Bankruptcy Circuit Update
Featuring cases from June 2017

First Circuit

***PLRP 2011 Holdings LLC v. Manuel Mediavilla Inc. (In re Manuel Mediavilla Inc.)*, BAP Nos. PR 16-053, PR 16-056, Bankr. Case. No. 13-02800-MCF, (1st Cir. BAP, June 16, 2017)**

In *PLRP 2011 Holdings LLC v. Manuel Mediavilla Inc. (In re Manuel Mediavilla Inc.)*, the First Circuit Bankruptcy Appellate Panel ("BAP") considered whether a bankruptcy court erred in confirming a chapter 11 plan filed by individual debtors and their corporation ("Debtors") in jointly administered bankruptcy cases where the court determined that a certain settlement agreement between the Debtors and their largest creditor PRLP 2011 Holdings LLP ("PRLP") was not enforceable. In brief, the facts are as follows. The bankruptcy court denied confirmation of the Debtors' first amended plan for numerous reasons including treatment of PRLP's claims. Both PRLP and the Debtors filed motions to reconsider. On December 30, 2015, the bankruptcy court issued an opinion resolving the pending motions for reconsideration in the Debtors' favor. One day after the bankruptcy court issued its opinion, PRLP filed a motion to inform the court that the parties had entered into a settlement agreement. The settlement agreement was very comprehensive, resolved all disputes between the parties, and required the Debtors to file a stipulation requesting approval from the bankruptcy court. Notwithstanding the settlement agreement, the Debtor's opposed PRLP's motion and argued that there was no binding settlement agreement because counsel for the Debtors had informed counsel for PRLP that the settlement had to be stayed until the Debtors had an opportunity to review the settlement in light of the favorable December 30, 2015 order. Subsequently, the Debtors filed their second amended plan and PRLP filed a motion to enforce the settlement agreement. The court rejected PRLP's arguments that the settlement agreement was binding and found that there was no agreement because the settlement agreement had not been approved by the court and lacked attorney signatures. Consequently, the court approved the Debtors' second amended plan.

The BAP vacated the confirmation order and concluded that: the bankruptcy court clearly erred when it found no settlement agreement; it committed legal error when it ruled there was no enforceable settlement agreement because the parties had not sought or obtained court approval under Bankruptcy Rule 9019; it abused its discretion in failing to determine or implicitly denying PRLP's motion to enforce the settlement agreement; and it committed legal error in confirming the second amended plan. The BAP stated that the bankruptcy court improperly conflated the issue of whether the settlement agreement was binding with the issue of whether the settlement agreement was enforceable under applicable bankruptcy law. First, the BAP held that under state law there was a valid contract. Second, the BAP held that simply because the attorneys had not signed the settlement agreement did not mean that the agreement was not binding between their clients, as the decision to settle litigation belongs to the client, not the lawyer. Additionally, with respect to the fact that the settlement agreement had not been approved by the bankruptcy court, the BAP stated "the absence of court approval is only a bar to enforceability; it does not equate to the lack of the 'existence' of the agreement between the parties as the bankruptcy court

erroneously determined." "The Debtors did not have a unilateral right to repudiate their Settlement Agreement prior to the court determination of whether to approve the settlement…" The Debtors had a contractual and good faith obligation to submit the compromise to the court for approval, and the Rule 9019 requirements do not create a right of unilateral repudiation pending the court's consideration of the proposed compromise.

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Second Circuit

***Barretta v. Wells Fargo Bank, N.A.*, 16-1836, 2017 WL 2392472 (2d Cir., June 2, 2017)**

The Second Circuit affirmed the judgment of the district court denying the motion for a stay pending appeal filed by Frances Ann Barretta ("Barretta") from the bankruptcy court's order granting relief from the automatic stay to one of Barretta's secured creditors.

Prior to Barretta's Chapter 13 bankruptcy filing, Wells Fargo Bank, N.A. ("Wells Fargo") obtained a judgment in strict foreclosure in state court on Barretta's home. Barretta then filed for bankruptcy, which stayed the foreclosure proceedings. The bankruptcy court granted Wells Fargo relief from the automatic stay, and Barretta appealed to the district court, where she filed a motion to stay the bankruptcy court's order pending appeal. The district court denied her motion, and Barretta appealed.

The Second Circuit first noted that when deciding a motion for a stay pending appeal, a court must consider four factors: (1) whether the stay applicant has made a strong showing that he or she is likely to succeed on the merits; (2) whether the applicant will be irreparably injured absent a stay; (3) whether issuance of the stay will substantially injure the other parties interested in the proceeding; and (4) where the public interest lies. Additionally, the *Rooker-Feldman* doctrine, which provides that lower federal courts lack subject matter jurisdiction over claims brought by state court losers that seek to review and reject state court judgments, must also be addressed in the context of the first of these factors. In the Second Circuit, four requirements must be met in order for a claim to be barred by the *Rooker-Feldman* doctrine: (1) the plaintiff must have lost in state court, (2) the plaintiff must complain of injuries caused by a state court judgment, (3) the plaintiff must invite district court review and rejection of the state court judgment, and (4) the state court judgment must have been rendered before the district court proceedings commenced.

Here, the Second Circuit found that each of the four *Rooker-Feldman* requirements was satisfied. First, Barretta lost in state court by virtue of the judgment in strict foreclosure. Second,

Barretta complained that she would be injured by the foreclosure of her property, which was authorized by the state court. Third, the objections she asserted to the bankruptcy court's order collaterally attacked the state court judgment and would effectively have required the district court to declare the state court judgment void. Finally, the state court judgment was issued before Barretta petitioned for bankruptcy.

The Second Circuit then held that the district court did not abuse its discretion in holding that the remaining three stay factors did not warrant granting the relief sought by Barretta. While she likely faced irreparable harm without a stay, this factor was outweighed by the others. As for the third factor, the record indicated that Wells Fargo had not been able to foreclose on the property despite being authorized to do so by the bankruptcy court's order, and had expended resources litigating this dispute. The Second Circuit found that the fourth factor also weighed against Barretta because there is a public interest in finality. In light of the balancing of these four factors, the Second Circuit held that the district court did not abuse its discretion in denying Barretta's motion for a stay pending appeal.

***In re JJE & MM Grp. LLC*, 16-1408, 2017 WL 2416897 (2d Cir., June 5, 2017)**

The Second Circuit vacated and remanded the district court's judgment affirming the bankruptcy court's order finding attorney Noson Kopel ("Kopel") in civil contempt and imposing compensatory sanctions for filing a second bankruptcy petition in violation of an earlier order from the bankruptcy court.

Months before the second filing, the bankruptcy court dismissed the first Chapter 11 petition filed by debtor JJE & MM Group LLC ("JJE") and barred JJE from filing a new petition for one year. The dismissal order provided that it was "without prejudice to the Debtor's right to seek modification of [that] order" in the event that a change of circumstances occurred that would have enabled JJE to reorganize. Kopel did not seek leave of court before filing the second petition. *Sua sponte*, the bankruptcy court ordered Kopel to show cause (1) why he should not be held in contempt and sanctioned for violating the earlier dismissal order, and (2) why he should not be sanctioned pursuant to Bankruptcy Rule 9011(c) for violating Bankruptcy Rule 9011(b) by filing the second petition. In response, Kopel stated that he had filed the second petition on an "emergency" basis, arguing that JJE's sole assets were about to be sold at foreclosure, but that JJE had a contract to sell the property at more than the outstanding secured debt, resulting in a change of circumstances that would allow JJE to reorganize. Kopel further argued that because he had not represented JJE during the initial bankruptcy proceedings, he was not aware of the first dismissal order.

After several hearings, the bankruptcy court held Kopel in civil contempt and later imposed a compensatory sanction requiring payment of legal fees and advertising expenses to a secured creditor's attorney for violating the first dismissal order. The bankruptcy court made no determination with respect to the portion of the show cause order concerning a sanction imposed pursuant to Bankruptcy Rule 9011(c). The district court affirmed the bankruptcy court's orders and denied Kopel's request for reconsideration. Although the bankruptcy court had imposed sanctions as a remedy for a finding of civil contempt, the district court gave no consideration to the propriety of a civil contempt finding and instead only considered the appropriateness of

sanctions pursuant to Bankruptcy Rule 9011(c) for a violation of Bankruptcy Rule 9011(b). The district court held that the bankruptcy court had acted within its discretion when it imposed sanctions because Kopel's actions were unreasonable and he had violated Bankruptcy Rule 9011.

The Second Circuit began its analysis by noting that bankruptcy courts are vested with inherent *sua sponte* contempt power and may issue a contempt order after notice and hearing. A party may be held in contempt if (1) there is a "specific and definite" court order which that party has violated, and (2) the party had actual knowledge of the order. While bankruptcy courts can impose compensatory sanctions for civil contempt, a bad faith finding is required when a court imposes attorney's fees as a sanction, or when the court sanctions an attorney for conduct that is integrally related to the attorney's role as an advocate for his or her client. Sanctions may also be imposed on an attorney for violating Bankruptcy Rule 9011, which parallels Rule 11 of the Federal Rules of Civil Procedure; accordingly, a finding of subjective bad faith on the part of the attorney is required to impose Rule 11 sanctions *sua sponte*.

On appeal, Kopel argued that the district court erred in affirming the civil contempt finding while considering only the standards applicable to a violation of Bankruptcy Rule 9011(b). He also contended that he could not be held in civil contempt for violating the order barring JJE from filing a bankruptcy petition for one year because he lacked knowledge of that order. After reviewing the record, the Second Circuit held that the bankruptcy court erred by holding Kopel in civil contempt *sua sponte* and imposing sanctions because it made no finding of bad faith. Likewise, the district court upheld the sanctions without inquiring further into whether Kopel knowingly violated the bankruptcy court's order. Accordingly, both the bankruptcy court and the district court expressly avoided making any finding of bad faith, and absent such a finding, the Second Circuit held that Kopel's carelessness alone could not support the bankruptcy court's *sua sponte* sanctions under its contempt power.

However, the Second Circuit noted that the infirmity of the civil contempt finding did not necessarily mean that compensatory sanctions could not have been imposed pursuant to Bankruptcy Rule 9011(c), because the order to show cause alerted Kopel to the fact that he faced such sanctions. However, the bankruptcy court made no determination of a Bankruptcy Rule 9011(b) violation. Accordingly, the Second Circuit vacated the finding of civil contempt and remanded the case to the district court with directions to remand to the bankruptcy court for consideration of the imposition of compensatory sanctions pursuant to Bankruptcy Rule 9011 (noting that if the bankruptcy court on remand acts to impose such sanctions *sua sponte*, a bad faith finding will be necessary).

B*PP Ill., LLC v. Royal Bank of Scotland Grp. PLC*,
15-3706, 859 F.3d 188 (2d Cir., June 13, 2017)

The Second Circuit affirmed the district court's dismissal of certain fraud claims asserted by a group of hotel-related businesses, along with their investors and guarantors, against the Royal Bank of Scotland and two of its subsidiaries because the hotel plaintiffs' failed to list the cause of action in a schedule of assets in their concluded bankruptcy proceeding and as such they lacked standing to bring the claim and were barred by judicial estoppel.

BPP Illinois, LLC, as one of a consortium of single-purpose entities that owned and managed hotels ("BPP"), together with certain corporate guarantors and an investor, entered into a loan-and-swap transaction with the Royal Bank of Scotland Group PLC ("RBS") and two of its subsidiaries, RBS Citizens, N.A. ("RBS Citizens") and the Citizens Bank of Pennsylvania ("Citizens Bank"). The loan component required BPP to pay Citizens Bank interest at 1.65% above the U.S. Dollar London Interbank Offered Rate ("LIBOR"). The swap required Citizens Bank to pay LIBOR to BPP, and required BPP to pay interest to Citizens Bank at 3.1625%. The net effect of the loan and swap was that BPP paid Citizens Bank a fixed interest rate of approximately 4.8%.

Two years later, BPP filed for bankruptcy in the Eastern District of Texas. BPP's schedule of its assets, including legal claims, did not list claims against RBS or RBS Citizens, nor did it include claims against Citizens Bank on the basis of alleged LIBOR manipulation. While the bankruptcy proceeding was ongoing, there were indications that RBS might be implicated in an improper manipulation of LIBOR and over the course of the bankruptcy proceeding, numerous lawsuits alleging LIBOR manipulation had been filed against different banks, including RBS. However, by the time BPP emerged from bankruptcy, it had still not disclosed any claim relating to LIBOR manipulation.

BPP and its related guarantor and investor plaintiffs later sued RBS, RBS Citizens, and Citizens Bank on their fraud claims, alleging that they were fraudulently induced to enter into the loan, and that the loan pushed BPP into bankruptcy. The district court initially dismissed the fraud and related claims asserted by BPP on the grounds that they were untimely under the applicable statutes of limitations, and dismissed the claims asserted by the other plaintiffs for failure to plead fraud with sufficient particularity.

In a previous appeal, the Second Circuit vacated the judgment as to BPP, and affirmed with respect to the other plaintiffs. On remand, the district court concluded that, based on BPP's failure to list its claims in its schedule of assets in the prior bankruptcy proceeding, BPP lacked standing to assert the claims against the defendants, or in the alternative, were judicially estopped from bringing the claims. The district court also denied a request from the other plaintiffs to amend their complaint, finding that amendment would be untimely and barred by the law of the case.

On appeal, the Second Circuit began its analysis by noting that the doctrine of judicial estoppel prevents a party from asserting a factual position in one legal proceeding that is contrary to a position that is successfully advanced in another proceeding. In the bankruptcy context, judicial estoppel prevents parties who fail to disclose a claim in bankruptcy proceedings from asserting that claim after emerging from bankruptcy. When faced with issues relating to judicial estoppel, courts will examine (i) whether a party's position is clearly inconsistent with an earlier position, (ii) whether a party's former position has been adopted by the court in the earlier proceeding, and (iii) whether the party asserting the contrary position would derive an unfair advantage against the party seeking estoppel.

Turning first to the inconsistency prong, the Second Circuit noted that the district court found that BPP advanced incompatible positions in separate judicial proceedings, having first

failed to list a LIBOR-fraud claim against Citizens Bank in BPP's bankruptcy proceeding in the Eastern District of Texas, and having then asserted such a claim in the Southern District of New York after the bankruptcy proceeding closed. In the Fifth Circuit, failure to list a LIBOR-fraud claim in a bankruptcy proceeding is equivalent to an assertion that the debtor does not have such a claim. Though this analysis may be impacted by a debtor's receipt of sufficient notice of a potential claim or cause of action, here BPP primarily argued that the district court erred in finding a duty to update based on information available *after* plan confirmation. The Second Circuit did not address that contention because it concluded that BPP was required by Fifth Circuit law to list its LIBOR claim *before* confirmation. This was because, prior to confirmation of the bankruptcy plan in October 2011, sufficient information was available to BPP to require listing a potential cause of action against the defendants based on LIBOR fraud. For example, the Second Circuit noted that before plan confirmation, (i) RBS publicly disclosed in a Form 6-K filing that regulatory authorities were "conducting investigations" into LIBOR manipulation, and that "RBS Group is co-operating with these investigations," (ii) numerous news articles had reported on the possibility of LIBOR fraud, and (iii) RBS had been sued for LIBOR manipulation (by others). The Second Circuit reasoned that such lawsuits suggested that BPP should have known sufficient facts to include a possible LIBOR-fraud claim against RBS on its list of assets. Accordingly, under Fifth Circuit law, the kind of LIBOR-fraud claim that BPP now sought to assert was a "known" cause of action at the time of confirmation, so that BPP's failure to list it in the schedule of assets was equivalent to a representation that none exists.

The Second Circuit then turned to the remaining two prongs (adoption and advantage), noting first that judicial estoppel does not apply unless the party's former position has been adopted in some way by the court in the earlier proceeding. Here, the Second Circuit found that the bankruptcy court "adopted" BPP's position that it had no LIBOR-fraud claim against RBS when it confirmed the plan. Finally turning to the advantage prong, the Second Circuit noted that it often limits the application of judicial estoppel to cases in which the party asserting the two positions would derive an unfair advantage against the party seeking estoppel. Here, the Second Circuit held that regardless of whether or not BPP actually knew of its possible LIBOR claims, and whether or not the claims were of great value, BPP's assertion of the claims now would allow it to enjoy an unfair advantage at the expense of its former creditors, who had a right to consider the claims during the bankruptcy proceeding.

The Second Circuit then considered similar claims asserted by the corporate guarantor and investor plaintiffs, and denied their request for leave to amend on the grounds of timeliness. Accordingly, the Second Circuit affirmed the judgment of the district court.

***Ashmore v. CGI Grp., Inc.*, 16-1758, 860 F.3d 80 (2d Cir., June 21, 2017)**

The Second Circuit dismissed for lack of jurisdiction the appeal filed by Benjamin Ashmore ("Ashmore") from the district court's order dismissing him as the plaintiff in his Sarbanes-Oxley whistleblower action for lack of standing and allowing Barbara A. Edwards, the Trustee of his bankruptcy estate (the "Trustee"), to be substituted as the plaintiff.

In November 2011, Ashmore filed a whistleblower action against the defendants CGI Group, Inc. and CGI Federal, Inc. (collectively, "CGI") under the Sarbanes-Oxley Act, 18 U.S.C.

§ 1514A. In that complaint, he alleged that CGI fired him for objecting to its purported scheme to defraud the United States Department of Housing and Urban Development. CGI maintained that it fired Ashmore for deficient job performance.

While his whistleblower action was pending, Ashmore filed a pro se bankruptcy petition, listing the whistleblower lawsuit in his Statement of Financial Affairs but failing to list it as an asset on the petition's Schedule B, which requires debtors to "list all personal property of the debtor of whatever kind." Although Ashmore did not disclose the lawsuit as an asset on Schedule B, he later informed the Trustee of the action and the potential for a financial award. Counsel for the Trustee believed that the best course of action would be for the Trustee to retain counsel representing the debtor in the whistleblower action, with any settlement or judgment to be administered through the bankruptcy court.

In a separate letter agreement, which was not disclosed to the district court or the bankruptcy court, the Trustee agreed to allow Ashmore to continue as the plaintiff in the whistleblower action as long as he met certain conditions. Specifically, the Trustee agreed that Ashmore could remain the plaintiff in the action in exchange for allowing the proceeds from the litigation to go to his bankruptcy estate and promising not to argue that the Trustee had abandoned the whistleblower lawsuit, which would otherwise be an asset of the bankruptcy estate, to Ashmore. Two months later, Ashmore was granted a discharge and his bankruptcy case was closed. The whistleblower action proceeded, with Ashmore as the plaintiff.

After extensive motion practice and failed settlement negotiations in the whistleblower action, CGI moved to dismiss the case for lack of jurisdiction, arguing that the lawsuit was property of the bankruptcy estate, that the Trustee was the proper plaintiff, and that Ashmore did not have standing to litigate the action. In opposing the motion to dismiss, Ashmore argued that the Trustee had abandoned the action as a potential asset of the estate and that the lawsuit therefore belonged to Ashmore. The district court granted the motion to dismiss, concluding that the Trustee had not abandoned the asset because Ashmore failed to "schedule" it within the meaning of Bankruptcy Code section 554(c). The district court did not, however, dismiss the suit altogether: it dismissed the case but delayed entering a judgment closing the case "to afford the Trustee the opportunity to move to be substituted as plaintiff."

Ashmore appealed immediately, before the Trustee moved to be substituted as the plaintiff. Ashmore then moved before the district court to stay the case pending appeal, and when that motion was denied, he requested a stay from the Second Circuit. An applications judge then entered a temporary stay of the district court's proceedings until a motions panel could resolve Ashmore's motion for a stay. One month later, the motions panel issued an order keeping the temporary stay in place with one exception: the district court was permitted to substitute the Trustee as the plaintiff. The Trustee promptly moved to be substituted as the plaintiff and the district court granted that motion. The district court proceedings otherwise remain paused.

On appeal in the Second Circuit, Ashmore argued that the district court erred in concluding that his action was not properly "scheduled" and that, therefore, the Trustee could not abandon the action by operation of law under Bankruptcy Code section 554(c). In response, CGI defended the district court's decision on the merits and argued that the Second Circuit did not

have appellate jurisdiction. In turn, Ashmore asserted that the Second Circuit had appellate jurisdiction because the order dismissing him from the whistleblower action as to him was either final under 28 U.S.C. § 1291 or immediately appealable under the collateral order doctrine.

The Second Circuit found neither of these arguments to be persuasive. Turning first to the argument that the order was final, the Second Circuit stated that, with only a handful of exceptions, orders that allow the litigation to continue are not final for purposes of § 1291 and therefore are not immediately appealable. Here, the Second Circuit stated that the district court's dismissal of the action as to Ashmore, and corresponding substitution of the Trustee as plaintiff, were plainly not final appealable orders under that definition. The district court had not entered a judgment, and upon dismissal of this appeal the whistleblower action would continue to its conclusion. Although the district court dismissed the action, it did so only as to Ashmore, and it expressly permitted the Trustee to move to be substituted as the plaintiff. Since the Trustee moved to be substituted as the plaintiff, and the district court granted that motion, the case was ongoing and there was no final order that is within the Second Circuit's jurisdiction to review.

Ashmore argued that the order was final because the district court erred in dismissing the action and substituting the Trustee, thereby depriving itself of subject matter jurisdiction. The Second Circuit has held, however, that immediate appeal is not automatically authorized whenever a party alleges that a district court order has permitted a suit to move forward in the absence of proper subject matter jurisdiction. Ashmore also attempted to analogize the district court's dismissal of the whistleblower action as to him to an order denying a motion for intervention as of right. However, the Second Circuit also found this argument unpersuasive, as here Ashmore would be able to appeal an unsatisfactory resolution of the case, as well as the district court's order dismissing him from the action, when the litigation eventually concluded.

The Second Circuit then turned to Ashmore's contention that, even if his dismissal from the action was not a final order, it was immediately appealable under the collateral order doctrine, which allows an appellate court to review non-final orders when they (1) conclusively determine the disputed question, (2) resolve an important issue completely separate from the merits of the action, and (3) are effectively unreviewable on appeal from a final judgment. The Second Circuit noted that these conditions are "stringent" and must be kept so for purposes of finality; accordingly, only a limited class of cases has been held to satisfy the collateral order doctrine.

Here, the Second Circuit held that the district court's order failed to satisfy the third prong, which is satisfied only where the order at issue involves an asserted right the legal and practical value of which would be destroyed if it were not vindicated before trial. Here, the Second Circuit noted that Ashmore could appeal from the final judgment in his whistleblower suit and challenge, at a minimum, the district court's order dismissing him from the suit. If he were to choose to take an appeal, and a future panel of the Second Circuit accepted Ashmore's view that he was improperly dismissed from the lawsuit, then he would be able to undo the harm associated with the inappropriate dismissal.

Ashmore also asserted that the Trustee had interests that diverged from his in prosecuting the action, arguing that the Trustee's duty was primarily to Ashmore's creditors, and thus she

might accept a settlement offer that does little more than compensate those creditors. The Second Circuit noted that the Trustee's divergent interests might indeed make it less likely that Ashmore would be satisfied with the outcome of the whistleblower action, but stated that such circumstances do not detract from Ashmore's ability to appeal after a final judgment.

Accordingly, the Second Circuit dismissed the appeal for lack of jurisdiction, vacated the temporary stay of the district court proceedings, and denied Ashmore's pending motion to stay as moot.

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Third Circuit

April:
In re: David Alan Lewis and Donna Lynn Lewis, Debtors -
David Alan Eisenberg, as Chapter 7 Trustee v. Pennsylvania State University,
2017 WL 1344622 (3rd Cir., April 7, 2017)

The U.S. Bankruptcy Court for the Eastern District of Pennsylvania held that a Parent Plus loan made directly from the Department of Education to Pennsylvania State University prior to the debtor's bankruptcy filing is not a fraudulent transfer, since the funds were never in Debtor's possession and would not have been available to his creditors. Debtor Daniel Lewis signed for two loans for his two children to attend Pennsylvania State University before filing for Chapter 7 bankruptcy. The payments were paid directly from the Department of Education to Penn State. The bankruptcy trustee filed two separate complaints which sought to recover the loan proceeds from Penn State for each child under a "relatively new legal theory" under which he claimed the payments were fraudulent transfers under both the Bankruptcy Code and the Pennsylvania Uniform Fraudulent Transfer Act (PUFTA). The bankruptcy court dismissed both complaints, holding that they failed to allege that Mr. Lewis did not receive reasonably equivalent value in exchange for the transfers. A trustee seeking to avoid a fraudulent transfer under either the Bankruptcy Code or PUFTA must show that the debtor had an interest in the property transferred which would have made the property part of the bankruptcy estate had the transfer not occurred. This prevents a debtor from concealing assets that would otherwise be available to creditors. Here, since the Parent Plus loan program was governed by the Department of Education and the funds were only accessible by Penn State, they were never in Debtor's possession, hence they would not have been available to his creditors. Even if the funds were deemed to have entered the bankruptcy estate, the bankruptcy court reasoned that "A parent's payment of a child's undergraduate college expenses is reasonable and necessary expense for maintenance of the family and for preparing family members for the future. The parent therefore receives reasonably equivalent value in exchange for the tuition payment." Finding that neither

Debtor nor his estate held an interest in the proceeds from the loans, and that Mr. Lewis received reasonably equivalent value in exchange for the transfers, no fraudulent transfer occurred. Complaints dismissed.

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June:
***Klaas v. Shovlin (In re: Klaas)*, 15-3341, 16-3482, 858 F.3d 820 (3rd Cir., June 1, 2017)**

In this case, the Third Circuit affirmed the lower courts' denial of a motion to dismiss a Chapter 13 discharge proceeding between Paul and Beth Klaas (the "Debtors"), Ronda Winnecour (the "Trustee") and Elizabeth Shovlin (the "Creditor"). On an issue of first impression for the Third Circuit, the court (i) held that bankruptcy courts have the discretion to grant a grace period when debtors have cured an arrearage after the expiration of the plan term and (ii) decided what factors are relevant for bankruptcy courts to consider when exercising such discretion.

In 2009, the Debtors filed a Chapter 13 petition and proposed a five-year monthly payment plan, which was confirmed. Bankruptcy Code section 1329(a)(2) allows a plan to be modified after confirmation and before completion to adjust time for payments. However, Bankruptcy Code section 1329(c) imposes a five-year limit from the date of the first payment that courts may not approve extension beyond. If the debtor makes all payments, Bankruptcy Code section 1328 allows a court to grant a completion discharge of remaining plan debts. If a debtor is unable to meet plan obligations, the bankruptcy court may dismiss the proceedings or convert it to Chapter 7 under Bankruptcy Code section 1307(c)(6). The bankruptcy court can also grant a hardship discharge under Bankruptcy Code section 1328(b) if the debtor justifiably cannot make all payments and modification is not practical.

Even though the Debtors made the required payments over the next five years, a final calculation showed the Debtors still owed $1,123, resulting in the Trustee moving for dismissal. After the Debtors cured the arrearage, the Trustee withdrew the motion, which had already been joined by the Creditor, who pressed forward. While the bankruptcy court agreed that not completely funding the plan within sixty months constituted a material default under Bankruptcy Code section 1307(c), it held that the Debtors had cured the default without unreasonable delay, making the default immaterial. The Bankruptcy court issued a completion discharge, which the district court affirmed.

The Third Circuit clarified that the issue being decided was not whether a court could extend payment beyond the five years, which it plainly could not do. Rather, the issue was whether, when a shortfall remains at the end of the term that the debtor is willing and able to cure, a court could deny a motion to dismiss. Focusing on the word "may" in Bankruptcy Code

section 1307(c), the court noted a discretionary aspect to such dismissals. The court also discussed the legislative history of these Bankruptcy Code sections, which created the five-year requirement to alleviate debtors from indefinite payment plans, not impose a stringent payment timeframe. The Creditor argued that the court could not grant forgiveness for a post-five-year default if it couldn't permit extension of payments post-five years; however, the Third Circuit held such late payments are not truly modifications, noting that earlier defaults can be cured without requesting formal modification. The Creditor's argument that a hardship discharge was the only available remedy was also denied because the Debtors were willing and able to make their late payment.

Relying on similar bankruptcy court decisions in other jurisdictions and factors relevant to a motion to dismiss, the Third Circuit held that the relevant factors when deciding to grant a grace period are (i) whether the debtor substantially complied with the plan, (ii) the feasibility of completing the plan if permitted, (iii) whether allowing a cure would prejudice any creditors, (iv) whether the debtor's conduct is excusable, considering the cause of the shortfall and timeliness of notice, (v) the availability and relative equities of other remedies. On these factors, the Third Circuit found that the bankruptcy court correctly applied their discretion to grant a grace period for the Debtors to correct their shortfall.

***In re Ross*, No. 15-2222, 2017 WL 2434707,**
Bankr. L. Rep. (CCH) P83, 113, 858 F.3d 779 (3d Cir. June 6, 2017).

This case arises out of an appeal of a broad filing injunction issued against a debtor after he used the bankruptcy process to delay a previously scheduled sheriff's sale of his home. The court addressed two issues: (1) whether a bankruptcy court had authority to issue a filing injunction in the context of approving a debtor's §1307(b) voluntary dismissal and (2) whether a broad filing injunction was appropriate under the facts of this case.

(1) *Whether a bankruptcy court had authority to issue a filing injunction in the context of approving a debtor's §1307(b) voluntary dismissal*

Bankruptcy courts possess statutory authority to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of" the Bankruptcy Code. 11 U.S.C. §1307(b). Bankruptcy courts also have inherent power to sanction "abusive litigation practices." *Marrama v. Citizens Bank of Mass.,* 549 U.S. 365, 375-76 (2007). This general authority is limited however, and does not extend to actions that conflict with "specific," "explicit," and "express" terms of the Bankruptcy Code. *Law v. Siegel*, 134 S. Ct. 1188, 1195-97 (2014).

There is a circuit split regarding whether or not the voluntary dismissal procedure of §1307(b), which provides that a bankruptcy court "shall" dismiss a Chapter 13 case at debtor's request if the case has not already been converted from a different chapter of the code, constitutes such an "explicit" restriction on a bankruptcy court's general authority.

The Second Circuit has held that §1307(b) creates an "absolute" right to dismissal. *In re Barbieri*, 199 F.3d 616, 620-21 (2d Cir. 1999). The Fifth Circuit has ruled that *Marrama* requires

finding a bad faith exception to §1307(b), allowing a bankruptcy court to delay ruling on a bad faith debtor's request for dismissal and instead first address a creditor's motion to dismiss. *In re Jacobsen*, 609 F.3d 647, 649 (5th Cir. 2010). The Ninth Circuit made a similar ruling. *In re Rosson*, 545 F.3d 764, 772, 773 n.12 (9th Cir. 2009).

The Court did not address this split, which the Third Circuit has yet to weigh in on. Instead, the Court ruled that even if debtor was correct that his request for voluntary dismissal must be considered first, "the Bankruptcy Court could have just as easily attached its filing injunction to Raymond's requested dismissal order."

(2) *Whether the bankruptcy court abused its discretion in issuing a broad filing injunction*

The bankruptcy court issued a filing injunction that barred debtor from making any bankruptcy filings anywhere without the court's express permission, without temporal restriction. The Court found this temporally and geographically broad injunction, which was granted without explanation by the bankruptcy court, to be "arbitrary or irrational" and therefore an abuse of the bankruptcy court's discretion. *United States v. Bailey*, 840 F.3d 99, 117 (3d Cir. 2016).

Three facts contributed to the Court's finding that the broad filing injunction was an abuse of discretion. First, the filing injunction went beyond the creditor's request for a 180-day filing injunction or a bar of the automatic stay on attempts to sell debtor's property. Second, the filing injunction was harsher than that applied to debtor's similarly situated wife in a related proceeding, where the bankruptcy court limited itself to the creditor's requested 180-day filing in junction. Third, although 11 U.S.C. §109(g) did not apply to the facts of this case, the court found the statute to be persuasive authority that a 180-day filing injunction was a sufficient remedy for dealing with bad faith debtors.

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Sixth Circuit

April:

***In re Dardinger*, 566 B.R. 481 (6th Cir. April 19, 2017)**

The Bankruptcy Court for the Southern District of Ohio, Eastern Division, held that debt arising from a civil judgment stemming from willful and malicious injury was nondischargeable in a Chapter 7 proceeding. Plaintiff Allison Dardinger, stepdaughter of Debtor-Defendant Jeffrey Dardinger, brought charges against him for assault and battery, invasion of privacy, and intentional infliction of emotional distress. The state court found in her favor and awarded

compensatory and punitive damages. After Debtor-Defendant failed to answer Plaintiff's initial state court complaint and filed a voluntary Chapter 7 bankruptcy petition, Plaintiff instituted an adversary proceeding seeking a declaration that her claim against Debtor-Defendant, which had not yet been liquidated, was nondischargeable under § 523(a)(6) of the Bankruptcy Code because the debt arose from "willful and malicious injury." Debtor-Defendant contended that, by failing to timely file an answer to Plaintiff's original complaint, the state court granted Plaintiff a default judgment rather than summary judgment. Consequently, he argued Plaitniff was not entitled to a determination of nondischargeability as a matter of law. The bankruptcy court disagreed, noting that the state court considered affidavits submitted before it entered summary judgment in Plaintiff's favor and issued findings of fact along with conclusions of law, which detailed Debtor-Defendant's misconduct. Even if the prior judgment was a default rather than summary judgment, it would be entitled to preclusive effect because it was based upon admissible evidence apart from Plaintiff's pleadings and was accompanied by the state court's findings and conclusions. Therefore, since that judgment had preclusive effect, the bankruptcy court concluded as a matter of law that Debtor-Defendant's debt to Plaintiff was for willful and malicious injury, which was excepted from discharge by § 523(a)(6). Debt held nondischargeable.

May:
***In re Town Center Flats, LLC,* 855 F.3d 721 (6th Cir. May 2, 2017)**

The Sixth Circuit examined property rights in an assigned stream of rents, holding that the assignment of rents resulted in a complete transfer of ownership and no residual interest in rents by the debtor-mortgagor that could enter the Chapter 11 bankruptcy estate. Debtor Town Center Flats, LLC, the owner of a 53–unit residential complex, filed for Chapter 11 bankruptcy relief, resulting in an automatic stay on the state court case filed by ECP Commercial II LLC, the assignee of Debtor's $5.3 million construction loan. ECP moved to prohibit Debtor from using rents collected after the petition was filed. In opposition, Debtor argued, and the U.S. Bankruptcy Court for the Eastern District of Michigan agreed, that Town Center would have no income to work with in its Chapter 11 reorganization plan if the rents were not part of the bankruptcy estate. The bankruptcy court denied ECP's motion, determining that the assigned rents would qualify as cash collateral in the bankruptcy estate, and, pursuant to Chapter 11, Debtor must provide "adequate protection" to ECP before using the cash. On appeal, the District Court agreed with ECP that Michigan law established a transfer of ownership in the assigned rents from Town Center to ECP, vacating the bankruptcy court's decision. Town Center appealed, and the Sixth Circuit considered whether the assigned rents were property of ECP or part of Debtor's bankruptcy estate. The Sixth Circuit held that, under Michigan law, completed assignment of rents are treated as transfer of ownership of rents from the mortgage property. Debtor's prepetition commercial mortgage showed an intent to assign rents to the maximum extent permitted by law, resulting in transfer of ownership of assigned rents before the defaulting mortgagor's Chapter 11 petition was filed. Thus, Debtor retained no residual rights in rents that could enter the bankruptcy estate. In abrogating its previous decision on this matter in In re Newberry Square, Inc., 175 B.R. 910 (Bankr. E.D. Mich. 1994), the Sixth Circuit explained that Newberry was "motivated by a policy concern that excluding the assigned rents from the estate would effectively foreclose Chapter 11 relief for companies … that receive their sole stream of

revenue" from rents of a single property. Order of bankruptcy court reversed.

June:
Indian Harbor Insurance Company v. Zucker for Liquidation Trust Of Capital Bancorp LTD. and Financial Commerce Corporation; Joseph Reid (16-1697); Cristin K. Reid and Brian K. English (16-1698)
860 F.3d 373 (6th Cir. June 20, 2017)

A split Sixth Circuit panel ruled that a pre- and post-Chapter 11 company are the same entity for the purpose of an insurance policy, thus relieving liability Insurer Indian Harbor from being required to cover officers of a bankrupt company, Capitol Bancorp, from an $18.8 million suit by the liquidation trustee. After Capitol Bancorp entered Chapter 11, it became a debtor-in-possession. After negotiations between Capitol's officers and the company's creditors, Capitol created a liquidation trust to pursue the estate's legal claims. The officers and liquidation trustee reached an agreement under which causes for actions taken by the officers before the Chapter 11 filing were assigned to the liquidating trust, provided the damages sought were limited to the amount recovered from the management liability policy Capitol had taken out. The liquidation trustee subsequently sued Capitol's officers, alleging they breached their fiduciary duties. Insurer denied coverage and filed a suit for declaratory judgment, claiming the policy covered both Capitol and the officers but contained an exclusion for an "insured-on-insured" suit. The officers and trustee filed suit in response, arguing that Capitol as a debtor-in-possession was legally distinct from the pre-Chapter 11 entity. The United States District Court for the Western District of Michigan granted Insurer's motion for partial summary judgment, finding that the policy did not cover the trustee's action. The Sixth Circuit agreed, pointing out that the Bankruptcy Code, prior case law, and the insurance policy itself supported the position that the policy contained a clause providing uninterrupted coverage during bankruptcy. A trust's action against officers of company was excluded from company's liability insurance policy under the "insured-versus-insured" exclusion, since, when the bank entered Chapter 11 under a debtor-in-possession plan, it did not become legally distinct from the bank that took out the policy to cover it and its executives. Affirmed.

***In re Pace*, 16–8036, --- B.R. ----, 2017 WL 2644630 (6th Cir. June 20, 2017)**

The Sixth Circuit Bankruptcy Appellate Panel held that § 522(f)(2)(C) precludes avoidance of a mortgage deficiency judgment lien, reversing and remanding the bankruptcy court's ruling. When Debtor Antoinette Pace filed a Chapter 13 bankruptcy petition, she claimed the Ohio homestead exemption in her residence, which listed judicial liens filed by foreclosure creditor Farmers National Bank of Canfield (FNB), Midland Funding, and Mahoning County for unpaid real estate taxes. Schedule D did not list a mortgage against the residence, but Part Four concerning prepetition lawsuits listed a concluded foreclosure case brought by FNB. After Debtor converted her Chapter 13 case to a Chapter 7 case, she filed a Motion to Avoid Liens, pursuant to § 522(f), to avoid judicial liens on her residence that impaired her homestead exemption. The bankruptcy court denied Debtor's motion as to one of FNB's judicial liens on grounds that § 522(f)(2)(C) specifically prohibits the avoidance of a deficiency judgment lien

because it is based on a judgment arising out of a mortgage foreclosure. The bankruptcy court also denied Debtor's motion seeking avoidance of FNB's other judicial lien, indicating it was duplicative of FNB's first judicial lien, but granted the motion to avoid the other two unrelated judicial liens. The U.S. Bankruptcy Appellate Panel of the Sixth Circuit reversed the bankruptcy court's ruling that § 522(f)(2)(C) precludes avoidance of a mortgage deficiency judgment lien, clarifying that § 522(f)(2)(C) simply designates that a judgment in a foreclosure action does not transform the underlying mortgage agreement into an avoidable judicial lien. Decision of bankruptcy court reversed and remanded.

***In re Baxter,* 13–61958 --- B.R. ----, 2017 WL 2591263 (June 15, 2017)**

The U.S. Bankruptcy Court for the Eastern District of Michigan, Southern Division, considered a Chapter 13 case concerning the meaning of Bankruptcy Code § 1329(a), which permits certain types of modifications of a confirmed Chapter 13 plan to be made, "[a]t any time ...before the completion of payments under such plan." Creditor Robert Mitchell proposed a post-confirmation plan modification, to which Debtor Marjorie Baxter objected timely. An issue raised at the hearing concerned the timeliness of the plan modification, which Debtor argued must be disapproved because "the completion of payments under" the Debtor's confirmed plan had occurred, per 11 U.S.C. § 1329(a). The Chapter 13 Trustee agreed and reported that Debtor completed all required payments under the confirmed plan on May 17, 2017, which was one day before the May 18 hearing on the plan modification, but well after the March 21 date on which Creditor filed and served his plan modification. The bankruptcy court held that a modification is not untimely if a proposed plan modification is filed and served before a debtor completes her payments under the confirmed plan, but a timely objection to the modification is filed and not ruled on until after the completion of such payments. The court ruled in Creditor's favor, concluding that Creditor's Plan Modification was not time-barred under § 1329(a). It did not decide other issues raised by Debtor in objecting to the plan modification but scheduled a further hearing for June 22, 2017.

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<u>Ninth Circuit</u>

Turner v. Wells Fargo Bank, N.A. (In re Turner),
2017 WL 2587981 (9th Cir. June 15, 2017).

In *Turner v. Wells Fargo Bank, N.A. (In re Turner)*, the debtors are borrowers and trustors on a deed of trust ("DOT") that named Fidelity National Title Insurance Company as

Trustee and Wells Fargo, N.A. ("Wells Fargo") as both lender and beneficiary. After the DOT was recorded, Wells Fargo sold the DOT along with the debtors' promissory note to Citigroup Global Markets Realty Corp. ("Citigroup") around August 2005. Citigroup then deposited them into a mortgage-backed security trust (the "CMLTI Trust"), which was securitized pursuant to a Pooling and Servicing Agreement ("PSA") naming U.S. Bank, N.A. ("U.S. Bank") as Trustee. The terms of CMLTI Trust required the transfer of all assets to the trust within ninety days of the Trust Pool's August 29, 2005 start date. However, the DOT was not transferred by Wells Fargo to Citigroup and by Citigroup to U.S. Bank as Trustee for the CMLTI Trust until May 12, 2011 and September 19, 2012, respectively. On June 4, 2012, the debtors filed for bankruptcy relief, and when the debtors failed to pay Wells Fargo under the bankruptcy plan, U.S. Bank sought and was granted relief from the automatic stay to proceed with the foreclosure of the property.

The debtors then filed an adversary proceeding alleging that the transfer of the DOT to the CMLTI Trust was *void* and is a breach of the PSA given that it was not effectuated within the ninety-day period. Specifically, the debtors alleged, among other things, wrongful foreclosure, breach of express agreement and the implied covenant of good faith and fair dealing under the PSA, and violation of California's business and professions code § 17200.

The Ninth Circuit affirmed the Bankruptcy Appellate Panel's decision to affirm the bankruptcy court's dismissal of the debtors' adversary proceeding for failure to state a claim. To start, the panel found that the borrowers lacked standing to bring a wrongful foreclosure action given that these DOT assignments were *voidable*. Citing three decisions from California Court of Appeal, the panel noted that a borrower has standing where an assignment by which the foreclosing party took a beneficial interest in a deed of trust is void – not merely voidable. The panel also found that the borrowers lacked standing to bring a breach of express agreement and the implied covenant of good faith and fair dealing under the PSA claim given that the borrowers were not third-parties beneficiaries of the PSA. Finally, the panel again found that the borrowers lacked standing to bring an unfair competition claim under California's business professions code given that they failed to demonstrate any economic injury as a result of unfair business practices. Specifically, the foreclosure would have occurred regardless of the alleged deficiencies in the timing of the assignments of the DOT since the borrowers caused the loan to default for their failure to make payments.

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