally move for leave to amend as required by Local Rule 7015. The court asked Plaintiff to describe the allegations he would add to the complaint if permitted to amend. Plaintiff never described any substantive allegations he would add to the complaint. The bankruptcy court dismissed the case pursuant to Debtor's motion and did not permit Plaintiff to amend his complaint. The district court affirmed the bankruptcy court's decision.

The Fifth Circuit found dismissal of the complaint was proper because Plaintiff's complaint did not meet the heightened pleading standards required by Rule 9(b) and Bankruptcy Rule 7009. Specifically, Plaintiffs' assertions that Debtor lied to induce a release from Plaintiff were barebones and conclusory:

Bennett's averment that [Debtor] "falsely swore . . . that each [subcontractor] had

[1] Section 523(a)(2)(A) renders "any debt for money . . . to the extent obtained by false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition) non-dischargable. 11 U.S.C.A § 523(a)(2)(A) (West 2018).

> been paid in full . . . when in fact other persons were still owed . . ." does not adequately explain how [Debtor's] actions harmed [Plaintiff]. [Plaintiff's] barebones assertion, made without any explanation for his belief that certain subcontractors were not paid, or, more importantly, any explanation of how [Debtor's] actions harmed [Plaintiff], is conclusory.

With respect to denying Plaintiff's leave to amend his complaint, the Fifth Circuit was not convinced that the bankruptcy court had abused its discretion. In addition to not filing an amended complaint in accordance with Local Rule 7015, when repeatedly asked to describe the substantive allegations Plaintiff would add to the complaint if the court were to allow an amendment, Plaintiff never described any substantive allegations he would add to the complaint.

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Fornesa v. Fifth Third Mortg. Co.,
____ F.3d ____, 2018 WL 3602367 (5th Cir. July 27, 2018)

Prior to filing for bankruptcy, chapter 13 debtor Ricardo Fornesa owned an equitable interest in his son's home, on which Fifth Third Bank held a mortgage. Fornesa did not record his equitable interest or inform Fifth Third of that interest. Similarly, although Fornesa listed the equitable interest on his bankruptcy schedules, he did not identify the property address or list Fifth Third as a creditor.

In November 2014, Fornesa's son defaulted on the mortgage. Several months later, Fornesa's son conveyed the property to him via quitclaim deed. Although the deed was recorded, Fornesa did not amend his bankruptcy schedules to reflect the property. Fifth Third was not informed of the transfer and subsequently foreclosed on the property. In response, Fornesa and his son brought a pro se lawsuit against Fifth Third for wrongful foreclosure and violation of the automatic stay. After a bench trial, the court determined the Fornesas' claims were barred by judicial estoppel.

On appeal, the Fifth Circuit affirmed, explaining judicial estoppel is particularly appropriate in bankruptcy matters where a debtor fails to disclose an asset but then pursues a claim in a separate tribunal based on that asset. The Court held the first and second elements of the judicial estoppel test (i.e., the plaintiff has taken a prior inconsistent position that was accepted by the court) was satisfied by the fact that Fornesa failed to amend his bankruptcy schedules to reflect his son's home and, thus "impliedly represented" to the bankruptcy court that

his financial status was unchanged. Further, the court implicitly accepted this representation by operating as though Fornesa's status was unchanged. Finally, the Fifth Circuit dismissed the notion that Fornesa could have acted inadvertently because he was aware of both (1) the fact that he received the quitclaim deed from his son and (2) the basis of his claims against Fifth Third. Because Fornesa would receive a potential financial benefit from his non-disclosure, his motive to conceal the asset was "self-evident." Thus, the district court correctly held judicial estoppel barred Fornesa's claims.

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Ninth Circuit

***Goudelock v. Sixty-01 Ass'n of Apartment* Owners**
895 F.3d 633 (9th Cir. 2018)

In Goudelock, the Ninth Circuit reversed the district court's affirmance of the bankruptcy court's summary judgment and held that post-petition condominium association assessments are dischargeable in a chapter 13 under §1328(a).

Debtor purchased a condominium in 2001 which was subject to CC&Rs that required payment of monthly assessments as a personal obligation and provided for a lien on the property for unpaid assessments. In March of 2011, Debtor moved out of her condo, filed a chapter 13, and proposed to surrender the property through her plan. After confirmation, the unit sat unoccupied until the secured lender foreclosed on February 26, 2015. Debtor completed her plan payments and received a discharge under §1328(a) on July 24, 2015. The condominium association ("CA") filed an adversary complaint seeking a determination that Debtor's personal obligation to pay post-petition assessments until the lender foreclosed was not dischargeable.

The bankruptcy court granted summary judgment in favor of the CA on the basis that the assessments "arose at the time of their assessment and were an incidence of legal ownership of the burdened property." The district court affirmed.

The Ninth Circuit reversed and held that under the "fair contemplation" test discussed in In re SNTL Corp., 571 F.3d 826 (9th Cir. 2009), Debtor's obligation to pay assessments arose as a contingent, unmatured debt when she purchased the condo. The Ninth Circuit reasoned that

although §523(a)(16) provides that assessments which become due and payable post-petition are non-dischargeable, Congress specifically excluded this section from the exceptions to discharge under §1328(a). As a result, Debtor's in personam obligation to pay both pre- and post-petition assessments was discharged. Consistent with the Fifth Amendment, the in rem lien was not discharged.

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Tenth Circuit

Cyberton Int'l, Inc. v. Capps (In re Capps),
No. 17-5090, 2018 WL 3635708 (Bankr. D. Kan. July 26, 2018)

The court held that the former employer of a chapter 7 debtor who had received a discharge was entitled to a declaratory judgment that any right to injunctive relief and liquidated damages ($50,000 per violation) arising from a post-petition breach of a covenant not to compete by the debtor was not discharged. The employer fired the debtor-employee less than 3 weeks after he filed his chapter 7 case, and subsequently brought suit in state court to enforce its rights under an employment agreement and restrictive covenant agreement. The employer then brought a declaratory judgment action in the former employee's chapter 7 case, seeking a declaration that enforcement of its rights did not violate the discharge injunction provided for in Code section 524. The court assumed that the subject restrictive covenants were enforceable under applicable Kansas law, in order to reach the issue of whether the debtor-employee's obligations constituted "claims" and, if so, whether such claims were discharged. The court concluded that those obligations did not constitute "claims" because they arose post-petition, and were as a result not discharged. The court then rejected the debtor's contention that the agreements were executory contracts that had been rejected, explaining that "nothing in § 365 provides for the release of the debtor from any obligations; rather, that section apportions and limits rights, duties, and liabilities among the debtor's contracting party and the bankruptcy estate." (Italics in original). Concluding, the court stated that even if the restrictive covenant agreement was an executory contract, which the court concluded it was not since the employer owed no bilateral obligations to the debtor-employee, its deemed rejection did not relieve the debtor from complying with that agreement.

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Eleventh Circuit

***In re Daughtrey,* 15-14544, 2018 WL 3545007 (11th Cir. July 24, 2018)**

As a matter of first impression, the Court considered what standard to apply to a motion to convert a Chapter 7 case to one under Chapter 11. Having concluded that the appropriate standard was abuse of discretion, the Court then considered whether the bankruptcy court abused its discretion when (i) denying the debtors' request to convert to Chapter 11; (ii) denying the debtor's motion for reconsideration of its order denying their motion to convert; and (iii) approving a compromise agreement between the trustee and the judgment creditor.

The debtors filed their Chapter 7 case for the sole purpose of preventing the sale of their property at a foreclosure sale. After the sale of the property was stayed because of the bankruptcy filing, the Chapter 7 trustee entered into a compromise agreement with a judgment creditor that granted all of the property to the judgment creditor except for the homestead portion. The debtors objected to the compromise agreement and moved to convert their case to Chapter 11. The facts of the case detail all the efforts the debtors took over several years to thwart the judgment creditor's collection efforts and their actions during the Chapter 7 case demonstrated an abuse of the bankruptcy process. Finding that the *Marrama*[2] case was controlling, the bankruptcy court denied the motion to convert the case to Chapter 11, primarily because the debtors failed to present a feasible plan of reorganization.

After entering an order denying the motion to convert, the bankruptcy court entered an order granting the Trustee's motion to approve the compromise agreement. Shortly thereafter, the debtors filed a motion for reconsideration of the order denying their motion to convert to Chapter 11, which the bankruptcy court denied. The District Court affirmed the bankruptcy court finding no abuse of discretion.

The Court, in affirming, looked at §706(a) and focused on the language "may convert…at any time," however the debtor's right to convert is expressly conditioned on his ability to qualify as a debtor under the chapter to which the debtor seeks to convert. To adopt the debtor's position would defy common sense because it would require the bankruptcy court to first go through the formality of granting conversion, then in considering §1112(b)(4)(A), the bankruptcy court would then need to either dismiss the case or convert the case back to chapter 7. Here cause existed to convert it back to Chapter 7 based on "substantial or continuing loss to or diminution of the estate and the absence of reasonable likelihood of rehabilitation."

In addition, the Court determined that the bankruptcy court did not abuse its discretion in approving the compromise motion. In fact, the compromise craved out the homestead portion for

[2] *Marrama v. Citizens Bank of Massachusetts*, 549 U.S. 365 (2007)

the benefit of the debtor, a result that would not have occurred had foreclosure occurred.

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