Bankruptcy Circuit Update

Featuring cases from November 2015

Second Circuit

ANZ Sales, Inc. v. Bank of Baroda (In re: Indu Craft, Inc.),
2015 WL 6875063, (November 10, 2015)

The Second Circuit affirmed the judgment of the district court denying the arguments presented by ANZ Sales, Inc. ("ANZ") that (1) the district court erred in not affording ANZ the opportunity to be heard on the issue of its standing to appeal two bankruptcy court orders before dismissing that appeal, and (2) the district court did not have jurisdiction to determine the issue of standing because another creditor's motion for reconsideration was still pending before the bankruptcy court.

Addressing ANZ's first argument, the Second Circuit noted that it is well-established that a district court may raise the issue of standing *sua sponte*, as it did here. Nevertheless, the Second Circuit stated that it is generally good practice for courts to give a party an opportunity to oppose a contemplated *sua sponte* dismissal for lack of standing because it ensures the presence of a fully-developed record before an appellate court, thus facilitating *de novo* review of legal conclusions; the Second Circuit has previously reversed dismissals for failure to afford such an opportunity. However, a district court may properly dismiss an action for lack of subject matter jurisdiction without providing notice and an opportunity to be heard where it is unmistakably clear that the court lacks jurisdiction, or that the appeal lacks merit or is otherwise defective.

The Second Circuit held that the dismissal without notice and a hearing was proper here because the district court was acting not as a trial court but as an appellate court and had a fully developed record before it. The Second Circuit noted that because the district court's decision was based on the nature and content of prior court orders, all of which were part of the record before it, the court properly addressed the issue of standing without asking the parties to brief or argue that issue. The Second Circuit then briefly discussed and dismissed ANZ's second argument, noting that ANZ's contention that the district court lacked subject matter jurisdiction to consider its own subject matter jurisdiction was "nonsensical."

Drake v. United States ex rel Internal Revenue Service,
2015 WL 7292441, (November 19, 2015)

The Second Circuit affirmed the judgment of the district court denying the objection asserted by Chapter 7 debtor Ralph H. Drake, Jr. ("Drake") to the proof of claim filed by the Internal Revenue Service (the "IRS") in his bankruptcy proceeding.

The Second Circuit first noted that whether a Chapter 7 debtor may object to a proof of claim is a question of statutory standing. Issues involving statutory standing do not generally implicate the subject matter jurisdiction of a federal court unless Congress has clearly stated that a limitation on a statute's scope is jurisdictional. The Second Circuit has held that other

limitations in the Bankruptcy Code are "decisively" nonjurisdictional. Additionally, nothing in 11 U.S.C. § 502 refers to jurisdiction or indicates that Congress intended the "party in interest" limitation to be jurisdictional in nature.

As such, the Second Circuit assumed without deciding that Drake had standing to object to the IRS's proof of claim in the bankruptcy court. After reviewing the issues on appeal and the record of the proceedings below, the Second Circuit concluded that the bankruptcy court did not err in denying Drake's objection to the IRS's proof of claim on the merits and did not abuse its discretion in doing so without holding a hearing. This was because Drake was given "notice and a hearing" as required by 11 U.S.C. § 502(b) and the evidence was sufficient to support the bankruptcy court's allowance of the IRS claim.

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Third Circuit

OCTOBER:

***In re Grigg*,**
2015 WL 5813153 (3d Cir. Oct. 6, 2015)

The Third Circuit affirmed the holding that a three million dollar judgment debt fell within the 11 U.S.C. § 523(a)(4) discharge exception for breach of fiduciary duty, defalcation, and fraud. Chaney, the judgment creditor, was a former client of Grigg, the chapter 7 debtor-attorney. In a prepetition fee dispute, an arbitrator found that Grigg had billed Chaney "an extravagant sum supported by dubious hours" and that Grigg's contingent fee was "so exorbitant and wholly disproportionate to the services performed as to shock the conscience...." The arbitrator thus issued an award in favor of Chaney. The bankruptcy court concluded that the award was nondischargeable, under section 523(a)(4), since it was incurred through a reckless disregard of Grigg's fiduciary duty to Chaney.

***In re Forever Green Athletic Fields, Inc.*,**
804 F.3d 328, 2015 WL 6080665 (3d Cir. 2015)

The Third Circuit found that the bankruptcy court did not abuse its discretion in dismissing an involuntary chapter 7 petition on the basis of bad faith, even though the petitioning creditors satisfied the 11 U.S.C. § 303(b)(1) filing requirements, and the alleged debtor admittedly was not paying debts as they became due. Highlighting language from section 303(h)(1), the petition creditors argued that a court "shall order relief" if the section 303(b)(1)

requirements are present and the debtor is not paying its debts. The Court, however, held that bad faith may serve as its own basis for dismissal, since section 303(b)(1)'s three requirements are "just the first hurdle" in determining whether an involuntary petition is proper. The Court explained, "if the three filing requirements are not satisfied, we agree the bankruptcy court must dismiss the case; but if the three requirements are satisfied, that doesn't mean the bankruptcy court can't dismiss the case." Further, section 303(h)(1) provides that a debtor not paying its debts is a necessary but not sufficient condition for ordering relief. Finally, the equitable nature of bankruptcy allows courts to prioritize good faith.

***In re Gigliotti*,**
2015 WL 6108247 (3d Cir. Oct. 16, 2015)

In a nonprecedential opinion, the Third Circuit reached the same conclusion as the bankruptcy court and district court: the plaintiffs did not meet their burden of proof to pierce the corporate veil of an LLC by showing that, on a number of occasions, large deposits were made into an LCC escrow account, and withdrawn a short time later in a similar amount. Rather, the plaintiffs had to show "[G]ross undercapitalization, failure to observe corporate formalities, nonpayment of dividends, insolvency of debtor corporation, siphoning of funds from the debtor corporation by the dominant stockholder, nonfunctioning officers and directors, absence of corporate records, and whether the corporation is merely a façade for the operations of the dominant stockholder." Because the plaintiffs failed to meet their evidentiary burden, they could not recover from Ronald and John Gigliotti on a state court judgment against the LLC.

***In re Coppedge*,**
2015 WL 6500736 (3d Cir. Oct. 28, 2015)

Upon the trustee's motion, the bankruptcy court had entered an order dismissing the debtor's case. The debtor's appeal from that order was filed outside of the 14-day time limit set forth in Federal Rule of Bankruptcy Procedure 8002(a). The debtor also did not request an extension. The district court thus determined that the notice of appeal was untimely, and that it lacked jurisdiction to review the bankruptcy court's order. The Third Circuit affirmed the district court's decision.

NOVEMBER:

In re Scheib,
2015 WL 6685714 (3d. Cir. Nov. 3, 2015)
Unreported decision

Ms. Scheib filed a Chapter 13 bankruptcy petition, and her case was converted to a Chapter 7 case. Creditor Mellon Bank, N.A. filed a motion for relief from the automatic stay to pursue foreclosure of Scheib's property in state court, and the motion was granted. Scheib received a discharge and her case was closed. Fourteen years after her bankruptcy case was closed, Scheib was evicted from the property that was the subject of Mellon Bank's stay relief motion. Scheib then filed numerous actions to challenge the foreclosure; Scheib filed a motion with the state court to challenge the foreclosure (which was denied), and filed a motion with the

Bankruptcy Court to re-open her bankruptcy case, asserting that Mellon Bank committed fraud in the foreclosure action and the bankruptcy proceeding. The Bankruptcy Court refused to reopen the case and ruled that (i) the motion was untimely and (ii) Scheib's challenge to the foreclosure was barred by the Rooker-Feldman doctrine. Scheib appealed to the District Court, which affirmed the Bankruptcy Court. The Third Circuit affirmed the Bankruptcy Court's decision to decline to re-open the case, noting that the Bankruptcy Court was not the appropriate forum for the relief sought by Scheib, and that a bankruptcy case may be reopened to administer assets, to accord the debtor relief, or for other cause, which standard was not satisfied by Scheib. 11 U.S.C. 350(b).

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Fourth Circuit

OCTOBER

Biltmore Invs., Ltd. v. TD Bank,
2015 WL 5730361 (4th Cir. Oct. 1, 2015):

On October 1, 2015, the Fourth Circuit issued a per curiam opinion, without hearing oral argument, that vacated and remanded the order of the U.S. District Court for the Western District of North Carolina. Post-petition, TD Bank obtained a state court judgment for $2.5 million against the sole shareholder of the Debtor's common stock. Post-confirmation of the Debtor's second amended plan, TD Bank sought to satisfy its judgment against the stockholder by executing on his shares in the Debtor.

TD Bank filed with the Bankruptcy Court a motion requesting confirmation that the automatic stay did not prohibit it from executing on the stockholder's shares, which the Bankruptcy Court granted. The Debtor appealed that order to the District Court, arguing that under *A.H. Robins Co. v. Piccinin*, 788 F.2d 994, 999 (4th Cir. 1986), unusual circumstances exist such that the automatic stay should protect acts against the stockholder. The District Court agreed with the Debtor, reversing the Bankruptcy Court, and citing the possibility that if TD Bank were to exercise control over the Debtor, then the Debtor may fail to comply with the terms of its confirmed plan.

On appeal, the Fourth Circuit reversed and remanded, noting that the lower court premised their rulings on the false notion that the automatic stay still applied to the Debtor. On confirmation of the Debtor's second amended plan, all assets were re-vested in the Debtor, "subject only to outstanding liens which are not avoidable by" the Debtor. In short, the automatic stay expired, and the District Court erred in applying it to enjoin TD Bank. The

Fourth Circuit vacated and remanded, also instructing the District Court to consider whether an injunction under § 105 of the Code ought to have been issued, which the Bankruptcy Court had previously refused to do.

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Eighth Circuit

Curtis v. Segraves (In re Segraves)
2015 WL 7738156 (8th Cir. Nov. 30, 2015)

The BAP affirmed an order of the bankruptcy court denying a motion to dismiss the debtor's Chapter 13 bankruptcy petition. The creditor bringing the motion argued that the debtor failed to comply with 11 U.S.C § 109(h)(3)(A) by not personally signing a statement of credit counseling under penalty of perjury. The BAP affirmed the order denying the motion on the basis that section 109(h) requires an individual to receive credit counseling and section 521(b)(1) requires the debtor to submit to the court a certificate from an approved credit counseling agency, but neither section requires the debtor to sign the certificate under penalty of perjury, or at all.

Jordahl v. Burell (In re Jordahl),
539 B.R. 567, 2015 WL 6847770 (B.A.P. 8th Cir. Nov. 2, 2015)

In this matter, the debtors appealed from the order confirming their Chapter 13 plan. In the bankruptcy proceedings the debtors initially sought to confirm a plan that would bifurcate the non-priority unsecured debt into student loans and all other non-priority unsecured debt. Under the plan they would maintain full payments on three student loans, making payments directly to the lenders, while other allowed claims would not be paid in full.

The Trustee objected to the plan for failing to meet the requirements of sections 1322(b)(1) and (b)(10) because it unfairly discriminated against a class of creditors and provided for payment of interest on the student loans while other allowed claims were not being paid in full. The bankruptcy court rejected the initial plan finding that the separate classification of the student loans constituted unfair discrimination. After several modifications, a plan was approved, over the debtors' objection, the modified plan maintained the payment on the principal for one of the loans during the plan term. The remaining student loans were to be paid pro rata with other unsecured non-priority claims.

On appeal the debtors argued that the original plan should have been approved. They asserted that section 1322(b)(5) allows for the maintenance of payments on claims on which the

last payment is due after the final payment under the plan is due, as was the case with the student loan payments, and thus compliance with the other subsections of section 1322(b) was not necessary. The Trustee argued that a Chapter 13 plan is required to meet all eleven subjections of section 1322(b).

The BAP, though it affirmed the bankruptcy court's order, did not agree with either the debtors or the Trustee. Instead, the BAP held that when a Chapter 13 debtor's treatment of a creditor under one subsection of 1322(b) falls within the contours of another subsection, all standards of both must be satisfied. In its analysis under this standard, the BAP determined that the initial plan the debtors sought unfairly discriminated again against a class of creditors. The BAP rejected the argument that the fairness requirement is met as a matter of law by the statutory authority granted under section 1322(b)(5) and stated that non-dischargeability alone did not justify special classification of the student loans.

Dittmaier v. Sosne (In re Dittmaier)
2015 WL 7253011 (8th Cir. Nov. 17, 2015.)

The Eighth Circuit affirmed the bankruptcy court and district court's determination that the debtor's earned income tax credit (EIC) was not exempt under Missouri law where the debtor received the EIC prior to filing the bankruptcy petition.

The Debtor received here an income tax refund, including the EIC, five hours prior to the filing of the bankruptcy petition. Following a motion to compel turnover of the tax refund brought by the Trustee, the debtor amended her schedules, asserting an exemption of the EIC pursuant to Mo. Re. Stat. § 513.4301(10)(a). The bankruptcy court later entered an order exempting some of the income tax refund, but denying the exemption of the EIC. The issue presented to the Eighth Circuit was whether under Missouri law a "public assistance benefit" is exempt from the bankruptcy estate when received prior to filing the bankruptcy petition. Both parties agreed for the purposes of appeal that the EIC qualifies as a public assistance benefit under Missouri law.

Section 513.4301(10)(a) lists as a type of property that is exempt a person's "right to receive…A Social Security benefit, unemployment compensation or a public assistance benefit." The Eighth Circuit held that the "right to receive" terminates when the monies are obtained because the funds become part of the personal property of the debtor, such that the EIC was not exempt. In reaching this decision, the Eighth Circuit noted that in the same statute the Missouri legislature exempted the "right to receive, or property traceable to" payments on account of the wrongful death of a person to whom the debtor was a dependent. The Court presumed that the decision to exclude the "property traceable to" language from the portion that speaks to public assistance benefits was intentional.

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Ninth Circuit

In re Penrod,
802 F.3d 1084, 2015 WL 5730425 (9th Cir. Oct. 1, 2015.)

On October 1, 2015, the United States Court of Appeals for the Ninth Circuit reversed and remanded the United States District Court for the District of Northern California's affirmance of the United States Bankruptcy Court for the District of Northern California's denial of a motion for an award of prevailing party attorney fees under California's reciprocal attorney fee statute.

The issue presented to the Court was whether a debtor who prevails in a contract dispute on the basis of federal bankruptcy law may recover reasonable attorney fees under California Civil Code § 1717.

In two previous opinions in this matter, one by the Bankruptcy Appellant Panel and one by the Ninth Circuit, ultimately, it was determined that the purchase money security interest protected by the hanging paragraph placed after 11 U.S.C. § 1325(a)(9) does not include amounts attributable to the negative equity from a trade in vehicle. The Debtor, after confirming the amended plan to reflect the creditor's bifurcated claim, filed a motion seeking to recover its attorney's fees incurred in opposing the creditor's objection to confirmation of the plan of reorganization. The basis for the request was the reliance on a provision in the contract with the creditor that allowed for the creditor to recover attorney fees for its collection efforts. California Civil Code § 1717 allows for the recovery of attorney fees to the prevailing party incurred in the enforcement of a contract. The bankruptcy court denied the Debtor's motion on the grounds that the Debtor did not prevail "on a contract" because the success of the Debtor's litigation turned on a question of federal bankruptcy law. Citing *Travelers Casualty & Surety Co. v. Pacific Gas & Electric Co.*, 549 U.S. 443 (2007), the Ninth Circuit held that the "hanging paragraph" litigation was an "action on a contract" in which the debtor prevailed and therefore was entitled to its reasonable attorney fees.

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Carpenter v. Montana Dept. of Labor and Industry Unemployment Ins. Contributions Bureau (In re Carpenter),
2015 WL 7289345 (BAP 9th Cir. Nov. 18, 2015)

The matter before the Ninth Circuit BAP was whether Montana's tax claim for unpaid corporate taxes against the debtors' responsible officers constituted a § 507(a)(8)(E) excise tax priority claim in their individual bankruptcy cases. Below, the bankruptcy court rejected the debtors' argument that, by negative inference from language in § 507(a)(8)(C), the § 507(a)(8)(E) excise priority could not apply to responsible officers. The debtors' theory would have enabled them to confirm a chapter 11 plan without paying the corporate tax in full and avoid non-dischargeable status for the unpaid portion of the taxes. The debtors relied on the absence of the phrase "for which the debtor is liable in whatever capacity" in § 507(a)(8)(C) in other subsections of § 508(a)(8), including § 507(a)(8)(E), to mean that they, as vicariously liable parties, were not liable for priority excise taxes. The BAP's affirmance was based in significant part on the Supreme Court's decision in *United States v. Sotelo*, 436 U.S. 268 (1978) and the subsequent amendment to the Code to include the "for which the debtor is liable in any capacity" argument. Specifically, the BAP explained that there was no indication in the legislative history to the Bankruptcy Code that Congress intended to limit Sotelo's construction of responsible officer liability qualifying for priority status despite the absence in § 17a(1)(e) of the Bankruptcy Act of previous reference to responsible officers and notwithstanding language that "no priority over general unsecured claims shall pertain to taxes not included in the foregoing priority." In other words, no legislative history suggested that Congress intended to limit the Supreme Court's responsible officer analysis to trust fund taxes when Congress enacted the Bankruptcy Code. The BAP noted that the § 507(a)(8) priorities were not mutually exclusive, that Sotelo did not construe responsible officer "penalty" in the Internal Revenue Code as beyond the scope of priority tax provisions, and concluded that Montana's statute imposing responsible officer liability was a tax. The BAP concluded it was an excise tax, as clarified by the State taxing authority, and had the same status as the underlying corporate tax. Accordingly, the BAP affirmed the bankruptcy court's holding that the tax claim constituted a § 507(a)(8)(E) excise tax with priority status.

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11th Circuit

In re All American Trailer Mfrs., Inc.,
2015 WL 6848033 (11th Cir. Nov. 9, 2015)

The bankruptcy court granted the United States Trustee's motion to dismiss the debtor's chapter 11 bankruptcy case, but after granting the motion, issues arose as to whether all creditors

had received notice of the motion. After the court noticed a second hearing on the motion to dismiss, the main judgment creditor recorded its judgment lien. Before the second hearing, the debtor filed an assignment for the benefit of creditors under § 727 of the Florida Statutes; the judgment creditor objected to the petition of assignment. The petition of assignment was dismissed, after which the judgment creditor terminated its judgment lien. After the second hearing, the bankruptcy court granted the motion to dismiss nunc pro tunc to the date of the first hearing, determining that adequate notice was given for the first hearing.

The judgment creditor appealed the nunc pro tunc order. The Eleventh Circuit held that the judgment creditor lacked standing to object to the nunc pro tunc order because it did not suffer any immediate, tangible harm. The judgment creditor argued it released its judgment lien without contemplating that the dismissal would be deemed nunc pro tunc, but the court reasoned that any resulting injury was attributable to the creditor's own actions and did not provide standing.

***In re Tobkin*, 2015 WL 7144748 (11th Cir. Nov. 16, 2015)**

A pro se debtor, also an attorney, sought a determination that contingency fees he received were "earnings" exempt under § 222.11 of the Florida Statutes.
The Eleventh Circuit held that under Florida law, "proceeds from a debtor's business, including a law practice, do not constitute 'earnings'" unless the debtor has an arms-length employment agreement that provides for a set salary or wages.

***U.S. v. Freeman,* 2015 WL 7171131 (11th Cir. Nov. 16, 2015)**

The defendant in this criminal case appealed his conviction for concealment of assets in a bankruptcy proceeding in violation of 18 U.S.C. § 152(a). The defendant's conviction was based on concealment of a joint account he held with his mother. Immediately before filing bankruptcy, the defendant deposited proceeds from the sale of real property, which according to his tax returns netted him $275,000.

The Eleventh Circuit affirmed the district court's denial of the defendant's motion to dismiss on statute of limitations grounds. The court determined that the statute of limitations began to run only upon the bankruptcy court's written order dismissing the defendant's bankruptcy case. Moreover, the appellate court affirmed the district court's denial of judgment of acquittal, holding that whether the defendant's interest in the joint account was property of the estate was a question of fact for the jury. Sufficient evidence supported the jury's verdict.

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