Bankruptcy Circuit Update

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Supreme Court

***In re Jevic (Czyzewski v. Jevic Holding Corp., et al)*, Case No. 15-649, 2017 WL 1066259 (S. Ct. Mar. 22, 2017)**

In *Jevic,* the Court considered whether a structured dismissal of a chapter 11 case over the objections of priority wage claimants and the United States Trustee is permitted under the Bankruptcy Code. In a 6-2 decision reversing the Third Circuit, Justice Breyer found that structured settlements are not permitted under the Code's priority scheme for payment to creditors. Justice Thomas, joined by Justice Alito, dissented, noting that the issue the Court decided was not the issue that certiorari was granted. As such, Justice Thomas argued that the petition for certiorari should be dismissed.

Jevic involved a leveraged buyout in which Sun Capital Partners acquired Jevic Transportation Corp. with money borrowed from CIT Group. Two years after Sun's buyout, Jevic filed a chapter 11 case. The Petitioners, a group of former Jevic truck drivers, filed suit in bankruptcy court against Jevic and Sun for failure to provide 60 day termination notices under the WARN Act. The unsecured creditors committee filed a separate preference and fraudulent conveyance action against Sun and CIT. The unsecured creditors committee, Sun, and CIT reached an agreement that provided for: (1) the dismissal of the fraudulent conveyance action; (2) that CIT would place $2 million in an account to pay the unsecured creditor committee's legal and administrative fees; and (3) that Sun would assign its lien on the debtor's remaining cash of $1.7 million to a trust for payment of taxes and make a pro-rata distribution to unsecured creditors. The WARN Act claimants, who obtained a bankruptcy court judgment in the amount of $8.3 million for wage claims under § 507(a)(4), and U.S. Trustee objected, arguing that the failure to pay the wage priority claims violated the priority distribution under chapter 11. The bankruptcy court acknowledged that the proposed settlement violated the ordinary priority rules for payment of creditors, but found that given the exigencies of the case and that only secured creditors would receive a distribution in the case, a structured settlement would provide for a pro-rata distribution to unsecured creditors. The district court affirmed, noting that priority rules governing payment only apply to chapter 11 plans. The Third Circuit affirmed, noting that structured settlements do not always need to follow priority of repayment.

The Court addressed two issues. First, the Court determined that the Petitioners had standing to pursue the appeal. The Respondents argued that the Petitioners would not suffer any injury because they could never receive any payment on their claims because of the debtor's insolvency and inability to reorganize. The Court found that the settlement with Sun provided that the Petitioners would not receive a distribution, but an unwinding of the settlement might result in Sun paying Petitioners something to settle the lawsuit. Second, the Court reasoned that the fraudulent transfer case had value of at least $3.7 million because it was settled. The Court noted that had the case gone to trial, the potential remained for a judgment or settlement that could have resulted in some distribution to Petitioners.

The Court then found that although structured settlements may be permissible where no party objects, in the context of a structured settlement involving an objection, the Code simply does not allow a creditor to be paid over the objection of a creditor higher in priority of payment. Further, the Court found that Code only contemplates three outcomes in chapter 11; confirmation of a plan, conversion to chapter 7, or dismissal. The Court found that under § 349(b), the inclusion of "cause" does not include an "end run" under the Code. Moreover, the Court noted that there is no "rare exception" provision to deviate from the Code's priority scheme distribution.

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First Circuit

***In re Cousins International Food Corp. (Encanto Restaurants Inc. v. Aquino et. al.)* Case No. 12-08567-MCF, BAP No. PR 16-034 (1st Cir. BAP March 21, 2017).**

In *Cousins International Food Corp.*, Encanto Restaurants Inc. ("Encanto"), the purchaser of substantially all of the assets of the chapter 11 debtor appealed orders of the bankruptcy court: one relating to Encanto's request for relief under § 362; and a second relating to its request for relief under the sale order pursuant to which Encanto purchased all of the debtor's assets free and clear of all liens, interest, and claims under 11 USC §§ 363, 365 ("Sale Order").

Pre-petition, Luis S. Aquino ("Aquino") filed a complaint against the debtor in state court. Approximately one year later, the debtor filed for chapter 11 relief but failed to disclose the state court action in its schedules and statement of financial affairs. A few months after the bankruptcy filing, debtor's counsel in the state court litigation filed a motion indicating that the debtor had filed for bankruptcy. Subsequently, the bankruptcy court approved the sale motion and an accompanying purchase agreement which provided that Encanto would not assume or be liable for any obligations of the debtor, including causes of action. Notwithstanding the bankruptcy and the Sale Order, the state court entered default judgment against the debtor, and Aquino sought to execute the judgment against Encanto. Encanto then initiated an adversary proceeding: (1) to enjoin any further litigation in state court; (2) to obtain declaratory judgment that the state court judgment was null and void and in violation of the automatic stay; and (3) for sanctions for willful violation of the automatic stay. Pursuant to cross motions for summary judgment, the bankruptcy court denied declaratory relief and did not find that the automatic stay or Sale Order were violated because Aquino was not provided with adequate notice of the bankruptcy filing, claims bar date or the sale.

On appeal, the First Circuit Bankruptcy Appellate Panel ("BAP") first addressed whether Encanto as a third party had standing to appeal both (1) the denial of relief under § 362 and the denial of relief under the Sale Order. The BAP held that Encanto as a non-debtor lacked standing to seek redress for a stay violation under the "person aggrieved" standard. A person aggrieved is one "whose pecuniary interests are directly and adversely affected by an order of the bankruptcy court." The BAP stated that nothing in the legislative history counsels that the automatic stay should be invoked in a manner which advances the interests of some third party. Thus, the BAP

held (1) that Encanto lacked standing to appeal the bankruptcy court's order under § 362. However, the BAP held that (2) Encanto had standing to appeal from the Sale Order but nevertheless affirmed the bankruptcy court's refusal to accord relief under the Sale Order. The BAP held that it is the duty of the sale proponent to ensure that interested parties are afforded appropriate notice of the material terms of an all-asset transfer. In the First Circuit, a creditor has the right to assume that proper and adequate notice will be provided before its claims are forever barred. A creditor's general awareness of a bankruptcy, does not in itself impose an affirmative duty to present its claim. Thus, the BAP found no error in the bankruptcy court's refusal to grant any relief pursuant to the Sale Order as against a known creditor who should have received proper notice of the sale proceedings but did not.

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Second Circuit

***In re Dreier LLP (Cosmetic Plus Grp. Ltd. v. Gowan),* Case No. 16-2827, 2017 WL 1087945 (2d Cir., March 21, 2017)**

The Second Circuit affirmed the judgment of the district court affirming the bankruptcy court's order granting the plan administrator's objections and reclassifying as unsecured claims the proofs of claim filed by Cosmetics Plus Group Ltd. ("CPG") and its secured creditors, Robin Bartosh and Toby Bartosh.

This case derived from the bankruptcy of the law firm Dreier LLP, but it more specifically stemmed from the 2001 bankruptcy of one of that firm's clients, CPG, which filed an adversary proceeding against its insurer in 2003. That suit settled, and in March 2008 the insurer issued a check for $350,000 to Dreier LLP, as attorneys for CPG. These funds were deposited in an attorney trust account that commingled client funds with both operating funds as well as the proceeds of attorney Mark Dreier's note-fraud scheme. By mid-August 2008, the account was depleted and had a negative balance.

In October 2008, the bankruptcy judge in the CPG bankruptcy dismissed the proceeding and directed CPG to pay various expenses and fees and distribute the remaining cash to secured creditors Robin and Toby Bartosh. By that time, the Dreier LLP account had been replenished. However, no money was paid to the Bartoshes out of the Dreier LLP trust account. Dreier LLP partners who represented CPG consulted the firm about releasing client funds, and on December 4, 2008, Dreier LLP transferred $441,145.58 to an outside account—an amount that was intended to include $350,000 for CPG. After Dreier LLP filed for bankruptcy, the bankruptcy trustee requested the return of the $441,145.58, which was transferred to the trustee in February 2009.

In March 2009, CPG and Robin and Toby Bartosh filed proofs of claim in the Dreier bankruptcy, each asserting a $350,000 secured claim based upon Dreier's retention of CPG's settlement proceeds. The plan administrator objected on the ground that the proceeds had become "hopelessly commingled" with other funds and that the claims should therefore be reclassified as general unsecured claims. Following a trial, the bankruptcy court sustained the objection and reclassified the claims as unsecured, and the district court affirmed.

The Second Circuit began its analysis by considering the argument that the bankruptcy court (and the district court) erred by holding that Dreier LLP's December 4, 2008, transfer of funds to an outside account was an avoidable preference under 11 U.S.C. § 547(b), which allows a trustee to avoid any transfer (i) of property of the debtor, (ii) made for benefit of a creditor, (iii) for an antecedent debt, (iv) while the debtor was insolvent, (v) within 90 days of filing for bankruptcy, (vi) allowing the creditor to receive more than it would receive in Chapter 7 liquidation if the transfer had not been made.

CPG and the Bartoshes argued that the transferred funds were never the "property of the debtor," but were instead held in trust for CPG as proceeds of a litigation settlement. The Second Circuit was not persuaded by this argument, noting that while it is not disputed that Dreier LLP received $350,000 of settlement proceeds to be held in trust for CPG in March 2008, Dreier nevertheless failed to honor that obligation based on the bankruptcy court's finding that, by mid-August 2008, the account into which those funds were deposited had a negative balance. The Second Circuit therefore reasoned that the settlement proceeds had been converted, and were gone well before the December 1 transfer. Although CPG was injured by this dissipation of funds, and had a claim for its injury, that claim was not for a traceable res. The funds that later replenished the Dreier LLP account and which were transferred on December 4 to satisfy the debt to CPG were not traceable to CPG's settlement proceeds but were from other sources, and were at the time of the transfer Dreier LLP's property. The Second Circuit therefor held that CPG and the Bartoshes had no greater right to those particular funds than other unsecured creditors.

The Second Circuit then turned to the argument that the bankruptcy and district courts should have imposed a constructive trust on what CPG characterized as "the settlement funds transferred" on December 4, 2008. The Second Circuit held that this argument failed for the same reasons set forth above, noting that CPG and the Bartoshes mischaracterized the December 4 transfer as being a transfer of the settlement funds. The Second Circuit again stated that by mid-August 2008, the settlement funds had been dissipated and no part of the funds transferred on December 4 was traceable to them. Those funds were therefore properly a part of Dreier LLP's estate, subject to the claims of all of its creditors. Accordingly, imposing a constructive trust would merely advantage CPG and the Bartoshes at the expense of other creditors.

In re Dunne (Dunne v. Coan), **Case No. 16-1778-bk, 2017 WL 1164379 (2d Cir., March 28, 2017)**

The Second Circuit dismissed for lack of standing the appeal filed by plaintiff Gayle Killilea Dunne ("Killilea") the wife of a chapter 7 debtor, from the district court's affirmance of the bankruptcy court's order granting the bankruptcy trustee's motion for relief from the automatic stay

with regard to litigation commenced by the equivalent of the trustee in the debtor's Irish bankruptcy case, the "Official Assignee," against Killilea (the "OA litigation"). In addition to granting relief from the stay, the bankruptcy court ruled that Killilea lacked standing to challenge the trustee's motion. The district court affirmed the grant of relief from the stay but declined to reach the question of Killilea's standing.

In the Second Circuit, Killilea argued that she had standing to challenge the bankruptcy court's order and that the order manifested abuse of discretion in several respects. The Second Circuit began its analysis by noting that although the current Bankruptcy Code prescribes no limits on standing beyond those implicit in Article III of the United States Constitution, for practical reasons the Second Circuit has adopted the general rule that in order to have standing to appeal from a bankruptcy court ruling, an appellant must be directly and adversely affected pecuniarily by the challenged order of the bankruptcy court. Accordingly, to pursue this appeal, Killilea was required to establish, in addition to Article III standing, that the bankruptcy court's order caused her a "direct" and "financial" injury.

The Second Circuit noted that the principal purpose of the automatic stay is to protect the debtor and to preserve the property of the debtor's estate for the benefit of all the creditors. Killilea was neither a creditor nor a co-debtor of the estate at issue, and she also asserted no direct pecuniary interest in the bankruptcy proceeding. Moreover, the Second Circuit found the possibility that Killilea could suffer financial injury as a result of a future adverse decision in the no-longer-stayed OA litigation was not directly attributable to the bankruptcy court order, but remote and speculative. Indeed, the challenged stay order dictated no relief that directly and adversely affected Killilea's pecuniary interests. Thus, the Second Circuit held that the mere fact that the bankruptcy court lifted the automatic stay despite Killilea's objection was not enough, by itself, to demonstrate her direct, financial injury and accordingly, Killilea lacked standing to appeal the bankruptcy court's order.

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Fourth Circuit

***In re Jemsek Clinic, P.A.* (*Blue Cross Blue Shield of N.C. v. Jemsek Clinic, P.A.)*, Case No. 16-1030, 850 F.3d 150 (4th Cir. 2017):**

On March 3, 2017, the Fourth Circuit vacated the judgment of the U.S. District Court for the Western District of North Carolina and remanded for further proceedings a ruling concerning sanctions entered against a creditor by the bankruptcy court.

In 2003, a group of doctors commenced a class action against Blue Cross and Blue Shield Association ("BCBS") in federal court in Florida, alleging, in part, improper business practices concerning the refusal to pay the doctors for covered medical treatments.

In 2006, Blue Cross NC ("BCNC") sued Dr. Joseph Jemsik and his clinic in state court in North Carolina. BCNC alleged that Dr. Jemsik received over $10 million in improper payments through fraudulent billing practices. Subsequently, Dr. Jemsik and his clinic (the "Debtors") each filed for chapter 11 relief in North Carolina. The Debtors removed BCNC's state court suit to bankruptcy court, and it proceeded as an adversary proceeding, in response to which the Debtors filed counter-claims asserting defamation and tortious interference. Thereafter, numerous discovery disputes ensued between the debtors and BCNC.

In 2007, the federal court presiding over the class action in Florida preliminarily approved a settlement between, on the one hand, the class, which included Dr. Jemsik, and, on the other hand, BCBS, and it issued an injunction concerning claims held by putative class members. Despite receipt of notice of the settlement, Dr. Jemsik did not opt out of the class. In the interim, the North Carolina bankruptcy court continued to oversee numerous discovery disputes. In 2008, BCNC informed the North Carolina court of the proposed class settlement and the injunction.

In 2009, the Debtors sought and obtained sanctions against BCNC. The bankruptcy court cited the delay in litigation, sizeable attorneys' fees and costs incurred, and the court time "needlessly consumed." The bankruptcy court entered a dismissal with prejudice in favor of the Debtors against BCNC and awarded to the debtors fees of nearly $1.3 million. The district court entered a final judgment, adopting the bankruptcy court's proposed findings and conclusions.

The Fourth Circuit wrote that bankruptcy courts, like all federal courts, have the "inherent power to sanction parties who abuse the litigation process in bad faith." The Fourth Circuit held that the bankruptcy court's ruling was not clearly erroneous in awarding sanctions, but the bankruptcy court did abuse its discretion given the severity of the sanctions levied against BCNC. In applying factors set out in *U.S. v. Shaffer Equip. Co.*, 11 F.3d 450 (4th Cir. 1993), the Court determined that a dismissal with prejudice was too severe. Also, the Fourth Circuit held that components that comprised the total fee award of $1.29 million were unjustified, including fees incurred in connection with discovery and defending the claims after issuance of the injunction by the Florida federal court. Therefore, the Fourth Circuit vacated the judgment and remanded the case for further proceedings.

***LVNV Funding, LLC v. Harling, et al.*, Case Nso. 16-1346 & 16-1347, 2017 WL 1190965 (4th Cir. March 30, 2017):**

On March 30, 2017, the Fourth Circuit held—in consolidated direct appeals from the U.S. Bankruptcy Court for the District of South Carolina—that confirmation of a chapter 13 plan does not have a *res judicata* effect on unsecured claims, such that a chapter 13 debtor may object to an unsecured claim ***after*** plan confirmation.

In two separate chapter 13 cases, the claim bar date in each case was after the date of plan confirmation. After plan confirmation, each respective debtor objected to unsecured claims filed

by LVNV Funding, LLC ("LVNV") on the basis of statute of limitations grounds, and LVNV conceded that "its claims would ordinarily be barred by the statute of limitations." But, LVNV asserted that the chapter 13 plan confirmation orders precluded the debtors' subsequent claim objections, due to *res judicata*, in that LVNV's claims should be allowed. The bankruptcy court sustained each claim objection.

The Fourth Circuit affirmed the bankruptcy court's rulings on direct appeal. The Fourth Circuit held that the final, third element for application of *res judicata*, "that the claims in the second matter are based upon the same cause of action involved in the earlier proceeding," was lacking.

The Fourth Circuit based its analysis on §§ 1322 and 1325, which provide the requirements for chapter 13 plans, and those chapter 13 provisions' intersection with § 502, as to claims allowance. The Court also contrasted chapter 13 plans' treatment of secured versus unsecured claims. While secured claims are treated on an individual basis, the treatment of unsecured claims is as a class according the plain language of the Code. If LVNV's argument were accepted, then it would create two classes of unsecured claims, as opposed to the structure of the Code. The Court also noted that "[n]othing in the Bankruptcy Code ties contested matters for unsecured claims to timeline related to plan confirmation." Thus, the Court held that the debtors' claim objections were not precluded as a result of chapter 13 plan confirmation.

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Fifth Circuit

***In re Galaz (Raul Galaz and Segundo Suenos, LLC v. Lisa Ann Galaz and Julian Jackson),* Case No. 15-51194, 850 F.3d 800, 2017 WL 955261 (5th Cir. Mar. 10, 2017).**

In this case, the Fifth Circuit considered for the second time the debtor's claim that her husband fraudulently transferred certain assets. Debtor Lisa Galaz ("Lisa") obtained a 25% share of Artists Rights Foundation LLC ("ARF") from her husband, Raul, in her 2002 divorce. ARF's assets consisted of certain music royalty rights. In June 2005, without Lisa's knowledge, Raul transferred ARF's royalty rights to Segundo Suenos ("Segundo") which, at that time, was not an organized business entity. Shortly thereafter, Raul assisted his father in registering Segundo as a Texas LLC. Soon afterward, the royalties transferred began to general substantial revenue.

Lisa alleged that the transfer was fraudulent under the Texas Uniform Fraudulent Transfer Act ("TUFTA"). After a bench trial, the bankruptcy court entered final judgment in favor of Lisa, but its ruling was ultimately overturned by the Fifth Circuit on jurisdictional grounds because Lisa's claims were non-core. On remand, the bankruptcy court again found Raul transferred the royalties with actual intent to defraud Lisa, issuing proposed findings of fact and conclusions of law for the

district court, which were adopted. The district court awarded Lisa actual damages of approximately $241,000 and exemplary damages of $250,000. Raul and Segundo appealed.

Citing the district court's factual findings, the Fifth Circuit affirmed, pointing to six badges of fraud that established Raul's fraudulent intent. The Court likewise rejected Raul's challenge of the damages awarded. Specifically, Raul argued the district court should have limited Lisa's damages to the nominal value of the royalty rights at the time of the transfer because § 24.009(c)(1) of TUFTA restricted the court from adjusting the value of the transfer to include improvements made by a good faith transferee. Citing § 24.008(a)(3)(C) of TUFTA, the Fifth Circuit explained that the court was entitled to adjust the value as the equities required because the transfer was actually fraudulent and Segundo was *not* a good faith transferee. Further, in light of the inadequate evidence proffered by Raul and Segundo, the Court rejected the notion that actual damages were not warranted because Segundo had produced no net operating income. Finally, the Fifth Circuit likewise affirmed the award of exemplary damages due to the evidence of actual fraudulent intent.

***Kipp Flores Architects LLC v. Mid-Continent Cas. Co.*, Case No. 16-20255, 2017 WL 1130861 (5th Cir. Mar. 24, 2017).**

In this case, the Fifth Circuit considered what "deemed allowed" means when a proof of claim is filed in a no asset bankruptcy case, no deadline is set for objections to claims, and no party in interest objects.

After Kipp Flores Architects ("KFA") sued Hallmark Collection of Homes LLC ("Hallmark") and related parties for copyright infringement, Hallmark commenced a no asset bankruptcy. KFA timely filed a proof of claim for its copyright infringement damages. The court did not set a deadline for objections to claims and, indeed, no party objected to KFA's claim. The bankruptcy court also did not enter an order either allowing or disallowing the claim. In August 2010, the trustee submitted a no asset report stating no funds were available for distribution, and the case was closed shortly thereafter. Meanwhile, relying on the deemed allowed status of its claim (pursuant to 11 U.S.C. § 502(a)) in the bankruptcy as a final judgment, KFA sought payment from Hallmark's liability insurer, Mid-Continent Casualty Co. ("Mid-Continent") for its proof of claim. When Mid-Continent refused, KFA sued for breach of contact. On cross-motions for summary judgment, the district court held KFA's proof of claim was not "deemed allowed" because, in a no asset bankruptcy, the claims allowance procedures are not triggered. KFA appealed.

On appeal, KFA argued that, under the plain language of § 502(a), a claim is deemed allowed if no party in interest objects. Therefore, when no party objected to KFA's claim, it became a final judgment that, under res judicata principles, trigged Mid-Continent's duty to defend. Mid-Continent countered that the Bankruptcy Code, when read as a whole, provides proofs of claim may be filed and become subject to bankruptcy court adjudication only when assets are available or believed to be forthcoming for distribution. Accordingly, Mid-Continent argued the allowance of KFA's claim for copyright damages served no bankruptcy purpose because there were no assets to be distributed to creditors.

The Fifth Circuit sided with Mid-Continent, instructing that interpretation of § 502 required an examination of the structure of the Code as a whole. First, the Court explained that under § 501, the filing of a proof of claim is permissive, rather than mandatory. Indeed, in no asset bankruptcies, the filing of proofs of claim is often characterized by courts as unnecessary, and creditors are discouraged from filing them. Further, no bar date is established. In sum, the Court stated that whether claims may be filed pursuant to § 502, is generally contingent on asset distribution.

Next, the Court pointed to the Official Bankruptcy Forms 9C and 9D as reinforcing the notion that § 502(a) deems claims allowed only where assets are available for distribution. Pursuant to the standard procedures set forth in these forms, the Court reasoned, creditors who are instructed not to file claims in no asset cases are effectively also deterred from objecting to other parties' claims. Section 502 would be substantially transformed if, under KFA's interpretation, parties such as Mid-Continent were required to monitor, object to, and litigate proofs of claim that need not even be filed in no asset cases. In short, there cannot be a "deemed allowed" claim where there are no distributable assets, no other bankruptcy purpose for the claim allowance process, and parties in interest were not on notice of an obligation to object to claims.

The Fifth Circuit also noted that filing a proof of claim in this instance was unnecessary for KFA to preserve its rights because it could have simply sought relief from the automatic stay to pursue its pending copyright litigation. Finally, the Court clarified that the bankruptcy court retains subject matter jurisdiction over proofs of claim in no asset cases; the claims allowance process is simply discretionary in such cases.

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***In re Carroll (Carroll, et al. v. Abide),* Case No. 16-30996, 850 F.3d 811, 2017 WL 963141 (5th Cir. Mar. 13, 2017).**

This appeal arises out of a converted Chapter 7 case, which was previously a Chapter 11 that originated as a Chapter 13. Chapter 7 Trustee sought to have Debtors, William Douglas Carroll and Carolyn K. Carroll, and their adult daughters determined as vexatious litigants and requested an order that would prohibit them from seeking relief against her both individually, and as trustee of the consolidated bankruptcy estates of Debtors and their Limited Liability Company (LLC). Trustee also sought relief for an award of attorney fees. The bankruptcy court previously declared that the Debtors and their daughters were vexatious litigants and sanctioned the debtors jointly and severally for the amount of $49,432. The bankruptcy court also issued a pre-filing injunction. The district court subsequently affirmed the bankruptcy court and the appeal was taken.

The Chapter 7 Trustee sought such relief due to the conduct of Debtors and their daughters within the bankruptcy cases. In granting relief for the trustee, the bankruptcy court noted a series of actions that demonstrated a distinct pattern of harassment of the bankruptcy process. Such bad actions included seeking to frustrate the sale of the residence of Debtors, as well as a five-acre tract of land owned by Debtors. The bankruptcy court, therefore, determined that the Debtors motives were to both harass the trustee and to delay administration of the estate in order to retain assets. The Fifth Circuit agreed. "To the extent that Appellants challenge the bankruptcy court's finding that they acted in bad faith, our probing review of the record establishes that the finding of bad faith is well supported. As both the bankruptcy court and the district court meticulously explained, Appellants have engaged in conduct intended to harass and delay."[1] The Court went on to further establish that while the actions of the Debtors' daughters was less egregious, the daughters still engaged in behavior constituting bad faith. To that end, "the bankruptcy court discussed the Carroll Daughters' conduct in the Movables Adversary, in which the district court had to hold the Carroll Daughters in contempt" and further ordered them to make the trustee whole.[2] "Yet, the Carroll Daughters remained undeterred, persisted in their unsupported filings, and eventually triggered another motion for contempt by failing to pay the attorneys' fees as ordered."[3]

The Fifth Circuit then addressed the sanction of $49,432, which represented the attorneys' fees incurred by trustee in responding to the Debtors' bad faith conduct. The Debtors argued that this award was erroneous as the estate had already incurred the attorneys' fees. The court, however, found that the Debtors' argument misunderstood the very purpose for ordering the fees which was to prevent the bankruptcy estate from bearing the costs of the Debtors and their daughters' vexatious conduct. As such, the court determined that the fee was not erroneous.

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***In re Jackson (Tower Credit, Inc. v. Schott)*, Case No. 16-30274, 850 F.3d 816, 2017 WL 963146 (5th Cir. Mar. 13, 2017).**

In this matter, the Fifth Circuit considered whether wages transferred under a prepetition garnishment order could be voided as preferential transfers pursuant to 11 U.S.C. § 547(b). The court concluded the garnished wages could be treated as preferential transfers.

Tower Credit, Inc., obtained a money judgment in Louisiana state court against Christon Jackson. Thereafter, Tower obtained a garnishment order, served it on Jackson's employer on January 19, 2012, and began collecting garnished wages. Jackson filed for Chapter 7 bankruptcy protection

[1] *In re Matter of Carroll*, 2017 WL 963141, 850 F.3d 811 (5th Cir. Mar. 13, 2017).
[2] *Id*. at 813.
[3] *Id*.

on November 17, 2012. In 2014, the trustee initiated an adversary action, seeking to void the garnishments collected by Tower within 90 days prior to the petition date, pursuant to 11 U.S.C. § 547(b). Tower argued that Jackson's interest in *all* garnished wages was transferred to Tower when it served the garnishment order on Jackson's employer, more than 90 days before Jackson filed his bankruptcy petition.

Noting that Section 547(a) provides the governing principles determining the timing of a transfer, the court reasoned that under § 547(e)(2)(B), a transfer is generally made at the time it is "perfected." In the context of non-real property, this occurs when "a creditor on a simple contract cannot acquire a judicial lien that is superior to the interest of the transferee." § 547(e)(1)(B). However, the court noted that § 547(e)(3) qualifies this general principle, and provides that "a transfer is not made until the debtor has acquired rights in the property transferred." Relying on the U.S. Supreme Court's decision in *Local Loan v. Hunt* – in which the court held that "[t]he earning power of an individual . . . is not translated into property within the meaning of the Bankruptcy Act until it has brought earnings into existence" – the Fifth Circuit reasoned that in the wage garnishment context, a debtor cannot logically obtain his rights in his future wages until he performs the services that entitle him to receive those wages. Thus, the court held that Jackson had not earned the disputed wages before the 90-day preference period, and under § 547(e)(3), could not have transferred such rights to Tower prior to the preference period. As such, the wages Tower garnished within 90 days before the petition date could be voided as preferential transfers.

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Seventh Circuit

***Randy Joseph Netzer v. Office of Lawyer Regulation & Matthew F. Anich,* Case Nos. 16-3226 & 16-2713, 2017 WL 961740 (7th Cir. March 13, 2017) (Easterbrook, J.)**

On March 13, 2017, the Seventh Circuit held that Bankruptcy Rules 8002 and 9022(a) operated to bar appeal from a bankruptcy court decision after 35 days. Specifically, the bankruptcy court had ruled that a sanction imposed by the Wisconsin Office of Lawyer Regulation was not dischargeable because it was a "fine, penalty, or forfeiture" under 11 U.S.C. § 523(a)(7). Bankruptcy Rule 8022(a)(1) gives 14 days to appeal. The debtor did not appeal until 41 days had passed. He also filed his appeal before the district court, rather than the bankruptcy court.

The Seventh Circuit noted that "the Supreme Court may soon decide how far rules about times for appeal, as opposed to statutory limits, can affect a court's jurisdiction," but the Court determined that it did not need to wait for that case to progress because a rule "is still a rule, and when invoked, it must be enforced." The Court further noted that the debtor had benefitted from the 14-day limit

in Rule 8002(a)(1) and that Rule 9022(a) expressly provides that "Lack of notice of the entry does not affect the time to appeal or relieve or authorize the court to relieve a party for failure to appeal within the time allowed, except as permitted in Rule 8002." In turn, Rule 8002(d) allows the bankruptcy judge (not the district court) to permit a belated appeal made within 35 days after the order's entry. The Court found this to be a reasonable time frame because "Litigants have only to check the court's electronic docket once a month in order to protect their interests." As the debtor did not meet this basic threshold, the Court affirmed the district court's determination that it lacked jurisdiction to hear the debtor's appeal.

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Ninth Circuit

***In re Gugliuzza (Gugliuzza v. Federal Trade Comm'n)*, Case No. 15-55510, 2017 WL 1101094 (9th Cir. Mar. 24, 2017)**

The Ninth Circuit dismissed a chapter 7 debtor's appeal of a district court order remanding to a bankruptcy court for further fact finding the issue of whether the debtor had the intent to deceive for collateral estoppel purposes in a nondischargeability proceeding under § 523(a)(2)(A). Prior to his chapter 7 filing, the FTC brought a successful enforcement action against the debtor's company under Section 5 of the FTC Act; the district court found the company had engaged in deceptive acts and the debtor could be held individually liable. The district court enjoined the debtor from further violating the FTC Act and awarded $18.2 million in restitution. The restitution order prompted the debtor filed his chapter 7 case. The FTC then brought an action under § 523(a)(2)(A) to have the restitution award deemed nondischargeable. The bankruptcy court granted the FTC's motion for summary judgment. On intermediate appeal the district court reversed in part the holding that the debtor was collaterally estopped from relitigating whether in re tthe intended to deceive his company's customers, and remanded that issue to the bankruptcy court for further fact-finding. The Ninth Circuit dismissed the debtor's appeal of the district court's order as non-final, based on the remand with directions for further fact-finding, because given the remand, the district court's order (which affirmed the other elements required for a nondischargeability finding under § 523(a)(2)(A)) did not alter the status quo and fix the rights and obligations of the parties as contemplated under *Bullard v. Blue Hills Bank*, 135 S. Ct. 1686, 1692 (2015). The Ninth Circuit relied on its prior decision in *Sahagun v. Landmark Fence Co. (In re Landmark Fence Co.)*, 801 F.3d 1099, 1126 (9th Cir. 2015), which post-dated *Bullard* and applied a 4-factor test to determine if an order remanding a matter to a bankruptcy court for further fact-finding was final for purposes of appeal: (i) the need to avoid piecemeal appeals, (ii) judicial efficiency, (iii) the systemic interest in preserving the bankruptcy court's role as the finder of fact, and (iv) whether delaying review would cause either party irreparable harm. The Ninth Circuit explained that the remand was not limited to "purely" mechanical or computational tasks. The Ninth Circuit further explained that a line of cases starting with *Bonner Mall P'ship v. U.S. Bancorp Mgt. Co. (In re Bonner Mall*

P'ship), 2 F.3d 899 (9th Cir. 1993), which provided that orders remanding for further fact findings on a central issue could be final for purposes of appeal if that issue was "purely" legal in nature and its resolution could dispose of the case or proceeding and obviate the need for further fact finding, or "materially aid" the bankruptcy court in reaching its disposition on remand did not survive *Bullard*, as construed by *Landmark Fence*.

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***In re Tenderloin Health (Shoenmann v. Bank of the West)*, Case No. 14-17090, 849 B.R. 1231 (9th Cir. 2017)**

In *Tenderloin Health*, the Ninth Circuit reversed the district court's order affirming the bankruptcy court's grant of summary judgment in favor of creditor Bank of the West ("BOTW") on the trustee's preference action. In 2012, Tenderloin Health elected to wind up its affairs and sold its only real property for $1,295,000. On June 13, 2012, Tenderloin paid BOTW $190,595 from escrow to satisfy two loans which were secured by Tenderloin's personal property including its deposit accounts. The remaining net proceeds of $526,402 were transferred from escrow into Tenderloin's BOTW deposit account. On July 20, 2012, Tenderloin filed its chapter 7 petition. After BOTW turned over the deposited funds, the trustee filed an adversary proceeding to avoid the $190,595 loan repayment as a preference.

The bankruptcy court granted summary judgment in favor of BOTW on the basis that the trustee could not show that BOTW received more than it would in a hypothetical liquidation because BOTW maintained a right of setoff and the account held more than $190,595 on the petition date. The district court affirmed.

The Ninth Circuit held that as part of the "greater amount test" of §547(b)(5), the court could include a hypothetical preference action within the hypothetical liquidation. The Circuit distinguished *New York County Nat'l Bank v. Massey*, 192 U.S. 138 (1904) on the basis that the Bankruptcy Code's expanded definition of transfer includes deposits. The Circuit held that the $526,402 deposit was a "transfer" which could be hypothetically avoided, and because the account would then have only $37,713 on the petition date, the loan payment constituted an avoidable preference.

Judge Korman concurred in part that a bankruptcy court should consider whether a trustee would prevail on preference actions as part of the hypothetical liquidation of §547. However, Judge Korman wrote that *Massey* "never said that customer deposits were not transfers" but rather that "such deposits were not *preferential*… solely because they create a right of setoff in a creditor." Although Congress expanded the definition of transfer, it preserved the right of setoff in §553 and there is no indication that Congress intended to disrupt the holding of *Massey*.

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***In re Miller (First Community Bank v. Gaughan),* Case No.: 14-16854, 2017 WL 1192205 (9th Cir. March 31, 2017).**

In *First Community Bank v. Gaughan*, the Ninth Circuit reversed and remanded the district court's reversal of the bankruptcy court's summary judgment in favor of a creditor bank who brought an adversary proceeding against the chapter 7 trustee seeking a declaration that the creditor had an enforceable judgment lien on a piece of real property.

In *First Community Bank*, the debtor Larry Miller and his wife, Kari Miller, both domiciled in Arizona, owned a co-op in San Francisco, California as husband and wife. Appellant First Community Bank ("FCB") extended credit to an entity affiliated with the debtor and organized under California law in exchange for a business loan, promissory note, and commercial guaranty by the debtor in his personal capacity. The entity failed to meet its obligations and the debtor defaulted on the loan. FCB sued both the debtor and his wife in the United States District Court of Arizona and moved for summary judgment as to liability and damages on the debtor's breach of the guaranty to which the court granted and entered judgment against the debtor. FCB registered its judgment in California and recorded the California judgment in the Official Records of the San Francisco County's Recorder's Office. The debtor later filed for bankruptcy relief. FCB filed an adversary proceeding seeking a declaration that it held an enforceable judgment lien on the co-op, thereby granting it priority over the proceeds of the sale of the co-op.

Applying California's choice-of-law rules, the Ninth Circuit held that California law governs and that the co-op would be treated as tenancy-in-common making the debtor's interest in the co-op subject to enforcement of the judgment lien. Disagreeing with FCB's main argument, the court found that registration of the judgment against the debtor pursuant to 28 U.S.C. § 1963 in the Northern District of California was by itself insufficient to create an enforceable lien against the co-op but rather a choice-of-law analysis must also be conducted. The federal choice-of-law rules is applied in federal question cases and whether a lien creates an interest in land and the nature of the interest created is determined by the law that would be applied by the court of the "situs," which in this case the real property is located in California. Under California law, the debtor and his wife owned the real property as tenants-in-common given that it was purchased, while they were domiciled in Arizona. Furthermore, a dual-signature is not required with respect to either community property, joint property, or a tenancy-in-common unlike Arizona. As a result, all such property is subject to the enforcement of a money judgment, even where a guaranty underlying the judgment is signed by only one of the two spouses.

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Eleventh Circuit

***In re Ferguson , (David Beem v. Gary A. Ferguson)*, Case No. 15-13358, 2017 WL 1173664 (11th Cir. March 30, 2017).**

Creditor, Beem appealed the district court's dismissal of his bankruptcy appeal and its orders denying his motions for rehearing of the same. Beem's appeal to the district court challenged several bankruptcy court orders— order confirming debtor's Chapter 11 plan, order granting debtor's motion to strike creditor's ballot and deny objections as untimely, and motions to reconsider the same.

The bankruptcy court scheduled confirmation hearing for September 15, 2014, and entered an order setting a deadline to object to the plan. The day after the deadline, Beem asserted a claim and filed an objection to the proposed plan and a ballot. The debtor moved to strike the objection and the ballot, which the bankruptcy court granted. Beem then "enlisted Jeffrey Norkin, an attorney suspended from the practice of law to fraudulently "concoct [] his own purported ballot.'" The next day the bankruptcy court entered an order confirming the debtor's Chapter 11 plan. Beem moved for rehearing of the order and for a stay to prevent the enactment of the plan until the bankruptcy court resolved his motion for reconsideration. The bankruptcy court denied both motions.

Beem then appealed the order striking his ballot and approving the plan and the orders denying reconsideration to the district court. After the debtor moved to strike Beem's brief as impermissibly excessive, that his appeal was untimely, and that he once again used the services of the suspended attorney while purportedly appearing as *pro se*. The district court stated that it would not allow the suspended attorney to circumvent the Florida Bar by having his clients file pleadings *pro se*. The district court struck the brief and ordered Beem to file his new initial brief by a date certain. Once again Beem missed the deadline to file and the new brief still bore evidence of the disbarred attorney's work. The district court dismissed the appeal by default. Beem moved for reconsideration, which the district court denied.

On appeal to the Eleventh Circuit, Beem argued that the district court erred when it dismissed his appeal because it made its decision based on facts irrelevant to the issues before the court— use of suspended attorney. The Eleventh circuit found this argument without merit since Beem failed to follow the district court's order, which gave him ample time for him to prepare and file a new brief. The district court had put Beem on notice that failure to comply with the court's order could result in dismissal of his appeal. The Eleventh Circuit affirmed holding that the district court did not err in dismissing the appeal as a federal court has at its disposal an array of means to enforce its orders, including dismissal in an appropriate case.

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