Bankruptcy Circuit Update

Featuring cases from June 2016

Special Announcement
Group Section Conference Call to Discuss Significant Cases

This month our writers Circuit Writers and Section Leaders will be convening a section-wide conference call on **Friday, July 22nd, at 4:00 E.S.T./1:00 P.S.T**. to present and discuss notable cases from the past few months of the summaries. Judge Gargotta will be covering the recent Supreme Court cases and other volunteers will be summarizing significant or interesting cases. The presenters will be open for questions and lead discussion of key points. We hope you will join us for this call. The call-in information is: **dial in 866-690-2070 – code 787-594-2077**.

Supreme Court

Commonwealth of Puerto Rico et al. v. Franklin Cal. Tax-Free Trust et al.,
136 S. Ct. 1938 (2016)

The Court held that the Bankruptcy Code pre-empts Puerto Rico's Recovery Act, which attempted to provide restructuring relief to three government-owned public utilities. In doing so, the Court held that Puerto Rico could not be a "debtor" under § 101(52), and, as such, could not authorize its municipalities for seeking chapter 9 relief. ***See*** § 109(c)(2). At the time this decision was issued, the Court's decision had serious consequences for Puerto Rico's municipalities because they had a combined deficit of $800 million for fiscal year 2013. Further, the Government Development Bank for Puerto Rico had loaned nearly half of its assets to Puerto Rico and its municipalities. While Congress has passed some legislation regarding Puerto Rico, that relief presently does not include any monetary assistance.

Respondents were bond holders that held nearly $2 billion in bonds issued from the Puerto Rico Electric Power Authority, who filed suit in district court alleging that the pre-emption provision of chapter 9 precluded Puerto Rico from implementing legislation providing bankruptcy relief to its municipalities. The district court enjoined the legislation, finding that Puerto Rico is a "State" under the Code "except for ... who may be a debtor under chapter 9." The First Circuit affirmed and similarly held that the pre-emption provisions of the Code did not allow Puerto Rico to legislate bankruptcy relief for its municipalities.

The Supreme Court determined that it had to decide three issues: who may be a "State" for purposes of determining if a State could authorize its municipalities for bankruptcy relief under § 109(c)(2); does the pre-emption provision barring States from enacting their own municipal bankruptcy schemes under § 903(1) apply to Puerto Rico: and does the definition of "State" under § 101(52) include Puerto Rico. The Court first determined that under the "gateway provision" of § 109(c)(2), the statute defines who may be a debtor for purposes of chapter 9 relief. The Court found that Puerto Rico is not a "State" under the plain meaning of § 101(52) because Congress in 1984 specifically excluded Puerto Rico from the definition of who may be a debtor under chapter 9. Second, the Court found that the definition of "State" under the Code does not preclude the pre-emption provision of § 903 applying to Puerto Rico because Puerto

Rico does meet the definition of "State" for purposes of pre-emption. Third, the Court found that under § 101(52), that Puerto Rico is a "State" for purposes of pre-emption, but not for purposes of authorizing its municipalities to file chapter 9. Justices Sotomayor and Ginsburg dissented; noting chapter 9 is the only means of providing any restructuring relief to Puerto Rico. Further, the dissent argued that the purpose of the Code and structure of § 903 authorized Puerto Rico to authorize bankruptcy relief for its municipalities.

Submitted by:

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United States Bankruptcy Court for the Western District of Texas

First Circuit

In re Hoover,
Case No. 15-2384, 2016 WL 3547475 (1st Cir. June 29, 2016)

Experienced debtor's counsel was sanctioned by the bankruptcy court for two instances of describing the applicable law in a misleading manner. Counsel represented an individual chapter 11 debtor who filed on the eve of foreclosure of his commercial property and at a time when he had significant tax debt. The bank continued the foreclosure sale and sent the debtor a notice of the rescheduled date. It also notified the debtor's counsel of its intent to seek relief from the automatic stay. The debtor's counsel then filed a motion for sanctions arguing that rescheduling the foreclosure sale violated the automatic stay. Four days later, the bank filed its stay relief motion.

In addition, the U.S. Trustee filed a motion to convert or dismiss because the debtor was spending cash that was subject to a tax lien. The debtor's counsel filed an objection to the motion, arguing that cash collateral only includes cash or other property that is subject to a consensual lien.

Counsel's argument in support of the sanctions motion misstated the law on the issue of whether a bank was first required to obtain stay relief before rescheduling the foreclosure sale. In response to the bankruptcy court's order to show cause, counsel argued that the law should require that the bank promptly file a stay relief motion. However, the bankruptcy court held that that was not the argument in the motion. The First Circuit agreed stating, "At best the two paragraphs [allegedly citing case law supporting the position that a stay violation had occurred] are unintelligible, saying in form: 'X, although not X when the law obscure, and now the law is not obscure."

As to the second issue, the bankruptcy court found that the debtor's counsel had selectively omitted critical parts of 11 U.S.C. § 363(a) so that the resulting quote had a different meaning than the statute when read in its entirety. Further, counsel's legal analysis in his objection to the motion to convert or dismiss was "absurd because the statute unambiguously

states the opposite." The First Circuit again agreed saying that counsel left out "the most discrediting" portion of the statute to his argument.

This type of conduct was not a first for debtor's counsel as he had been sanctioned on at least three prior occasions for conduct that included "asserting frivolous defenses, advancing argument contrary to express statutory provisions, and filing a meritless motion for sanctions." In those cases, counsel had been monetarily sanctioned. Concluding that the monetary sanctions did not deter the behavior, the bankruptcy counsel ordered the counsel to take an ethics course in person at an ABA accredited law school. In reviewing the sanction, the First Circuit recognized that "Bankruptcy Courts often need to act quickly, and should be able to assume that counsel are truthful. Even when they fail to deceive a court, filings supported only by artifice serve to delay the proceedings and impose costs on the other parties." The order imposing the sanction was affirmed.

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Second Circuit

Adelphia Recovery Tr. v. FPL Grp., Inc. (In re Adelphia Commc'ns Corp.),
Case No. 15-1015, 2016 WL 3315847 (2d Cir. June 15, 2016)

The Second Circuit affirmed the judgment of the district court denying the fraudulent transfer claim asserted by Adelphia Recovery Trust ("Recovery Trust"), successor to the rights of Adelphia Communications Corp ("Adelphia"). The Recovery Trust sought to recover a $150 million payment by Adelphia to FPL Group, Inc. and West Boca Security, Inc. for the repurchase of Adelphia's own stock.

At trial in the lower courts, the Recovery Trust attempted to prove that the stock repurchase transaction was a constructive fraudulent conveyance under Pennsylvania's Uniform Fraudulent Transfer Act ("PUFTA"), 12 Pa. Cons. Stat. § 5104(a)(2). Pursuant to PUFTA, a trustee may avoid any transfer of an interest of the debtor if (1) the property is transferred for less than fair consideration, and (2) either (a) the debtor was insolvent on the date of the transfer or (b) the debtor's remaining assets were unreasonably small in relation to the transaction. On appeal in the Second Circuit, the sole issue presented was whether the district court erred in finding that Adelphia's assets were not "unreasonably small" at the time of the challenged repurchase.

The Second Circuit began its analysis by considering PUFTA, noting that the term "unreasonably small" is not defined in PUFTA, but that courts have interpreted the term to

describe transactions that leave a debtor technically solvent but doomed to fail. The test for whether assets are "unreasonably small" focuses on reasonable foreseeability and is satisfied if at the time of the transaction the debtor had so few assets that insolvency was inevitable in the reasonably foreseeable future. To determine the reasonably foreseeable financial future of a corporate debtor such as Adelphia, courts examine an array of factors including the company's debt to equity ratio, its historical capital cushion, the need for working capital in the specific industry at issue, and all reasonably anticipated sources of operating funds, which may include new equity infusions, cash from operations, or cash from secured or unsecured loans over the relevant time period.

The Second Circuit first rejected Recovery Trust's argument that the district court improperly conflated its analysis of Adelphia's solvency with its evaluation of whether Adelphia had unreasonably small capital, noting that though these concepts are conceptually distinct, there is some overlap between them. Additionally, the Second Circuit found that the district court in this case had analyzed Adelphia's solvency separately from the adequacy of its capital. The Second Circuit therefore held that the district court properly relied on some of the same key facts to support its findings on both of these issues.

The Second Circuit was also not persuaded by Recovery Trust's other arguments, which were primarily factual in nature. The Second Circuit noted that neither party disputed that at the time of the challenged transfer, Adelphia needed approximately $600 million to meet its capital needs over the next three years and that this transfer still left the company with an equity cushion of approximately $2.5 billion. Though Recovery Trust had presented evidence in the lower courts that Adelphia had exceeded its maximum leverage ratio under its debt instruments as of January 1999, that it had a negative cash flow, that it was beset by ongoing fraud within the company, and that it was already in default under its existing bond indentures, both the bankruptcy and district courts found that, in spite of these troubling indications, Adelphia could have sold sufficient assets or otherwise obtained credit to continue its business for the foreseeable future. Ultimately, the Second Circuit stated that the issue of adequate capitalization would be decided by a "battle of the experts" and there was no evidence that the district court clearly erred in accepting as more persuasive the evidence presented by defendants' experts. The Second Circuit therefore affirmed the judgment of the district court denying Recovery Trust's fraudulent transfer claim.

Gold v. Harrington (In re Gold),
Case No. 15-2310, 2016 WL 3391205 (2d Cir. June 16, 2016)

The Second Circuit affirmed the judgment of the district court affirming the bankruptcy court's award of attorney's fees to Peter Ressler ("Ressler"). After conducting an independent review of the record and relevant authority, the Second Circuit held that the record amply supported the district court's conclusions that the bankruptcy court acted within its discretion when it determined that Ressler (i) lacked the authority to represent the estate of debtor Arlene Gold after the appointment of a new executor who did not retain Ressler to represent Arlene Gold's estate; and (ii) failed to adequately record his time, had a conflict of interest, and violated the court's rules governing compensation requests.

Based on the foregoing, the Second Circuit found the grant of attorney's fees proper pursuant to Bankruptcy Code sections 330(a)(1) and 330(a)(3), which allows a court to award reasonable compensation for an attorney's "actual, necessary services rendered… taking into account all relevant factors" and Bankruptcy Code section 330(a)(2), which allows a court to award "compensation that is less than the amount of compensation that is requested."

Moxey v. Pryor (In re Moxey),
Case No. 15-3042, 2016 WL 3569937 (2d Cir. June 30, 2016)

The Second Circuit denied the appeal filed by Kenneth Moxey ("Moxey"), pro se, as moot. Moxey's appeal related to the district court's judgment affirming the bankruptcy court's denial of his request for a protective order limiting the scope of questioning at a deposition concerning whether an attorney assisted Moxey with his pro se filings.

The Second Circuit noted that because mootness is a jurisdictional question, the court has an obligation to address it when considering an appeal. Article III limits federal court jurisdiction to "cases" and "controversies," which requires that an actual controversy be extant at all stages of review, not merely at the time the complaint is filed. If at any point during the lawsuit an intervening event or circumstance deprives the plaintiff of a personal stake in the outcome of the lawsuit, then the action can no longer proceed and must be dismissed as moot.

Here, the Second Circuit held that Moxey's appeal was moot. Because the underlying bankruptcy proceeding had concluded, a determination as to the scope of questioning would not matter because Moxey had already been questioned. Furthermore, since Moxey refused to answer the questions during the deposition, there was no threat that his responses could lead to future litigation such that he was harmed by the bankruptcy court's decision not to grant the protective order. Finally, there was no order requiring Moxey to submit to another deposition; and he was not threatened with sanctions for his refusal to respond. As such, the issue whether Moxey was erroneously denied a protective order limiting the scope of the deposition was moot, and the Second Circuit therefore lacked jurisdiction over the appeal.

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Third Circuit

In re Jarusik,
Case No. 15-3262, 2016 WL 3209471 (3d Cir. June 10, 2016)

After the bankruptcy court dismissed debtors' case, the debtors filed a "motion seeking reconsideration of the Bankruptcy Court's . . . dismissal order," in District Court. The Third Circuit agreed with the District Court's decision to characterize this motion for reconsideration as a notice of appeal, given that the debtors "were clearly seeking to appeal the Bankruptcy Court's final order." Despite its willingness to liberally construe a notice of appeal, the Third Circuit ultimately affirmed the dismissal of the appeal because it was untimely under Bankruptcy Rule 8002(a). In doing so, the Third Circuit reiterated that Bankruptcy Rule 8002(a)(1)'s requirement that a notice of appeal must be filed within 14 days of the entry of a bankruptcy court's order is both mandatory and jurisdictional.

In re Pac. Sunwear of California, Inc., et al.,
Case No. 16-10882, 2016 WL 3564484 (Bankr. D. Del. June 22, 2016)

Judge Silverstein granted, in part, motions for class certification under Fed. R. Bankr. P. 7023 and Fed. R. Civ. P. 23. Importantly, the bankruptcy court rejected the debtor's argument that the Third Circuit categorically prohibited the filing of class proofs of claim in bankruptcy cases in its opinion in *SEC v. Aberdeen Securities Co.*, 480 F.2d 1121 (3d Cir. 1973). Rather, in *Aberdeen*, the movants failed to show that a class action would be superior to the procedures already employed by the bankruptcy court. After noting that *Aberdeen* is not a *per se* ban on class certification in the bankruptcy context, the court outlined the two-step analysis employed in determining whether to grant class certification: (1) whether it is beneficial to apply Bankruptcy Rule 7023 to the claims administration process and (2) whether the requirements of Federal Rule 23 have been satisfied, such that a class proof of claim may properly be filed.

The court then applied what it termed the *Musicland* factors, in order to guide its discretion in determining if Rule 7023 should be extended. The court quickly determined that the first two *Musicland* factors—whether the class was certified pre-petition and whether members of the putative class received notice of the bar date—mitigated in favor of applying Rule 7023, as the class was certified well before the filing and the debtor conceded it had not noticed each member of the putative class. As to the third factor—the effect of certification on the bankruptcy, the court ultimately determined that the application of Rule 7023 will promote efficiency by placing thousands of individual claims before the court in a single class claim with competent counsel representing the interests of the class. As such, the court exercised its discretion to apply Rule 7023.

Next, the court considered whether both sections of Federal Rule 23 were met. First, it looked at the four elements of Rule 23(a): (i) numerosity; (ii) commonality; (iii) typicality; and (iv) adequacy of representation. The court determined that numerosity, commonality, and typicality factors were met, but hesitated as to adequacy of representation. In the Third Circuit, adequacy of representation has two components: (1) the experience and performance of class counsel and (2) the interest and incentives of the representative plaintiffs. Only concerned about the second component, the court noted that the representative plaintiff could only be a member of the general unsecured class under the Bankruptcy Code, and thus has an incentive to favor general unsecured creditors over creditors in other classes. As such, Rule 23(a)(4) was met only with respect to those unnamed class members who would hold general unsecured claims. Finally, the court concluded the second section of Rule 23 was met, as common questions of law or fact

predominated over whatever individualized determinations that had to be made. Therefore, the court certified the class as to those members holding general unsecured claims.

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Fifth Circuit

Smith v. Dallas Cnty. Hosp. Dist.,
Case No. 14-11370, 2016 WL 3209217 (5th Cir. June 9, 2016).

In this matter, the Fifth Circuit considered whether the district court properly applied the doctrine of judicial estoppel on the basis that the plaintiff had failed to disclose her potential claims in a prior bankruptcy petition. The plaintiff, Smith, filed a *pro se* Title VII suit against her former employer, Parkland. Parkland filed a motion for summary judgment, arguing that because Smith had failed to disclose her potential claim against Parkland in a previous bankruptcy proceeding, she was judicially estopped from asserting her claim in the present litigation.

The Circuit Court noted that bankruptcy debtors are required to disclose contingent claims and potential causes of action in bankruptcy proceedings. For purposes of applying judicial estoppel, courts look at the following elements: "(1) the party against whom judicial estoppel is sought has asserted a legal position which is plainly inconsistent with a prior position; (2) a court accepted the prior position; and (3) the party did not act inadvertently." Reasoning that judicial estoppel is "particularly appropriate" when a party fails to disclose a potential claim to a bankruptcy court, but then pursues the claim in a separate tribunal, the Court found that Smith's claim should be judicially estopped if her failure to disclose the claim was not inadvertent. Parkland argued that Smith's failure to disclose was not inadvertent because she did not lack knowledge of the undisclosed claim and because the potential for a future recovery against Parkland provided a motive for concealment. Pointing to Parkland's arguments, the Fifth Circuit found that Smith had failed to meet her burden of presenting admissible summary judgment evidence creating a genuine dispute regarding whether her concealment was inadvertent.

The Court thus affirmed the district court's application of the doctrine of judicial estoppel and dismissed Smith's appeal as frivolous for lacking any issue of arguable merit.

In re Monge,
Case No. 15-50180, 2016 WL 3269032 (5th Cir. June 14, 2016).

This case discusses an adversary matter arising out of a Chapter 11 bankruptcy proceeding. Following a series of transactions involving foreclosure and redemption of real

property known as the Thoroughbred Property, Alicia Rojas and her husband, Francisco Jayme, sold the property to Joe and Rosana Monge. The Monges then leased the property back to Rojas and Jayme. Due to Rojas and Jayme's failure to pay rent, the Monges eventually defaulted on their mortgage on the property and filed for bankruptcy in 2009 to prevent foreclosure. The Monges then filed an adversary proceeding against Rojas and Jayme, claiming fraud.

Following a bench trial, the bankruptcy court submitted proposed findings of fact and conclusions of law to the district court, pursuant to 28 U.S.C. § 157(c)(1), many of which the district court adopted. Under Rule 9033(b), the Monges made timely objections to the proposed findings. Rojas and Jayme failed to respond to the Monges' objections and did not make objections of their own. The district court overruled all of the Monges objections, adopted the proposed findings in part, and entered final judgment, from which the Monges appealed.

The consequence of the bankruptcy court's submission of proposed findings to the district court was that the district court did not sit as an appellate court and did not review the proposed findings of fact and conclusions of law *de novo*. Thus, the Fifth Circuit would not review the bankruptcy court's proposed findings and conclusion *de novo*. Instead, the Circuit Court reviewed the district court's findings of fact for clear error and its conclusions of law *de novo*.

The Monges argued that because Rojas and Jayme failed to respond to their objections or make objections of their own, the district court could not overrule the Monges' objections. The Fifth Circuit disagreed. Noting that the district court was free to overrule the Monges' unopposed objections if they lacked merit, the Fifth Circuit found no clear error, and upheld the district court's findings.

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***In the Matter of Cengiz J. Comu*,**
Case No. 15-10804, 2016 WL 3209220 (5th Cir. June 9, 2016).

The Fifth Circuit affirmed revocation of the debtor's discharge from bankruptcy pursuant to 11 U.S.C. § 727(d). After the bankruptcy court revoked Comu's discharge for his fraudulent concealment of estate assets, Comu appealed. However, he did not challenge the bankruptcy court's finding that he fraudulently hid assets; rather, he argued the court erred in holding the trustee and his creditors did not know of the fraud pre-discharge. Noting the favorable standard of review for a bankruptcy court's discharge determinations, the Fifth Circuit affirmed. Specifically, it pointed to the creditors' and trustee's trial testimony stating they did not know of Comu's fraudulent behavior before the discharge was granted. Because there was no clearly

contradictory evidence, the Fifth Circuit reasoned the bankruptcy court was entitled to credit this testimony.

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Seventh Circuit

Unsecured Creditors Committee of Sparrer Sausage Co., Inc. v. Jason's Foods, Inc.,
Case No. 15-2356, 2016 WL 3213096 (7th Cir. June 10, 2016)

On June 10, 2016, the Seventh Circuit Court of Appeals reversed the decision of the bankruptcy court, holding that the court clearly erred in its application of the average-lateness method for determining whether certain payments were made in the ordinary course or preferential transfers under 11 U.S.C. § 547. Specifically, the Court held that it was clear error to find that invoices paid more than 6 days on either side of the 22-day average were outside the ordinary course. In particular, the 16-to-28 day baseline range chosen encompassed only 64% of the invoices paid during the historical period, but adding only two days to either end of the range would have encompassed 88% of the invoices during the historical period. Thus, the 16-to-28 day baseline appeared to be "not only excessively narrow but also arbitrary." As such, the Court concluded that the bankruptcy court erred in finding that invoices paid within 14, 29 and 31 days of issuance were outside the ordinary course. However, it affirmed as to payments made 37 and 38 days after they were issued, as being substantially outside the 14-to-30 day baseline. In the end, however, the Court agreed with the supplier's new-value defense. Because the supplier extended new value greater than the remaining preference liability, the liability was entirely offset.

In re Robert Sobczak-Slomczweski,
Case No. 15-1162, 2016 WL 3245340 (7th Cir. June 13, 2016)

On June 13, 2016, the Seventh Circuit Court of Appeals affirmed the decision of the district court, holding that Federal Rule of Bankruptcy Procedure 8002(a)'s14-day time limit in which to file a notice of appeal is jurisdictional and therefore failure to file a timely notice of appeal strips the district court of jurisdiction to hear the appeal. Because there are no equitable exceptions to this jurisdictional requirement, the district court did not have jurisdiction to hear the appeal at issue even though the notice of appeal was filed only one day late and even though the would-be appellant did not receive the order at issue until the actual deadline to submit the notice of appeal.

John Gemeraad v. Myrick Powers and Elvie Owens-Powers,
Case No. 15-3237, 2016 WL 3443342 (7th Cir. June 23, 2016)

On June 13, 2016, the Seventh Circuit Court of Appeals reversed the decision of the district and bankruptcy courts, holding that 11 U.S.C. § 1329 does allow a trustee to modify a Chapter 13 plan to increase payments where the debtor's income has substantially increased. In so holding, the Court (1) held that the order was final because the trustee could not re-file his motion on the same grounds as had been rejected and (2) rejected the debtor's argument that the modification was moot now that the five year payment period had elapsed because (a) there is a difference between a plan requiring payments for more than five years and a debtor being allowed to make cure payments to conform to a retroactively-amended plan, and (b) Section 1329's language that a plan "may be modified" only "before the completion of payments" under the original plan refers to the time of making the request for modification, not the time within which the bankruptcy court may approve the modification.

In addition, the Court specifically held that Section 1329 allows modification where, as here, the purpose of the modification is to increase payments to the unsecured creditors and otherwise complied with the rest of Section 1329. In so holding, the Court rejected the debtor's argument that trustee needed to establish that "good faith" under Section 1325 required the increase; instead, Section 1325 means that a party may not propose a plan in bad faith, such as by "manipulation of code provisions." Similarly, the Court rejected the argument that a plan may be modified to increase payments only where necessary to bring *the debtor* into compliance with the good faith requirement of Section 1325; that "good faith" requirement did not apply here because by its terms it applies only to the proponent of the plan – who here was not the debtor. As a result, this matter was remanded for further proceedings on the alternate holding of the bankruptcy court not addressed by the district court: whether the trustee in fact had failed to show that the debtor's financial circumstances had changed such that it was now equitable to require higher payments.

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Eighth Circuit

Bugg v. Gray (In re Gray),
Case No. 15-1345, 2016 WL 1696793 (8th Cir. April 28, 2016)

The Eighth Circuit reversed the judgment of the bankruptcy court and district court that the debtor was entitled to actual damages for willful violation of automatic stay and affirmed the district court's reversal of the award of punitive damages.

The issue in question was whether a post-petition eviction of the debtor from his residence and removal of his vehicle and personal effects therefrom was a willful violation of the automatic stay. The court held that the debtor would be entitled to damages under § 362(k) if, at the time of the eviction, he had both (1) legal or equitable interests in the property and (2) to the extent he had such interests, they had not been released from the estate. As to the personal effects, the court found that the items were divested from the estate prior to the eviction pursuant to the debtor's claimed exemptions for their full value. As to the residence, the court found that the bankruptcy court had not met the requirements of § 362(e) and, therefore, the stay was terminated prior to the eviction. Therefore, the debtor was not entitled to relief under § 362(k) because the estate suffered no harm.

Peet v. Checkett (In re Peet),
819 F.3d 1067 (8th Cir. 2016)

Affirming the district court and bankruptcy court, the Eighth Circuit confirmed that ownership of property as joint tenants with rights of survivorship remains intact through the creation of a bankruptcy estate and confirmed the chapter 7 trustee's sale of such property. The debtors asserted that the filing of a bankruptcy and creation of a bankruptcy estate severed the unities of time and title, thus turning joint tenants into tenants in common. Referring to § 541(a)'s definition of property of the estate, the court held that state law determines a debtor's legal interest in property up to the moment a bankruptcy petition is filed and does not limit the transferability of that interest to the bankruptcy estate.

State of Missouri, Department of Social Services, Family Support Division v. Spencer (In re Spencer), **Case No. 15-6030, 2016 WL 3228324 (8th Cir. B.A.P. June 13, 2016)**

The Eighth Circuit B.A.P. reversed the bankruptcy court's imposition of sanction for violation of the discharge injunction by the State of Missouri, Department of Social Services, Family Support Division ("DSS") for attempting to collect on a support debt after entry of the debtors' discharge. The court found that the chapter 13 discharge injunction under §§ 523(a)(5) and 1328(a) does not apply to domestic support obligations, including domestic support obligations disallowed under § 502.

The male debtor owed a pre-petition domestic support obligation to his former spouse. DSS timely filed a proof of claim for the arrearage. Upon a review, the DSS determined that it had incorrectly calculated the arrearage and amended its proof of claim. The debtors objected to the amended DSS proof of claim, and the objection sustained allowing the claim at the original amount. The objection was sustained on the basis that DSS had waived a portion of the support arrears under Missouri law. After entry of the debtors' discharge, DSS issued a wage order to Mr. Spencer's employer for the balance of the support owed, including the disallowed amount. The debtors filed a motion for contempt for a willful violation of the discharge injunction against DSS which the bankruptcy court granted. The B.A.P. reversed, holding the bankruptcy court abused its discretion and DSS was entitled to collect the remainder of its nondischargeable debt.

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***Opportunity Finance, LLC v. Kelly*,**
822 F.3d 451 (8th Cir. May 16, 2016)

In this Chapter 11 proceeding following in the wake of a Ponzi scheme. Lenders who were net winners appealed from an order from the bankruptcy court substantively consolidating the nine entities through which the Ponzi scheme was perpetuated. The district court dismissed the Lenders appeal for lack of standing, finding that the Lenders were not "persons aggrieved" by the consolidation order. The lenders then appealed to the 8th Circuit, which upheld the district court's finding.

The lenders, each being the sole creditor of one of the nine entities argued that they were "persons aggrieved" by the consolidation order because consolidation would (1) diminish their property by increasing the bankruptcy estate's potential recovery from them in avoidance actions against them and decreasing the value of their contingent claims, and (2) preclude potential affirmative defenses in the avoidance actions.

The Court rejected the lenders' first argument because to be a "person aggrieved" for the purposes of standing a person must be directly and adversely affected pecuniarily by the order. The Court found that any potential pecuniary harm to the lenders was not direct on was several steps removed. The Court similarly rejected the lenders' second argument because an order that would potentially strip the lenders of certain defenses would cause only indirect harm. The Court further held that the lenders' interest in avoiding liability to the estate as opposed to the primary goal of the Bankruptcy Code which is to minimize the injury to creditors and the principles underlying the persons aggrieved doctrine supported the district court's decision.

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Ninth Circuit

In Greif & Co. v. Shapiro (In re Western Funding, Inc., et al.),
Case No. NV-15-1238, 2016 WL 3194666 (BAP 9th Cir. June 8, 2016)

The Ninth Circuit BAP affirmed a bankruptcy courts' approval of a compromise submitted by a liquidating trustee (Trustee) appointed under a confirmed chapter 11 plan (Plan) over the objection of a single creditor (Objector) who challenged the settlement as too small and the Trustee had undervalued claims urged by the Objector. The Trustee agreed to compromise approximately $2 Million in claims against American Express entities (AMEX) for $331,476.53. The principals of one of the debtors caused that debtor to pay credit card debt due AMEX even though it was not the credit card holder. The Plan gave the Trustee the exclusive right to prosecute and compromise claims with or without consent of third parties, or approval of the bankruptcy court unless the claim exceeded $50,000. The BAP first held that the well-recognized settlement standards governing trustees under the Bankruptcy Code, e.g., Martin v. Kane (In re A&C Properties), 784 F.2d 1377, 1381 (9th Cir. 1986) (probability of success in the litigation, difficulties, if any, in collection complexity of the litigation, and the expense, inconvenience and delay necessarily attending it, and the paramount interests of creditors and proper deference to their views), are not necessarily the standards governing a liquidating trustee under confirmed plans as he /she is a "representative" under section 1123(b)(3)(B), not a "trustee" under section 323(a). The BAP declined to adopt a requirement that post-confirmation settlements agreed to by liquidating trustees are subject to the same standards as settlements negotiated by bankruptcy trustees or debtors-in-possession, that is, that the proposed compromise must be "fair and equitable." The BAP found no error in the bankruptcy court construing language in the liquidating trust agreement requiring the Trustee to exercise "good faith judgment" to the "business judgment" standard under applicable (Nevada) law; the BAP concluded that standard "was somewhat less exacting than the A& C Properties standard." Slip Op. at 16. Ultimately, the BAP found no abuse of discretion on the part of the bankruptcy court in approving the compromise and overruling the objections raised by the Objector under the standards set forth in A & C Properties, so by definition the "somewhat less exacting" business judgment standard was necessarily met.

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DeNoce v. Neff (In Neff),
Case No. 14-60017, 2016 WL 3201236 (9th Cir. June 9, 2016)

In *Denoce v. Neff*, the Ninth Circuit affirming the bankruptcy appellate panel's decision to affirm the bankruptcy court's summary judgment held that section 727(a)(2), which prevents the bankruptcy court from granting a debtor a discharge if the debtor improperly transferred property within one year before the date of the filing of the bankruptcy petition, is not subject to equitable tolling. Section 727(a)(2) provides that a court will grant a debtor a discharge unless the debtor, with intent to hinder, delay, or defraud a creditor, has transferred property within one

year before the date of the filing of the petition. At issue is whether section 727(a)(2) is a statute of limitations that is subject to the presumption that equitable tolling is available.

The Court noted that as a general matter, equitable tolling pauses the running of, or tolls, a statute of limitations when a litigant has pursued his or her rights diligently but some extraordinary circumstance prevents him or her from brining a timely action. In determining whether a time period set by federal law is a statute of limitations, courts must consider the "functional characteristics" of the statute: whether the time period encourages plaintiffs to prosecute their actions promptly or risk losing rights.

The Ninth Circuit found that unlike statutes of limitations, section 727(a)(2) is not designed to encourage a specific creditor to prosecute its claim properly to avoid losing rights. The one-year period does not give creditors an opportunity to protect their rights because the improper conduct that triggers the one-year period in section 727(a)(2) may be done secretly without creditors' knowledge. As such, this particular statute is not subject to tolling.

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Ulrich v. Schian Walker, P.L.C. (In re Boates),
Case No. AZ-15-1279, 2016 WL 3213665 (B.A.P. 9th Cir. 2016)

In *In re Boates*, the 9th Cir. BAP reversed and remanded the bankruptcy court's grant of summary judgment in favor of defendant Schian Walker, P.L.C. In the underlying adversary, the chapter 7 trustee sought to recover a $60,000 prepetition flat fee paid to debtor's counsel Schian Walker, for representation in an impending nondischargeability action. The BAP held that the debtor's obligation to pay costs in the adversary was sufficient to make the retainer agreement an executory contract, and held that the agreement was deemed rejected by the trustee under §365(d).

Quoting *In re Hines*, 147 F.3d 1185, 1189 (9th Cir. 1998), the BAP stated that "the trustee can liquidate the debtor's [prepaid] right to legal services by rejecting the contract with the attorney and demanding a refund of the unearned fees," but held that the trustee can only terminate a retainer agreement if it is an executory contract.

The BAP determined that the rejection of the retainer agreement constituted a breach by the debtor as of the petition date but did not deprive the estate of its interests under the agreement, including the debtor's right under Arizona law to terminate Schian Walker and receive a refund of the prepaid fees less the value of services provided prior to termination. The

BAP held that rejection of the executory contract did not automatically terminate the agreement and remanded the case for a determination of when the trustee exercised the estate's right to terminate Schian Walker.

In a subsequently published Order on Motion for Rehearing, the BAP considered Schian Walker's argument that its letter agreement with the debtor was intended to cover all costs and services in exchange for the flat fee and therefore the contract was not executory. The BAP denied the motion for rehearing and held that the contract rights held by the debtor on the petition date became property of the estate regardless of whether they were executory contracts and that to the extent that its previous holding that the contract was executory was error, it was harmless.

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Tenth Circuit

Rich Dad Operating Co., LLC v. Zubrod (In re Rich Global, LLC),
Case No. 15-8103, 2016 WL 3397685 (10th Cir. June 14, 2016)

After appealing a $23.7 million judgment rendered against it, Rich Global filed a chapter 7 bankruptcy. RDOC, the sole member and manager of Rich Global, offered to indemnify the estate for the costs of pursuing the appeal. After rejecting this offer, the trustee entered into a settlement agreement with the judgment creditor that provided, among other terms, that the judgment creditor would pay the bankruptcy estate $100,000 and the trustee would dismiss the appeal with prejudice. Over RDOC's objection, the bankruptcy court approved the settlement, and RODC moved for and was granted a stay pending appeal to the district court. The district court then affirmed the bankruptcy court.

After rejecting several arguments concerning the mootness of the appeal of the settlement, the Tenth Circuit focused on whether the bankruptcy court should have applied 11 U.SC. § 363's standards to the settlement and whether the settlement should have been approved under Fed. R. Bankr. P. 9019(a). While courts are split on whether settlement claims can also qualify as a sale of property under § 363, the Tenth Circuit adopted the majority position that they can. Nonetheless, whether to impose formal sales procedures is ultimately a matter of discretion that depends upon the dynamics of the particular situation. Here, where the only other offer was to indemnify the estate and the parties were unable to agree upon the terms of an auction, it was not necessary that the settlement pass muster as a sale under § 363.

The Tenth Circuit further found that under Fed. R. Bankr. P. 9019(a), a bankruptcy court's general charge is to determine whether the settlement is fair and equitable and in the best interests of the estate. Here, the bankruptcy court considered several factors like the chance of success of litigation on the merits; possible problems collecting judgments; the expense and complexity of litigation; and the interests of the creditors. The Tenth Circuit determined that approval of the agreement did not achieve an unjust result amounting to a clear abuse of discretion. Essentially, the Tenth Circuit echoed that the approval of a settlement agreement is heavily dependent upon the facts of each case.

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Eleventh Circuit

Johnson v. Midland Funding, LLC,
Case Nos. 15-11240 and 15-14116, 2016 WL 2996372 (11th Cir. May 24, 2016)

In *Johnson*, the Eleventh Circuit decided the issue left open by its prior decision of *Crawford v. LVNV Funding, LLC*, 758 F.3d 1254 (11th Cir. 2014), which considered whether a creditor's filing of a proof of claim in a chapter 13 bankruptcy case for a time-barred debt could result in a violation of the provisions of the Fair Debt Collection Practices Act ("FDCPA"). If the Bankruptcy Code permits creditors to file claims on time-barred debts, does that permissive authority override the FDCPA's damages for seeking to collect on a time-barred debt? The district court decisions on appeal both found "irreconcilable conflict" between the Bankruptcy Code's authorization for creditors to file a proof of claim and the FDCPA's damages provisions. And under the doctrine of implied repeal, the Bankruptcy Code prevailed, resulting in dismissal of the FDCPA suits.

The Eleventh Circuit rejected the district courts' reading of the two federal statutes, finding they *could* be read together coherently. The court found that although the bankruptcy code permits creditors to file claims for stale debts, the FDCPA provides for damages only as to certain creditors—"debt collectors"—who file time-barred claims. Thus, "[t]he FDCPA easily lies over the top of the Code's regime, so as to provide an additional layer of protection against a particular kind of creditor." The appellate court ultimately reversed the district court's dismissal and remanded consistent with its findings.

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