Bankruptcy Circuit Update

Featuring cases from September 2016

Special Announcement
Group Section Conference Call to Discuss Significant Cases

This month our writers Circuit Writers and Section Leaders will be convening our third section-wide conference call on **Friday, November 18th, at 4:00 E.S.T./1:00 P.S.T**. to present and discuss notable cases from the past few months of the summaries. Volunteers will be summarizing significant or interesting cases. The presenters will be open for questions and lead discussion of key points. We hope you will join us for this call. The call-in information is: **dial in 866-690-2070 – code 787-594-2077**. We had a good first kick-off to this section-wide conference call last month and are looking forward to the second call! If any section–members, whether or not you are a Circuit Writer, would like to volunteer to discuss a significant case or recent bankruptcy development, please e-mail us at csullivan@diamondmccarthy.com.

First Circuit

Perez v. Deutsche Bank Nat'l Trust Co. (In re Perez)
BAP NO. MS 16-007, 2016 WL 5462453 (B.A.P. 1st Cir., September 28, 2016)

Debtor filed a chapter 13 bankruptcy on the Sunday evening before a foreclosure auction scheduled for Tuesday at 10:00 AM. Due to extreme weather, the creditor's counsel did not receive the debtor's counsel's voice message providing notice of the filing until 12:00 PM on Tuesday. In the meantime, the creditor had already decided to postpone the sale due to the weather until the following day. Upon receiving notice of the filing, the creditor then further postponed the sale. The Debtor argued that the creditor violated the automatic stay because of the two post-petition foreclosure sale continuances.

The Panel noted that First Circuit precedent and a majority of cases hold that post-petition postponement of a foreclosure sale is not a stay violation. At oral argument, the Debtor's counsel conceded that the creditor did not have notice of the bankruptcy before the first continuance but argued that the second continuance was a willful violation of the automatic stay. The Panel rejected the Debtor's argument that any post-petition postponement violates the automatic stay and held that *Martir Lugo v. De Jesus Saez (In re De Jesus Saez*), 721 F.2d 848 (1st Cir. 1983) controlled. *De Jesus* specifically held that postponing and re-advertising a foreclosure sale post-petition were "preparatory acts" that did not violate the automatic stay. Accordingly, the bankruptcy court's order denying the Debtor's Motion for Finding of Breaches of the Automatic Stay and Damages was affirmed.

Submitted by:
Sabrina C. Beavens, Esquire
Iurillo Law Group, P.A.

125 Brewery Lane, Suite 7
Portsmouth, NH 03801
Email: sbeavens@iurillolaw.com

Second Circuit

Licata v. Coan (In re Licata),
Case No. 15-3172, 2016 WL 4598573 (2d Cir., September 2, 2016)

The Second Circuit affirmed the judgment of the district court affirming the dismissal of an appeal filed by Chapter 7 debtor-appellant James J. Licata ("Licata"). In the bankruptcy court, Licata had appealed an order approving the settlement of certain disputed claims involving an asset sale, and the bankruptcy court found that Licata lacked standing to challenge the settlement because he failed to demonstrate a pecuniary interest in the estate. On appeal, the district court held that the bankruptcy court's findings were not clearly erroneous and that consequently Licata lacked standing to challenge the settlement.

The Second Circuit began its analysis by noting that a Chapter 7 debtor only has standing to object to an asset sale if there could be a surplus after all creditors' claims are paid. To establish standing, the Chapter 7 debtor has the burden of showing that there is at least a reasonable possibility of a surplus. Here, the bankruptcy court found that Licata did not have standing because he failed to show that there was a reasonable possibility that there could be a surplus after the estate paid the $120 million it owed in unsecured claims.

To prove a reasonable possibility of a surplus, Licata relied on a one-page letter submitted to the bankruptcy court by a New Jersey real-estate firm, which opined that the disputed assets had a value in excess of $1 billion. The Second Circuit noted, however, that this valuation was belied by the actual, substantially lower offers for the same property received over several years. In fact, between 2006 and 2013, the bankruptcy court had conducted three auctions to sell the assets and the highest offer received was only $12.6 million. The Second Circuit also noted that the letter was not sworn to and that the record was silent as to the qualifications of the author. The Second Circuit thus held that the bankruptcy court did not abuse its discretion in concluding that the letter "was both vague and of insignificant probative value," and accordingly, the Second Circuit held that the bankruptcy court did not err in holding that Licata lacked standing.

Submitted by:
Bram A. Strochlic
Skadden, Arps, Slate, Meagher & Flom LLP
Four Times Square
New York, NY 10036-6522
Email: bstrochl@skadden.com

Third Circuit

Bertucci v. Elian (In re Elian),
15-3415, 2016 WL 5390343 (3d Cir., Sept. 27, 2016)(Not Precedential)

In a non-precedential opinion, the Third Circuit reinforced that the reckless indifference to the truth is the functional equivalent of fraud for purposes of denying a discharge under § 727(a)(4). The debtor's failure to disclose numerous assets and amendment of schedules only after its discovery resulted in a false oath that could not be undone by the subsequent amendment. Further, the court confirmed that a loan application showing $1.15 million in liquid assets completed 19 months prior to the petition, without evidence to corroborate where the assets were lost or why the document was inaccurate, was sufficient to deny discharge under § 727(a)(5).

Submitted by:
Elizabeth L. Gunn
Office of the Attorney General
Division of Child Support Enforcement
Email: elizabeth.gunn@dss.virginia.gov

Fifth Circuit

In re Scarbrough,
--- F. 3d ---, 2016 WL 4575566 (5th Cir. Sept. 1, 2016)

Beginning in 2012, attorney-debtor Jerry Scarbrough represented a client in a Texas state court proceeding brought by a third party against Helen Pursur, JoAnn Pursur, Sue Pursur, Gary Pursur and Elizabeth Tipton (collectively, "Appellees"). In that action, Scarbrough advanced a scorched earth litigation strategy in which he, among other things, concealed evidence and accused certain of the Appellees of drug use, elder abuse, and murder. As a result, Scarborough was sanctioned by the state court, and Appellees obtained several judgments against him for fraud, civil conspiracy, and defamation.

After Scarbrough filed for Chapter 7 bankruptcy in June 2012, Appellees brought an adversary proceeding pursuant to 11 U.S.C. § 523(a)(2), (4), and (6), claiming Scarbrough's debts arising from the state court judgments were non-dischargeable based on fraud and willful and malicious conduct. After granting partial summary judgment and presiding over a nine-day trial, the bankruptcy court found in favor of Appellees, and the district court affirmed. Scarbrough appealed to the Fifth Circuit.

First, Scarbrough argued Appellees' amended complaint seeking non-dischargeability of his sanctions debt was time-barred because it was filed outside of the 60-day deadline set forth in Bankruptcy Rule 4007(c). The Fifth Circuit disagreed, finding the amendment merely added facts supporting the allegations in the original complaint and therefore related back to Appellee's original pleading.

Second, Scarbrough attacked the conclusion that his debts were non-dischargeable under the § 523(a)(2) exception for fraud, which requires proof of: (1) a knowing false representation by the debtor; (2) made with intent to deceive a creditor; (3) on which the creditor actually and justifiably relied; and (4) which reliance proximately caused a loss to the creditor. Scarbrough argued the court erred in applying collateral estoppel to certain elements of the Appellees' fraud claim that were considered by the state court jury but allowing other elements to proceed to trial. Specifically, he claimed that once the court determined certain elements must be litigated, all elements of the claim should have been litigated. The Fifth Circuit summarily determined the bankruptcy court's separation of the issues was proper. Scarborough also claimed the jury's findings did not meet § 523(a)'s requirements because there was no finding he received a direct benefit as a result of his fraud. In rejecting this contention, the Fifth Circuit recognized a creditor is not required to show a direct benefit to the debtor to prove dischargability--an indirect benefit is sufficient.

Third, the Fifth Circuit affirmed the bankruptcy court's finding that Scarbrough's sanctions, fraud, and defamation judgment debts were non-dischargeable under §523(a)(6) as willful and malicious conduct. In short, the Court found Scarbrough's false allegations of drug use, elder abuse, and murder, among other things, satisfied the willful and malicious standard.

Finally, Scarbrough claimed the bankruptcy court's application of collateral estoppel to the jury's damage findings for both fraud and defamation was improper because they were based on multiple acts by Scarbrough. The Fifth Circuit, however, held these damage findings were independently sufficient to support the judgment and therefore precluded re-litigation in the subsequent bankruptcy case.

Submitted by:
Sarah Williams
Kirkland & Ellis LLP
600 Travis, Suite 3300
Houston, TX 77002
Email: sarah.williams@kirkland.com

Ninth Circuit

***Deocampo v. Potts*,**
— F3d —, 2016 WL 4698299 (9th Cir., September 08, 2016)

In *Deocampo v. Potts*, the Ninth Circuit affirmed the district court's denial of a Rule 60 motion and held that a judgment for compensatory damages and attorneys' fees against City of Vallejo ("Vallejo") police officers for excessive force against plaintiffs Deocampo, Grant, and Berry ("Plaintiffs"), was not discharged by Vallejo's confirmed chapter 9. The panel held that Vallejo's statutory obligation to indemnify the individual officers was also not discharged.

The officers argued that even though the judgment was against them personally, it should be treated as a personal obligation of Vallejo because California Government Code §825 required Vallejo to indemnify the officers for §1983 claims. Therefore, the judgment should be limited to plan treatment of 20-30% for litigation claims with the remainder discharged.

The Ninth Circuit held that Plaintiffs could only enforce the judgment against the officers and not Vallejo and that the indemnity statute created a "purely intramural arrangement between a state and its officers." Without deciding on the propriety of such, the panel noted that the Plan did not provide for third-party releases of claims against the officers. Finally, the Court held that any obligation to indemnify only arose when Vallejo undertook the officers' defense which occurred post-petition and therefore could not have been discharged under the plan.

Submitted by:
Jeffrey Coe
Mesch Clark Rothschild
259 N. Meyer Ave.
Tucson, AZ 85701
Email: jcoe@mcrazlaw.com

Picerne Construction Corporation, dba Camelback Construction v. Castellino Villas, A.K.F. LLC (In re Castellino Villas, A.K.F. LLC),
2016 WL 4608146 (9th Cir. Sept. 6, 2016).

In *Picerne v. Castellino*, the Ninth Circuit affirmed the district court's affirmance of the bankruptcy court's order denying a motion for post-discharge attorneys' fees arising from state court litigation and held that attorneys' fees incurred during litigation after confirmation of the debtor's Chapter 11 bankruptcy plan were discharged by that bankruptcy.

Castellino and Picerne first entered into an agreement, whereby Picerne would construct an apartment complex on Castellino's property. This agreement contained a provision awarding the prevailing party attorneys' fees in any action arising from their agreement. Castellino, however, defaulted on its obligation and failed to pay Picerne. In response, Picerne filed a mechanic's lien against the apartment complex and filed a complaint in state court against Castellino to foreclose on its mechanic's lien. Castellino, thereafter, filed a Chapter 11 petition for bankruptcy. Picerne and Castellino eventually entered into a settlement agreement in light of Picerne's objection to Castellino's proposed plan of reorganization. This settlement agreement provided, among other things, that if Picerne's state court action resulted in a determination that its mechanic's lien was a valid, properly perfected, and enforceable mechanic's lien against the Castellino property, then Picerne would receive payments from the Castellino's trust account. The attorneys' fees, however, were still in contention. The bankruptcy approved the settlement agreement and discharged Castellino from bankruptcy. A judgment in favor of Picerne was entered in state court. Picerne then moved for attorneys' fees but the state court held that it lacked authority to adjudicate or award attorney's fees. While appealing this decision, Picerne also moved the bankruptcy court for

a ruling that the state court had authority to award attorneys' fees. The bankruptcy court, however, denied the motion. Because Picerne's claim arose before Castellino filed its petition, the unliquidated and contingent claim was discharged by confirmation of Castellino's plan of reorganization. The district court affirmed the bankruptcy court's order.

Before the Ninth Circuit, Picerne largely argued that its claim for attorneys' fees arising from the state court litigation arose after Castellino filed its bankruptcy petition and thus was not discharged by the confirmation of Castellino's plan of reorganization. Relying on the Circuit's prior decisions in *Ybarra* and *Seigal*, Picerne maintained that when a debtor voluntarily "returns to the fray" of litigation that began before the filing of the petition, the debtor was not free from liability for attorneys' fees incurred after discharged. The panel for the Ninth Circuit, however, disagreed.

Refusing to read *Ybarra* and *Siegal* broadly, the Ninth Circuit stated the Picerne, a creditor – not Castellino, the debtor – chose to return to the fray of litigation or undertook a new course of litigation. Furthermore, given that Picerne and Castellino entered into a prepetition contract containing the attorneys' fees provision, Picerne could have fairly or reasonably contemplated that it would have a claim for attorneys' fees under the "fair contemplation" test. Accordingly, Picerne's claim arose prepetition and thereby, the district court's determination that the claim was discharged when the bankruptcy court confirmed Castellino's plan was correct.

Submitted by:
Karen Diep
Diamond McCarthy LLP
150 California Street, Suite 2200
San Francisco, CA 94111
Email: kdiep@diamondmccarthy.com

Tenth Circuit

Rhino Energy LLC v. C.O.P. Coal Dev. Co.,
No. 15-4108, 2016 WL 4943500 (10th Cor. Sept. 16, 2016) (unpublished).

The Tenth Circuit dismissed an appeal of an order entered by a district court which reversed a bankruptcy court's determination that it lacked jurisdiction to hear certain claims and counter-claims before it in an adversary proceedings. The district court remanded the claims to the bankruptcy court to determine them, in the summary judgment context in which they were presented, in the first instance. The counter-claimants appealed the district court's order to the Tenth Circuit; the claimant moved to dismiss the appeal for lack of jurisdiction given the remand. The Tenth Circuit, relying on prior precedent, *Cascade Energy & Metals Corp. v. Banks (In re Cascade Energy & Metals Corp.)*, 956 F.2d 935 (10th Cir. 1992), held that the district court's order was not final for purposes of appeal due to the remand, meaning that the Tenth Circuit lacked jurisdiction over the appeal. Finally, the Tenth Circuit addressed the counter-claimants' argument that the court could exercise jurisdiction under the collateral order doctrine,

rejecting the contention because the order of the district court was ultimately reviewable on appeal.

Clabaugh v. Grant (In re Grant),
No. 16-6062, 2016 WL 5210793 (10th Cir. Sept. 20, 2016) (unpublished).

The Tenth Circuit affirmed the BAP's decision which affirmed a bankruptcy court's order avoiding a judicial lien impairing the debtor's homestead exemption. The appellant had recorded a $1.25 Million judgment she obtained prepetition against the debtor which had listed his residence as exempt as his homestead. The bankruptcy court granted the debtor's motion to avoid the judgment creditor's lien under Code § 522(f)(1)(A). The BAP affirmed, as did the Tenth Circuit which first rejected arguments challenging the debtor's homestead exemption because the judgment creditor relinquished the objections she previously asserted before the bankruptcy court. The Tenth Circuit then rejected the judgment creditor's contention that the bankruptcy court could have denied the motion to avoid her lien due to equitable reasons, including that the debt to her was deemed nondischargeable under § 523(a)(6). The Tenth Circuit relied upon *Law v. Siegel*, 134 S. Ct. 1188 (2014) which held that the Bankruptcy Code does not confer "a general equitable power in bankruptcy courts to deny exemptions based on a debtor's bad-faith conduct." 134 S. Ct. at 1197. And it rejected the judgment-creditor's attempt to distinguish the facts before the bankruptcy court and those in Siegel.

Submitted by:
Paul Avron
Berger Singerman
One Town Center Road, Suite 301
Boca Raton, FL 33486
Phone: (561) 241-9500
Email: PAvron@bergersingerman.com

Eleventh Circuit

***Steffen v. Menchise* --- Fed. Appx. ----,**
2016 WL 4608124 (11th Cir. Sept. 9, 2016)

Appellant in three consolidated appeals, appealed the district court's order affirming the bankruptcy court's entry of default judgment in an adversary action filed by the Government and the district court's dismissal of an appeal from two related cases on procedural grounds. Both the Trustee (Menchise) and the Government filed an adversary proceedings objecting to the Debtor's discharge—the adversary proceedings were consolidated by the bankruptcy court.

After the debtor failed to attend a deposition, the bankruptcy court granted the Government's motion for sanctions and ordered that the debtor attend a deposition until completed. Despite sufficient advance notice, the debtor appeared at the deposition without an attorney and

then refused to answer questions without grounds to do so despite the bankruptcy court's prior order that the deposition should continue despite objections. The bankruptcy court sanctioned the Debtor by entering a default judgment against the Debtor. As a result of the default judgment, the bankruptcy court denied the Debtor's discharge.

The Court held that bankruptcy court did not abuse its discretion in imposing a default judgment as a sanction for failing to comply with discovery order where the Debtor repeatedly engaged in discovery delays and failed to act in good faith to complete discovery requirements.

Arnold, Plaintiff-Appellant, v. Bayview Loan Servicing
--- Fed.Appx. ----, 2016 WL 4750211 (11th Cir. Sept. 9, 2016)

Bayview sent Arnold two mortgage statements in December 2013, a year after Arnold received a discharge in his bankruptcy case and several weeks after the property had been foreclosed. Arnold alleged that the issuance of the mortgage statements violated the Fair Debt Collection Practices Act.

The Court affirmed the district court's granting of summary judgment. Bayview raised the "bona fide error" defense, which provided a narrow carve-out to the general rule of strict liability. In asserting this defense, the debt collector must show that the act (1) was not intentional; (2) was a bona fide error; and (3) occurred despite the maintenance of procedures reasonably adapted to avoid any such error.

In affirming the district court, the Court concluded that the act was not intentional and that record established ample evidence to show that the December statements were sent to Arnold due to what could only be described as a mistake—accidently changing one character in one field such that the computerized system began sending out statements automatically. In addition, the alternative procedures advanced by Arnold would not have cured the alleged violation since it too was susceptible to human error.

Submitted by:
Susan Heath Sharp
Stichter, Riedel, Blain & Postler, P.A.
110 East Madison Street, Suite 200
Tampa, Florida 33602
Email: ssharp@srbp.com