Bankruptcy Circuit Update
Featuring cases from November 2018

Fourth Circuit

***Dep't of Social Servs., Div. of Child Support Enforcement v. Webb* (*In re Webb*), No. 17-2328, 908 F.3d 941 (4th Cir. Nov. 19, 2018)**:

On November 19, 2018, the Fourth Circuit affirmed the bankruptcy court's and district court's decisions that held that, upon dismissal of a chapter 13 case, post-petition payments made to the chapter 13 trustee, including payments for delinquent child support, must be returned to the debtor. In July 2016, the Debtor, Barry Webb, filed a chapter 13 petition with the U.S. Bankruptcy Court for the Western District of Virginia. At that time, Webb owed approximately $75,000.00 to Virginia's Division of Child Support Enforcement (the "Division") for unpaid child support. Webb began making post-petition payments to the chapter 13 trustee, but he was unable to propose a confirmable plan. After having paid $3,000 to the trustee, his case was dismissed in February 2017.

Shortly after dismissal, the Division served on the chapter 13 trustee an order to withhold, directing the trustee to pay to the Division the $3,000 in post-petition payments, which order purported to hold the trustee personally liable for that sum if he did not comply. Thereafter, the trustee filed a motion with the bankruptcy court seeking guidance, noting the "conflicting obligations" between § 1326(a)(2) of the Code and Virginia law. The bankruptcy court held that § 1326(a)(2) was clear and controlling: "[i]f a plan is not confirmed, the trustee . . . shall return such payments . . . to the debtor." Accordingly, the bankruptcy court adhered to the plain language of the Code, holding that the trustee was obligated to return the funds to the debtor. The bankruptcy court also noted that, if accepted, the Division's argument would create a "race to the trustee" that would contravene § 349(b)(3), which controls the effect of a dismissal. On appeal, the district court affirmed the bankruptcy court, relying on the plain language of § 1326(a)(2).

The Fourth Circuit also applied the plain meaning of § 1326(a)(2), finding it unambiguous that the trustee "shall return" post-petition payments to the Debtor. While an exception exists for administrative claims under § 503(b), that exception did not apply to the Division. The Court also noted that Congress did include certain exceptions concerning child support payments, including § 1325(b)(2), no exception existed in § 1326(a)(2). Further, the Fourth Circuit rejected the Division's three key arguments, noting that (i) the Division ignored the mandatory language in § 1326(a)(2), (ii) the Division's § 362 argument was "unrelated to the clear requirement of § 1326(a)(2);" and (iii) that Virginia law, including the Division's right to levy, is superseded by the Supremacy Clause of the Constitution.

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Fifth Circuit

Penn v. Viegelahn (In re Penn),
No. 18-CV-354, 2018 WL 5984844 (W.D. Tex. Nov. 13, 2018).

On appeal is whether the bankruptcy court erred in determining that a Chapter 13 debtor could not keep her tax refund in an amount greater than $2,000 because the tax refund was disposable income that was not "reasonably necessary to be expended . . . for the maintenance and support of the debtor" under 11 U.S.C. § 1325(b)(2).

Gloria Artesia Penn ("Debtor") filed a voluntary petition for relief under Chapter 13 of the Bankruptcy Code.[1] Debtor's schedules disclosed an interest in real property (the "Real Property") and in personal property described as "2017 Tax Refund." Debtor's amended plan included a nonstandard provision providing that Debtor "reserves the right to file relevant motion to retain tax refund should special need arise, to the extent said potential refund is not disposable income."

Pre-confirmation, Debtor filed a motion requesting to retain her 2017 tax refund to make certain repairs to the Real Property that would allow it to become habitable and insurable.[2] The Chapter 13 trustee ("Trustee") objected, arguing that the tax refund should be governed by the section of the Form Plan that required turnover of any tax refund in excess of $2,000.[3] At the hearing on the motion, Debtor asserted that her 2017 tax refund was not disposable income under § 1325(b)(2), because use of the funds to repair the Real Property would constitute a reasonably necessary expenditure for her support and that of her dependents.

The bankruptcy court presented Debtor with several options, including: (1) modifying the plan to allocate a greater monthly amount for home improvements; (2) dismissal of the case for Debtor to choose how to use her tax refund; and (3) conversion of her case to a Chapter 7 case. Debtor chose to dismiss her Chapter 13 case. Thereafter, the bankruptcy court dismissed Debtor's

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[1] Debtor filed her Chapter 13 case in the United States Bankruptcy Court for the Western District of Texas. The Bankruptcy Judges for the Western District of Texas have adopted a Standing Order adopting a District Form Chapter 13 Plan in accordance with Federal Rules of Bankruptcy Procedure 3015(c) and 3015.1 ("Form Plan").
[2] During her Chapter 13 case, Debtor did not reside in the Real Property. Debtor wanted to make repairs to the Real Property so that she could move into it and eliminate monthly rental expenses or derive rental income.
[3] The Form Plan allows a debtor to retain tax refunds received while the Chapter 13 case is pending, subject to an annual limit of $2,000. To the extent tax refunds exceed $2,000, the Form Plan provides that such funds shall be turned over to the Chapter 13 trustee as additional disposable income.

case and entered an order denying her motion to retain her 2017 tax refund.

The district court affirmed the bankruptcy court's determination, finding that it was not reasonably necessary for Debtor to retain her 2017 tax refund to repair the Real Property–particularly when the bankruptcy court offered the alternative of allowing Debtor to amend her monthly budget to include improvements to the Real Property.

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Eighth Circuit

Page v. JP Morgan Chase Bank,
No. 18-6011, 592 B.R. 334 (B.A.P. 8th Cir. Nov. 20, 2018)

In 2006, debtor Richelle Page obtained a loan from Chase Bank through its Education One Undergraduate Loan Program. The loan instruction sheet directed applicants to submit the agreement either by regular mail or expedited delivery to The Educational Resources Institute, Inc. ("TERI"), a non-profit organization. The loan was later sold to the National Collegiate Student Loan Trust ("NCSLT").

Page filed for bankruptcy in 2010. The bankruptcy court entered a discharge order providing that certain debts, including those for most student loans, were not discharged. Six years later, Page filed a complaint seeking a determination that her student loan debt was not excepted from discharge. NCSLT moved for summary judgment, seeking a finding that the loan was nondischargeable under section 523(a)(8). The bankruptcy court granted NCSLT's motion for summary judgment.

Section 523(a)(8)(A)(i) creates an exception from discharge for "an educational . . . loan made, insured, or guaranteed by a governmental unit, or made under any program funded in whole or in part by a governmental unit or nonprofit institution."

On appeal, Page first challenged the bankruptcy court's finding that the loan met the definition of "educational loan." Regardless of the loan's commercial features, which Page pointed out, the panel looked to the original purpose of the loan finding that it met the test for "educational loan," because it was identified as an "undergraduate loan," was made through an education loan program, covered the academic year, and specified that Page was enrolled in school.

Next, the panel addressed whether the loan was "funded" by the nonprofit, TERI. The bankruptcy court determined because TERI was included in the mailing instructions for processing the applications, TERI at least spent some resources on the facilities where the processing occurred, sufficient to qualify for Section 523(a)(8)(A)(i).

The panel, however, disagreed with the broad interpretation of the term "funded," finding it inconsistent with Congress' intent that exceptions to discharge be narrowly construed against the creditor and liberally in favor of the debtor. The panel stated that it was not established that TERI guaranteed the loans, processed the loans, or even received all the loans. TERI merely provided an address to which applications could be delivered, which was not sufficient to support the inference that TERI "funded" this loan program.

The panel reversed and remanded, instructing to the bankruptcy court to consider whether TERI guaranteed the loan or was otherwise more than peripherally involved in its processing.

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Ninth Circuit

Wilson v. Rigby,
909 F.3d 306 (9th Cir. 2018)

In *Wison v. Rigby*, the 9th Circuit affirmed the district court's affirmance of the bankruptcy court's order denying Debtor's request to amend Schedule C to claim a Washington homestead exemption in post-petition appreciation of Debtor's residence.

Debtor Debra Wilson filed a Chapter 7 petition on December 18, 2013 and claimed the federal "wildcard" exemption for her condo which she valued at $250,000 and which was encumbered by a $246,440 secured claim. The property appreciated during the pendency of the case and on July 18, 2016, Debtor amended Schedule C and claimed the Washington homestead exemption. Debtor listed the value of the property as $412,500. The Trustee opposed the amendments. The bankruptcy court held that Debtor could not amend her exemptions in light of post-petition changes in value and limited Debtor's exemption to $3,560.

The Ninth Circuit reasoned that exemptions are fixed on the filing date and the snapshot rule also fixes the value that debtors are entitled to claim. The Panel distinguished prior precedent

involving California law, which allowed debtors to benefit from post-petition appreciation, on the basis that California's homestead exemption is a "fixed dollar value, based on demographic criteria—not home equity," and Washington's statute allows "the lesser of (1) the total net value of the [homestead]…or (2) the sum of one hundred twenty-five thousand dollars…" The Panel held that Washington law fixed the "total net equity" on the petition date.

Sitting by designation, Judge Huck dissented and wrote that binding Ninth Circuit precedent and fundamental bankruptcy principles require that debtors be allowed to exempt post-petition appreciation up to statutory limits. Judge Huck argued that the distinction between Washington and California law is illusory because all capped homestead exemptions are necessarily limited by the equity in the property. Judge Huck noted that of the nine states in the Ninth Circuit, seven limit the dollar amount of the homestead exemption while two limit the dollar amount and the acreage.

Judge Huck wrote that *Alsberg v. Robertson (In re Alsberg)*, 68 F.3d 312 (9th Cir. 1995) and other Ninth Circuit precedents cannot be legally distinguished because as stated by the Ninth Circuit in *In re Gebhart*, 621 F.3d 1206, 1211 (9th Cir. 2010), all capped homestead exemption schemes are treated the same way. Finally, Judge Huck reasoned that the majority opinion runs counter to fundamental principles of bankruptcy including (1) liberal interpretation of exemption statutes; (2) inability of a court to deny an exemption absent an explicit provision of the code; and (3) permission of debtors to amend schedules as a matter of course.

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Tenth Circuit

Renfrow v. Grogan (In re Renfrow),
Adv. Pro. No. 17-1027-R, 2018 WL 6131768 (Bankr. N.D. Okla. Nov. 20, 2018)

The matter before the court was defendants' motion for summary judgment on debtor-plaintiff's complaint alleging violations of the discharge injunction under section 542(a)(2) by prosecuting until judgment a claim based on pre-bankruptcy debt. The court first rejected defendants' contention that the court lacked subject matter jurisdiction under the Rooker-Feldman doctrine, explaining that because the debtor-plaintiff commenced the action prior to entry of the state court judgment the debtor-plaintiff was not, at that time, a "state-court loser." The court explained that the Rooker-Feldman doctrine "does not strip a federal court of properly assumed jurisdiction if a state court thereafter enters a judgment on the same or a similar matter." Next, the court rejected defendants' contention that the debtor-plaintiff was precluded by issue preclusion or collateral estoppel from asserting a violation of the discharge injunction, explaining in part that

because the debtor-plaintiff had perfected an appeal of the state court judgment it is not final for issue preclusion purposes. Regarding the debtor-plaintiff's request for the court to hold the defendants in contempt for violating the discharge injunction, the court stated that defendants had actual knowledge of debtor-plaintiff's bankruptcy proceeding and there was no allegation that defendants' actions were unintentional. Continuing, the court stated that debtor-plaintiff did not have to prove that defendants had the specific intent to violate the discharge injunction, and that whether their conduct violated the discharge injunction depended on the resolution of facts that are in genuine dispute. Accordingly, the court denied the defendants' motion for summary judgment.

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