2019 WL 3330808
United States Court of Appeals, Second Circuit.

IN RE: Alice Phillips BELMONTE, Debtor.
Harold D. Jones, Plaintiff-Appellee,
v.
The Brand Law Firm, P.A. Defendant-Appellant.

Docket No. 18-2098-bk
|
August Term, 2018
|
Submitted: May 30, 2019
|
Decided: July 25, 2019

Synopsis

Background: Chapter 7 trustee brought adversary proceeding to set aside postpetition fee payment to debtor's attorneys as being in nature of unauthorized postpetition transfer. The United States Bankruptcy Court for the Eastern District of New York, Trust, J., avoided the postpetition transfer and ordered law firm to remit $59,432 to the trustee. The District Court, Azrack, J., affirmed, and the firm appealed.

[Holding:] The Court of Appeals, Lynch, Senior Circuit Judge, held that trustee's recovery of a portion of $250,000 mortgage loan proceeds that debtor transferred postpetition to attorneys as payment for representing her in a criminal proceeding did not constitute a double recovery.

Affirmed.

Procedural Posture(s): Judgment; On Appeal.

West Headnotes (6)

[1] Bankruptcy
Conclusions of law; de novo review

Review by Court of Appeals of a district court's order in its capacity as an appellate bankruptcy court is plenary, and the factual determinations and legal conclusions of the bankruptcy court are therefore reviewed independently by Court of Appeals.

1 Cases that cite this headnote

[2] Bankruptcy
Clear error

Bankruptcy court's findings of fact are reviewed for clear error.

Cases that cite this headnote

[3] Bankruptcy
Conclusions of law; de novo review

Bankruptcy court's legal conclusions are reviewed de novo.

1 Cases that cite this headnote

[4] Bankruptcy
Post-petition transactions

Bankruptcy
Avoidance rights and limits thereon, in general

The bankruptcy court has broad discretion in applying the Bankruptcy Code's postpetition transfer avoidance provision as well as in ordering the return of transferred property or its value. 11 U.S.C.A. §§ 549, 550.

Cases that cite this headnote

[5] Bankruptcy
Avoidance rights and limits thereon, in general

Chapter 7 trustee's recovery of a portion of $250,000 mortgage loan proceeds that debtor transferred postpetition to attorneys as payment for representing her in a criminal proceeding did not constitute a double recovery, as the estate realized none of the equity value of the mortgage for the benefit of the creditors and did not obtain title to real property. 11 U.S.C.A. §§ 549, 550(d).

Cases that cite this headnote

[6] Bankruptcy

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Avoidance rights and limits thereon, in general

Trustee may pursue recovery of avoided postpetition transfer from all available sources until the full amount of unlawfully transferred estate property is fully realized for the estate's creditors. 11 U.S.C.A. §§ 549, 550.

1 Cases that cite this headnote

Appeal from the United States District Court for the Eastern District of New York (Azrack, *J.*).

Attorneys and Law Firms

Robert N. Michaelson, Rich Michaelson Magaliff, LLP, New York, NY, for Plaintiff-Appellee.

Craig A. Brand, The Brand Law Firm, P.A., Orlando, FL, for Defendant-Appellant.

Before: Calabresi, Lynch, and Lohier, Circuit Judges.

Opinion

Gerard E. Lynch, Circuit Judge:

***1** While an involuntary bankruptcy petition was pending against her, Alice Belmonte (the "Debtor"), executed a second mortgage on property of her bankruptcy estate in exchange for a $250,000 loan. She then transferred the loan proceeds to the Brand Law Firm ("Brand") as payment for representing her in a criminal proceeding. Harold D. Jones, the trustee of the Debtor's estate (the "Trustee"), sought to have the mortgage and the transfer of the $250,000 loan avoided as illegal post-petition transfers of the estate's property. He also sought to recover for the estate the $250,000 that had been illegally transferred to Brand. Brand opposed, arguing that the Trustee's recovery of any part of the $250,000 from Brand violated 11 U.S.C. § 550(d), which limits a trustee to a single recovery of the illegally transferred property. The Bankruptcy Court for the Eastern District of New York (Alan S. Trust, *J.*) avoided the two post-petition transfers and also ordered Brand to remit $59,432 of the proceeds of the loan to the Trustee. The United States District Court for the Eastern District of New York (Joan M. Azrack, *J.*) affirmed the bankruptcy court's order. Both the bankruptcy court and the district court rejected Brand's argument that the Trustee's recovery of the $59,432 from Brand constituted a double recovery for the estate. For the reasons that follow, we AFFIRM the judgment of the district court.

BACKGROUND

On October 5, 2012 (the "Petition Date"), an involuntary petition for bankruptcy was filed against the Debtor pursuant to Section 303(b) of the Bankruptcy Code in the Bankruptcy Court for the Eastern District of New York. The Debtor hired Craig Brand, a criminal defense and commercial litigator, and the proprietor and sole employee of Brand, to represent her in the bankruptcy proceedings.

On December 13, 2012, the bankruptcy court entered an order enjoining the Debtor from transferring any property pending resolution of the involuntary petition. At such time, the Debtor and her husband, William Belmonte ("Belmonte"), owned the home and property located at 5 Crescent Court, Wading River, Suffolk County, New York (the "Crescent Court Property"), as tenants by the entirety. The Crescent Court Property was subject to a first mortgage dated October 4, 2011, issued by the Debtor and Belmonte in favor of People's United Bank in the original principal sum of $460,000. As of the Petition Date the Debtor estimated the value of the Crescent Court Property at $721,000. Under state law, the Debtor, as a tenant by the entirety with her husband, possessed an undivided 50% interest in the home's equity, meaning that half of the roughly $260,000 equity cushion in the Crescent Court Property belonged to the Debtor.

On April 8, 2013, the bankruptcy court held a trial on the involuntary petition against the Debtor. Then, on April 26, 2013, the court adjudicated the Debtor bankrupt and entered an order for relief against her, placing her into Chapter 7 bankruptcy. At that time the Debtor's interest in the Crescent Court Property, which consisted of half of the equity in the Crescent Court Property that was unencumbered by the first mortgage (roughly $130,000), became property of her bankruptcy estate (the "Estate"). By force of 11 U.S.C. § 362, an automatic stay was imposed prohibiting the transfer of property belonging to the Estate.

***2** On October 17, 2013, the Debtor was arrested pursuant to a 49-count indictment filed in the Supreme Court of the State of New York, New York County, which alleged, *inter alia*, that the Debtor had engaged in a scheme to defraud, and had committed grand larceny against, certain creditors of the Estate. The Debtor hired Brand and two other attorneys,

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Brian D. Waller and Thomas A. Sadaka, to represent her in the criminal proceedings.

In order to fund her defense in the criminal case, Patrick Thompson, a personal friend of the Debtor, agreed to lend $250,000 (the "Thompson Loan") to the Debtor and her husband, secured by a lien on the Crescent Court Property (the "Second Mortgage"). In January 2014, Craig Brand drew up the paperwork for the transaction by which Belmonte and the Debtor executed a promissory note in favor of Thompson, and by which Belmonte, on his own behalf and via power of attorney for the Debtor, executed the Second Mortgage in favor of Thompson. At the time that the Second Mortgage was executed both Thompson and Belmonte knew of the bankruptcy case pending against the Debtor.

To effectuate the funding of the Debtor's criminal defense, Thompson wired the $250,000 loan from one of his wholly owned subsidiaries to Brand in two separate installments. Per an agreement between Brand and the Debtor's other two criminal defense attorneys Brand transferred $73,147 to Sadaka and $54,490 to Waller as payment for their legal services. Brand retained $118,864 of the Thompson Loan.

On November 21, 2014, the Trustee filed an adversary proceeding in the bankruptcy court against the Debtor, Belmonte, and Thompson, seeking to avoid the Second Mortgage. The Trustee alleged that the mortgage was a transfer of the Estate's property that violated the automatic stay on any transfers of the Estate's property. He thus sought to have the transaction avoided pursuant to 11 U.S.C. § 549, which allows a trustee to avoid a transfer of property of an estate that occurs after the commencement of the bankruptcy case and is not otherwise authorized by the Bankruptcy Code or by the court. On February 27, 2015, the bankruptcy court approved a settlement between the Trustee and Thompson, in which the adversary proceeding against Thompson was dismissed, the Second Mortgage was avoided pursuant to § 549, and the lien created by the Second Mortgage was preserved for the benefit of the Debtor's Estate pursuant to § 551.

In April 2015, the Trustee filed an adversary proceeding against Belmonte seeking to force the sale of the Crescent Court Property pursuant to 11 U.S.C. § 363(h), which allows a trustee to sell property in which the estate has an interest, despite the interest of a non-debtor co-owner, if various criteria are satisfied. A trial in that proceeding was held on March 29, 2016, and the bankruptcy court subsequently entered an oral order denying the forced sale. The bankruptcy court recognized that the Estate held a lien on the Crescent Court Property by virtue of the avoided Second Mortgage, and that a sale would allow the Trustee to realize the value of the Estate's interest in the property for the benefit of the creditors. However, mindful that the Crescent Court Property was owned as a tenancy by the entirety, [1] the bankruptcy court refused to approve the sale of the Crescent Court Property on the ground that noneconomic factors—Belmonte's and his daughter's interest in remaining in their home—outweighed the economic benefit to the Estate.

***3** Almost simultaneously with his filing the proceeding against Belmonte to compel the sale of the Crescent Court Property, the Trustee also filed a complaint in the bankruptcy court against Brand, seeking to have the Thompson Loan avoided. The Trustee alleged that the money the Debtor obtained from the Thompson Loan was property of the Estate, because the loan was secured by the Crescent Court Property and 11 U.S.C. § 541(a)(6) makes the "[p]roceeds, product, offspring, rents, or profits of or from property of the estate" also property of the estate. Because the transfer took place when the Debtor was not authorized to transfer Estate property, the Trustee concluded, the transfer of the Thompson Loan to Brand was avoidable pursuant to § 549. The Trustee therefore sought to recover the value of the Thompson Loan proceeds from Brand pursuant to 11 U.S.C. § 550(a), which allows a trustee to recover from the transferee "the property transferred, or ... the value of such property" to the extent that a transfer is avoided under § 549, "for the benefit of the estate."

In the answer to the complaint, Brand alleged that the Trustee's claim was barred by the election of remedies doctrine and the prohibition on double recovery, as a result of the Trustee's settlement with Thompson avoiding the Second Mortgage and preserving the lien created by the Second Mortgage for the benefit of the Estate. In a June 28, 2016, interlocutory order, the bankruptcy court rejected Brand's contention that, because the Trustee had successfully avoided the Second Mortgage, he was prohibited from recovering any of the loan proceeds as a double recovery. *See* *Jones v. Brand (In re Belmonte)*, 551 B.R. 723, 732 (Bankr. E.D.N.Y. 2016). The bankruptcy court reasoned that, "until finally paid, litigants may look to multiple parties to recover the same loss" and that here the Trustee had not recovered any of the $250,000 allegedly borrowed by the Debtor and transferred to the defendants. *Id.*

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The bankruptcy court held a bench trial in the Thompson Loan avoidance and recovery case against Brand on November 2 and 3, 2016. On March 16, 2017, the bankruptcy court ruled that the Thompson Loan transfer to Brand was avoidable under § 549 as an unauthorized transfer of the Estate's property. The only contested issue with respect to whether the Thompson Loan was avoidable was whether the Thompson Loan itself was property of the Estate. The court found that it was, reasoning as follows:

> The Debtor's interest in her home was, without question, property of the bankruptcy estate once the order for relief was entered, which happened ... eight months before the ... $250,000 loan was made. While the $250,000 was nominally transferred to [Brand] by an entity allegedly owned or controlled by Patrick Thompson, the true transaction based upon the record was a loan being made by Mr. Thompson or his entity to the Debtor and her non-filing spouse. That loan transaction was clearly evidenced by a note and mortgage drafted by Mr. Brand which created a lien against the Debtor's interest in her home and therefore a lien against this estate's interest in the Debtor's home. Under Section 541(a)(6), property of the estate clearly includes proceeds, products, offering, rents, or profits from property of the estate.

J. App'x at 598. The bankruptcy court concluded that because the Debtor transferred the Thompson Loan to Brand eight months after the entry of the order for relief in her Chapter 7 case, when she had no legal right to exercise control over property of the Estate, the transfer was avoidable pursuant to § 549.

The court then considered whether the Trustee, having successfully avoided the Thompson Loan pursuant to § 549, could also recover "the property transferred" or "the value of such property" pursuant to § 550(a). The court concluded that it could, and that the Trustee was entitled to a judgment for one-half of the Thompson Loan. [2]

***4** Although the bankruptcy court concluded that $125,000 of the Thompson Loan was recoverable by the Trustee, it held that only $59,432 was recoverable from Brand. That sum represented half of the $118,864 from the Thompson Loan that Brand retained after it paid the Debtor's other criminal defense attorneys. [3]

In its post-trial ruling, the bankruptcy court also addressed an objection filed by Thompson to the Estate's ability to recover any amount of the Thompson Loan received by Brand on the ground that such recovery would amount to a double recovery for the Estate, since the Second Mortgage had already been avoided. The court rejected this argument, explaining:

> The fact that the Court voided the second lien granted in favor of Mr. Thompson's entity does not by any circumstances create the prospect for a double recovery by the estate. The estate simply succeeded to any lien rights claimed by Mr. Thompson's entity against the Debtor's home. But recovering the fruits of that unauthorized transfer does not result in a double recovery.

J. App'x at 587.

Brand appealed to the district court, reiterating the argument made in Thompson's objection. It argued that when the Trustee settled with Thompson, and the Second Mortgage was avoided and the lien created by it was preserved for the Estate, the Trustee was restored to the position he had been in before the unauthorized transfers took place. The Trustee's recovery of an additional amount violated § 550(d)'s proscription that "[t]he trustee is entitled to only a single satisfaction under subsection (a) of this section" because the Trustee had already recovered the equity encumbered by the Second Mortgage. Thus, Brand argued that by recovering *both* the lien created by the Second Mortgage *and* any portion of the Thompson Loan, the Estate had obtained a double recovery.

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The district court issued an opinion and order on June 7, 2018, rejecting Brand's double recovery theory and affirming the bankruptcy court's judgment. The court concluded that Brand conflated two separate, if factually related, transactions: (i) the transfer of the Second Mortgage to Thompson; and (ii) the transfer of the $250,000 Thompson Loan to Brand. The district court explained that the avoidance of the Second Mortgage simply allowed the Debtor's Estate to assume the lien rights to the Crescent Court Property that had been improperly transferred to Thompson. That did not bar the Trustee from seeking to recover the loan proceeds the Debtor received from Thompson and then transferred to Brand.

The district court entered judgment on June 15, 2018, affirming the bankruptcy court's rulings. Brand now appeals from that judgment.

DISCUSSION

A. Standard of Review

[1] **[2]** **[3]** A district court's rulings when sitting as an appellate court in a bankruptcy case are subject to plenary review. *Denton v. Hyman (In re Hyman)*, 502 F.3d 61, 65 (2d Cir. 2007). "The factual determinations and legal conclusions of the [b]ankruptcy [c]ourt are, therefore, reviewed independently by this Court." *Id.* We review the bankruptcy court's findings of fact for clear error and its legal conclusions *de novo*. *Id.*

[4] The bankruptcy court has broad discretion in applying § 549's post-petition transfer avoidance provision as well as in ordering the return of transferred property or its value pursuant to § 550. *See, e.g.*, *Sapir v. C.P.Q. Colorchrome Corp. (In re Photo Promotion Assocs., Inc.)*, 881 F.2d 6, 8 (2d Cir. 1989) (noting bankruptcy court's broad discretion in applying § 549(a)); *see also Bankr. Receivables Mgmt. v. Lopez (In re Lopez)*, 345 F.3d 701, 705 (9th Cir. 2003) ("The bankruptcy court's choice of remedies is reviewed for an abuse of discretion."); *Feltman v. Warmus (In re Am. Way Serv. Corp.)*, 229 B.R. 496, 531 (Bankr. S.D. Fla. 1999) ("[T]he Code permits the court, in its discretion, to award *both* a money judgment *and* recovery of the property in kind, provided that the Trustees are limited to a single satisfaction."); *Hirsch v. Gersten (In re Centennial Textiles, Inc.)*, 220 B.R. 165, 176–77 (Bankr. S.D.N.Y. 1998) ("[S]ince the Bankruptcy Code does not provide guidance on when the Court should order payment of the value of property rather than order the return of the property itself, it is within the Court's discretion to make such a determination.").

B. The Trustee's Recovery of a Portion of the Thompson Loan from Brand Does Not Constitute a Double Recovery in Violation of § 550(d).

***5** **[5]** Because the Thompson Loan transfer was avoided pursuant to § 549, the Trustee was permitted to seek recovery of either the transferred property or its value pursuant to 11 U.S.C. § 550, which states, in relevant part:

> (a) Except as otherwise provided in this section, to the extent that a transfer is avoided under section 544, 545, 547, 548, 549, 553(b), or 724(a) of this title, the trustee may recover, for the benefit of the estate, the property transferred, or, if the court so orders, the value of such property, from --
>
> (1) the initial transferee of such transfer or the entity for whose benefit such transfer was made;
>
> or
>
> (2) any immediate or mediate transferee of such initial transferee.

The plain language of § 550(a) thus grants the Trustee the right to seek recovery of the Thompson Loan from Brand.

On appeal, Brand revives its argument that the Trustee's recovery of the Thompson Loan under § 550(a) constitutes a double recovery for the Estate in violation of § 550(d), which states that "[t]he trustee is entitled to only a single satisfaction under subsection (a) of this section." Brand argues that, through the Trustee's settlement with Thompson, which avoided the Second Mortgage and preserved the lien created by it for the benefit of the Estate, the Trustee had already recovered the Debtor's equity interest in the Crescent Court Property for the Estate. It contends that the settlement with Thompson restored the Estate to its pre-transfer position and that the Estate suffered no monetary damage as a result of the Second Mortgage. Thus, Brand argues that the bankruptcy court and the district court erred in concluding that the Thompson Loan was an additional recoverable asset of the Debtor's Estate.

We disagree, and conclude that the Trustee's recovery of a portion of the Thompson Loan from Brand does not violate

the single satisfaction rule of § 550(d). At the outset, we note that the bankruptcy court held that the Thompson Loan, which was secured by the Crescent Court Property, was a "proceed[ ]" of the Estate pursuant to § 541(a)(6). Brand argued before the district court that the Thompson Loan is not a proceed, and the district court disagreed. On appeal, Brand does not argue and, thus, has abandoned any claim that the district court erred in arriving at this conclusion. We therefore assume without deciding that the Thompson Loan is a proceed of the Estate for the purpose of resolving this appeal. *See, e.g.,* *Biediger v. Quinnipiac Univ.*, 691 F.3d 85, 98–99 & n.6 (2d Cir. 2012); *State St. Bank & Tr. Co. v. Inversiones Errazuriz Limitada*, 374 F.3d 158, 172 (2d Cir. 2004). Brand's argument hinges entirely on its reading of the double recovery provision of § 550(d). But Brand misapplies that provision to the facts of this case.

Section 550(d) most commonly applies in cases where § 550(a) enables a trustee to recover the value of transferred property from more than one transferee, "possibly allowing the trustee to recover more than the value of the avoided transfer." *See* *Dobin v. Presidential Fin. Corp. of Del. Valley (In re Cybridge Corp.)*, 312 B.R. 262, 268 (D.N.J. 2004). For example, had the Trustee here recovered $125,000 from Brand, and then subsequently sought to recover approximately $125,000 in proceeds of the Thompson Loan that was transferred by Brand to Sadaka and Waller, resulting in the collection of $125,000 two times over, § 550(d) would clearly be violated.

***6** Brand's § 550(d) argument is different, however. Brand contends that, when the Trustee successfully avoided the Second Mortgage, the Estate was restored to the position it was in before the avoided transfers, and that, as a result, recovering *any* amount of the Thompson Loan proceeds from it constitutes a double recovery for the Estate. But Brand misapprehends the nature of bankruptcy law, the language of § 550(d), and the economic realities of this case.

At the time the Trustee sought to recover the Thompson Loan from Brand, the Trustee had not realized any part, let alone all, of the value of the Debtor's equity interest in the Crescent Court Property. The Trustee's settlement with Thompson gave the Trustee the rights of a lien creditor with respect to the Crescent Court Property. But in itself, a mortgage carries only a right to foreclose on a debtor's property in the event of default. *See* *DeGiacomo v. Traverse (In re Traverse)*, 753 F.3d 19, 29 (1st Cir. 2014) ("Just because the preserved mortgage entitles the estate to benefit from the sale of [the debtor's] property ... does not mean that the trustee is by that fact empowered to sell the property so as to immediately realize that benefit."). Here, moreover, the bankruptcy court prohibited the Trustee from forcing a sale of the Crescent Court Property.

Because the Trustee was unable to liquidate the Estate's equity in the Crescent Court Property, preservation of the lien did not create any realized value for the Estate's creditors. The Trustee's settlement with Thompson did not provide for any payment to the Estate, let alone payment of the roughly $130,000 equity value of the Debtor's interest in the Crescent Court Property. Thus, while the lien on the Crescent Court Property was preserved for the benefit of the Estate, the Trustee's only route to realize any recovery for the Estate from the unlawful transfer of Estate property by the Debtor was by seeking the proceeds of the Thompson Loan.

[6] Section 550(a) authorizes the Trustee to pursue recovery from all available sources until the full amount of unlawfully transferred Estate property is fully realized for the Estate's creditors. *See* *Freeland v. Enodis Corp.*, 540 F.3d 721, 740 (7th Cir. 2008) ("[T]he trustee can recover from any combination of the entities mentioned [in § 550] subject to the limitation of a single satisfaction.") (quoting 5 COLLIER ON BANKRUPTCY ¶ 550.02[4] at 550–16 (Alan N. Resnick et al. eds., 15th ed. 2007)); *Aalfs v. Wirum (In re Straightline Invs., Inc.)*, 525 F.3d 870, 883 n.3 (9th Cir. 2008) ("Although the statute contains the conjunction 'or,' at least one court has held that the remedies of the value of the property or the property itself are not mutually exclusive, and the bankruptcy court may award a judgment that involves both types of recovery, as long as it does not result in double recovery for the estate.") (citing *Feltman,* 229 B.R. at 531); *Burtrum v. Laughlin (In re Laughlin)*, 18 B.R. 778, 781 (Bankr. W.D. Mo. 1982) ("[T]he value of the transferred property should be restored to the estate, even if composite elements of that value must come from more than one transferee."). By recovering a portion of the Thompson Loan proceeds from Brand, the Trustee merely expedited the ultimate satisfaction of the claim for the benefit of the creditors.

Brand cites *McCord v. Agard (In re Bean)*, 252 F.3d 113 (2d Cir. 2001), in which we held that the trustee had obtained a double recovery when the bankruptcy court ordered both a turnover of title to real property and a money judgment equal to the fair market value of that property. But even

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a cursory review of the facts of that case reveals why it is easily distinguishable. In *Bean*, the debtor sold the title to real property of the estate to the defendants for $165,000. *Id.* at 115. The debtor then used the proceeds of the sale to pay off two mortgages on the property totaling $87,761.65, a broker's commission of $9,990, and city and state transfer taxes of $2,310. *Id.* He then remitted the remaining $59,949.35 proceeds of the sale to the trustee. *Id.* The trustee brought an action in the bankruptcy court claiming that the sale of the property was an unauthorized post-petition transfer under § 549(a). *Id.* The bankruptcy court granted summary judgment in favor of the trustee against the defendants ordering both that the purchasers turn over title of the property to the estate, and that the defendants pay a money judgment in the amount of the property's fair market value. *Id.* The trustee admitted that since he had recovered the $60,000 net proceeds of the sale and the title to the real property, the further award of the $165,000 fair market value of the property was a windfall to the estate. *Id.* at 116.

***7** On appeal, we explained that the precise question was "whether § 550(a)(1) of the Code requires a bankruptcy court to permit a trustee to recover from the transferee and for the benefit of the estate, the fair market value of property that was the subject of an avoidable transfer, even after that trustee has already recovered the equity value of the property from the transferor." *Id.*

The issue before us is different from that in *Bean* precisely because the Trustee here has *not* recovered the equity value of the Second Mortgage. Unlike the debtor in *Bean*, the Debtor and Belmonte realized $250,000 in net proceeds by granting a mortgage to Thompson, remitted none of that money to the Estate, and instead transferred the entire proceeds directly to Brand. The Estate realized none of the equity value of the Second Mortgage for the benefit of the creditors and, notably, did not obtain title to real property. [4]

In *Seaver v. Mortg. Elec. Registration Sys., Inc. (In re Schwartz)*, 383 B.R. 119, 126 (8th Cir. B.A.P. 2008), a Bankruptcy Appellate Panel of the Eighth Circuit explained that "[i]n certain instances avoidance of a transfer is sufficient to undo the preferential transfer and make the estate whole ... [such as where] the avoidance results in the value of the avoided lien becoming available for liquidation and distribution to creditors." However, where (as here) avoidance does *not* result in the avoided lien becoming available for liquidation and distribution to creditors, § 550(d)'s single satisfaction rule is no obstacle to recovery by the Estate from other sources.

The Trustee here freely and correctly concedes that he is entitled to recover the value of the Crescent Court Property only once, whether as a result of his rights as the holder of the Second Mortgage, or from the recovery of the Thompson Loan proceeds. Appellee's Br. at 8–9. If the Trustee is eventually able to liquidate the Debtor's equity interest in the Crescent Court Property, his recovery will be the amount of the Debtor's equity interest less the $59,432 he has already recovered from Brand. But the Trustee's present recovery of a portion of the Thompson Loan from Brand is not barred by § 550(d).

CONCLUSION

For the reasons stated above, we AFFIRM the judgment of the district court.

All Citations

--- F.3d ----, 2019 WL 3330808, 67 Bankr.Ct.Dec. 138

Footnotes

1 Sometime after the trial, the Debtor and Belmonte divorced, which would have converted their interests in the Crescent Court Property from a tenancy by the entirety to a joint tenancy.

2 The court reasoned that, because the Thompson Loan was secured by a mortgage on the Crescent Court Property, in which the Estate held a 50% interest, half of the loan proceeds, or $125,000, was recoverable by the Trustee.

3 The bankruptcy court entered judgment solely against Brand because the record indicated that each of the payments were made to Brand and not to Craig Brand individually.

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4 That fact also distinguishes this case from the out-of-circuit cases that Brand cites in which avoidance and preservation of a lien were deemed enough to make the estate whole. *See* *Rodriguez v. Drive Fin. Servs., L.P. (In Re Trout)*, 609 F.3d 1106, 1109 (10th Cir. 2010) (concluding that where a trustee successfully avoided a preferential vehicle lien under 11 U.S.C. § 547, the trustee was not entitled to a money judgment equal to the value of the avoided liens under § 550(a) on facts before it, even though "there may be circumstances involving nonpossessory liens in which the Trustee is also entitled to permissive recovery under § 550(a)"); *Schnittjer v. Linn Area Credit Union (In re Sickels)*, 392 B.R. 423, 426 (Bankr. N.D. Iowa 2008) (concluding that "ordering [the transferee] to pay the trustee the value of its secured claim would allow the trustee to collect twice on the secured claim—once from [the transferee] and again by *realizing* on the preserved mortgage) (emphasis added) (alterations omitted).

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2019 WL 3540420
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United States Court of Appeals, Seventh Circuit.

IN RE: Scott N. JAFFE, Debtor-Appellee,
Appeal of: Laverne Williams.

No. 18-2726
|
Argued February 7, 2019
|
Decided August 5, 2019

Synopsis

Background: Chapter 7 debtor moved to avoid judgment lien on exemption-impairment grounds. The United States Bankruptcy Court for the Northern District of Illinois, A. Benjamin Goldgar, J., 568 B.R. 292, denied motion, and debtor appealed. The District Court, John J. Tharp, Jr., J., 2018 WL 2324351, reversed and remanded, and judgment creditor appealed.

Holdings: The Court of Appeals, Bauer, Circuit Judge, held that:

[1] under Illinois law, tenant by the entirety's contingent future interest in the entire real property that he owned as tenant by the entirety with his wife, in the event of wife's death, came within broad definition of the "real estate" to which creditor's judgment lien could attach, but

[2] debtor-attorney could not avoid, on exemption-impairment grounds, the judgment lien that his former client possessed to secure judgment debt for his alleged malpractice, at least not to extent that this lien had attached to debtor's contingent future interest in property.

Reversed and remanded.

Procedural Posture(s): On Appeal; Motion to Avoid Lien on Exemption Impairment Grounds.

West Headnotes (9)

[1] Bankruptcy
Judicial liens

On motion to avoid judgment lien on exemption-impairment grounds, court first had to determine whether a lien existed and what interests it attached to; if no lien existed, then debtor could not seek an exemption for purposes of avoiding it, and court's inquiry was complete. 11 U.S.C.A. § 522(f).

Cases that cite this headnote

[2] Bankruptcy
Judicial liens

On motion to avoid judgment lien on exemption-impairment grounds, if court determined that a judgment existed and that it attached to a property interest of debtor, court then had to determine whether that property interest was exempt. 11 U.S.C.A. § 522(f).

Cases that cite this headnote

[3] Federal Courts
Anticipating or predicting state decision

When presented with a state law issue on which the state's highest court has not ruled, federal court must apply the law in manner that it believes the state's highest court would, if presented with the issue.

Cases that cite this headnote

[4] Judgment
Estate or Interest of Judgment Debtor

Under Illinois law, tenant by the entirety's contingent future interest in entire real property that he owned as tenant by the entirety with his wife, in event of his wife's death, came within broad definition of the "real estate" to which his creditor's judgment lien could attach. 735 Ill. Comp. Stat. Ann. 5/12-101, 5/12-105; 765 Ill. Comp. Stat. Ann. 1005/1c.

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Cases that cite this headnote

[5] **Bankruptcy**
Interests in joint, entireties, or community property

"Property of the estate" includes an individual debtor's interest in property held as a tenant by the entirety with his or her nondebtor-spouse. 11 U.S.C.A. § 541(a)(1).

Cases that cite this headnote

[6] **Bankruptcy**
Entireties property

Under bankruptcy exemption for interests that debtor holds as tenant by the entirety, interests that a debtor holds as tenant by the entirety are exempt to extent that those interests the debtor holds as a tenant by the entirety are exempt under state law. 11 U.S.C.A. § 522(b)(3)(B).

Cases that cite this headnote

[7] **Bankruptcy**
Judicial liens

Exemptions
Ownership or possession of property in general

Chapter 7 debtor-attorney could not avoid, on exemption-impairment grounds, the judgment lien that his former client possessed to secure judgment debt for his alleged malpractice, at least not to extent that this lien had attached to the contingent future interest that debtor had, on petition date, in real property that he owned as tenant by the entirety with his since-deceased wife; Illinois law did not make all interests held by tenants by the entirety, including such contingent future interests, immune from process. 11 U.S.C.A. § 522(b)(3)(B); 765 Ill. Comp. Stat. Ann. 1005/1c.

Cases that cite this headnote

[8] **Marriage and Cohabitation**
Individual debts and expenses

Main protection that Illinois law provides tenants by the entirety is that a creditor is unable to force the sale of entireties property to collect a debt against only one of the tenants. 735 Ill. Comp. Stat. Ann. 5/12-112.

Cases that cite this headnote

[9] **Exemptions**
Ownership or possession of property in general

Marriage and Cohabitation
Enforcement against entireties property

Illinois legislature did not make all interests held by tenants by the entirety immune from process, choosing not to exempt income from entirety properties and failing to provide exemption for the contingent future interest that each tenant has in the property as whole in event of the other tenant's death. 765 Ill. Comp. Stat. Ann. 1005/1c.

Cases that cite this headnote

Appeal from the United States District Court for the Northern District of Illinois, Eastern Division. No. 17 C 04662 — **John J. Tharp, Jr.**, *Judge*.

Attorneys and Law Firms

Stephen J. Rosenfeld, Attorney, MCDONALD HOPKINS LLC, Chicago, IL, for Debtor - Appellee.

Bert J. Zaczek, Ph. D., Attorney, LAW OFFICES OF BERT ZACZEK, Chicago, IL, for Appellant.

Before Bauer, Hamilton, and Brennan, Circuit Judges.

Opinion

Bauer, Circuit Judge.

***1** Section 522(b)(1) of the United States Bankruptcy Code states that a "debtor may exempt from property of the [bankruptcy] estate the property listed in either paragraph (2) or, in the alternative paragraph (3)." At issue in this case is paragraph (3) subsection (B), which states, in full, that:

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> Property listed in this paragraph is any interest in property which the debtor had, immediately before the commencement of the case, an interest as a tenant by the entirety or joint tenant to the extent that such interest as a tenant by the entirety or joint tenant is exempt from process under applicable nonbankruptcy law.

11 U.S.C. § 522(b)(3)(B). We must determine to what extent contingent future interests created by Illinois law are exempt under this section. The most natural reading of the statute exempts any interest held by an individual as a tenant by the entirety to the extent that state law exempts that particular interest. The district court found that any interest held by the debtor is exempt to the extent that state law exempted the entirety interest. We reverse the district court and hold that the debtor's property cannot be excluded from the bankruptcy estate.

I. BACKGROUND

In 1998, Laverne Williams wanted to file a medical malpractice lawsuit and hired Scott Jaffe to be her attorney. The statute of limitations expired before Jaffe filed a complaint and Williams sued for legal malpractice, obtained a default judgment, and recorded that judgment on a property that Jaffe and his wife owned as tenants by the entirety. Williams now claims post-judgment interest brings her total claim against Jaffe to $1.04 million.

Jaffe filed a chapter 7 bankruptcy petition in November 2015, which identified his debt to Williams and indicated it was secured by a judgment lien on his residence. On the petition date Jaffe and his wife owned the property as tenants by the entirety, but before bankruptcy proceedings were complete Jaffe's wife died. According to Illinois law, when his wife died the tenancy by the entirety terminated and Jaffe held the property individually in fee simple. To avoid the judgment lien Jaffe filed a motion in the bankruptcy court arguing the property was exempt under 11 U.S.C. § 522(b)(3)(B). Williams responded that the property was not exempt because the federal bankruptcy provision that Jaffe relied upon looks to state law to determine whether a tenancy property is exempt. Because Illinois does not exempt contingent future interests, Williams argued, the federal bankruptcy statute does not allow Jaffe to exempt the property from the bankruptcy estate. On appeal the parties renew these arguments.

II. DISCUSSION

[1] **[2]** We must first determine whether a lien exists and what interests it attached to. If no lien exists the debtor cannot seek an exemption under 11 U.S.C. § 522(f) and our inquiry is complete. *See* *In re Chinosorn*, 243 B.R. 688, 694 (Bankr. N.D. Ill. 2000) (noting there are "three elements for lien avoidance: (1) a lien must have fixed on an interest of the debtor in property, (2) the lien must impair an exemption to which the debtor would have been entitled under § 522(b), and (3) the lien must be a judicial lien—with the debtor bearing the burden of each element."). If a lien attached we must also determine to what interests it attached. Jaffe argues that, if any lien exists, it attached only to his tenancy interest which is exempt under Illinois law. Williams asserts her lien attached to Jaffe's contingent future interest in the property. If we determine a lien attached to a property interest we must then determine whether that interest is exempt under § 522(b)(3)(B). We will address each issue in turn.

A. The Existence of a Lien

***2** **[3]** If a judicial lien attaches to property that is entitled to exemption from the bankruptcy estate, § 522(f) allows the debtor to avoid the fixing of the lien. *See* 11 U.S.C. § 522(f). Illinois courts have not decided whether a judgment lien attaches to the individual interests (in particular contingent future interests) of a tenant by the entirety. Where a state's highest court has not ruled on an issue, we must apply the law in a manner we believe the state supreme court would, if presented with the issue. *Liberty Mut. Fire Ins. Co. v. Statewide Ins. Co.*, 352 F.3d 1098, 1100 (7th Cir. 2003).

To answer this question we turn to the applicable Illinois statutes, which have long controlled the attachment of judgment liens. *Lehman v. Cottrell*, 298 Ill.App. 434, 19 N.E.2d 111, 114 (2d Dist. 1939) ("At common law, land was subject neither to execution nor to the lien of a judgment. Both these results are purely statutory."). Section 12–101 of the Illinois code creates judgment liens and controls their

ability to attach to certain property interests. The statute dictates that judgment liens may attach to all "real estate" and defines "real estate" broadly to include all "lands, tenements, hereditaments, and all legal and equitable rights therein." 735 ILCS 5/12–105.

[4] The Illinois legislature enumerated the precise interests tenants by the entirety enjoy individually, including the following contingent future interests: "(a) an interest as a tenant in common in the event of a divorce, (b) an interest as a joint tenant in the event that another homestead is established, and (c) a survivorship interest in the entire property in the event of the other tenant's death." 765 ILCS 1005/1c. These contingent future interests fall within the statute's broad definition of "real estate." Therefore, a judgment lien attaches to these individual interests, absent some exception. *See* *In re Tolson*, 338 B.R. 359, 369 (Bkrtcy. C.D. Ill. 2005). The only exception that 12-101 identifies is section 12-901—the homestead exception. *See* 735 ILCS 5/12-901 (the "homestead and all rights in and title to that homestead is exempt from attachment, judgment, levy or judgment sale for the payment of his or her debts or other purposes ... .").

Otherwise, "where the Illinois legislature has determined that a judgment lien should not be created as to a debtor's interest in particular property, it has provided that the property is 'exempt from judgment,' *see* 735 ILCS 5/12-1001 (specified personal property), or that it is not 'subject to any lien,' *see* 820 ILCS 305/21 (workers' compensation award)." *Chinosorn*, 243 B.R. at 695–95. But Illinois does not "exempt from judgment" interests held in tenancy by the entirety or contingent future interests held by tenants by the entirety. Illinois law merely exempts the *tenancy interest* from the attachment of a judgment lien. 735 ILCS 5/12-112. Section 12-112 provides that judgment liens may attach to all "lands, tenements, goods and chattels." It then carves out a narrow exception, the tenancy interest, without mentioning the contingent future interests explicitly created by the Illinois legislature.

It is clear that if the Illinois legislature wanted to exempt particular interests from the attachment of judgment liens, it had no problem in doing so. Because the Illinois legislature failed to do so, we find that Williams's judgment lien attached to Jaffe's contingent future interest in the property. *See* *In re Yotis*, 518 B.R. 481, 486–90 (Bkrtcy. N.D. Ill. 2014); *Tolson*, 338 B.R. at 367 (holding that "the contingent right of survivorship of each entireties tenant is a present property right to which a judgment lien extends.").

B. Exemption Under § 522(b)(3)(B)

***3** Tenancy by the entirety is a form of property ownership that arose out of common law and developed as part of the English feudal system. Oval A. Phipps, *Tenancy by the Entireties*, 25 Temp. L.Q. 24 (1951). Until the nineteenth century, married women in the United States were subject to coverture. This meant a wife's legal identity and property were absorbed by her husband and he was granted legal dominion over everything. *Id.* Therefore, if a married couple purchased property, it could not be owned by the husband and wife because both spouses were considered a single legal entity (the husband). *Id.* Tenancy by the entirety was created so spouses could own property jointly and upon the death of one spouse the property would belong to the surviving spouse. Then, "during the middle and latter part of the nineteenth century, as part of a reform movement aimed at emancipating married women from their state of social and economic dependency, the Married Women's Property Acts were enacted practically universally by the legislatures of the several states." *Id.*

Following the passage of the Married Women's Property Acts, states splintered in their approach to tenancy by the entirety. Many state courts thought the acts destroyed tenancy by the entirety and a few courts held they were unaffected; several state courts gave both spouses the rights of the husband under common law and a large number of states found both spouses had only the limited interests a wife previously had under common law. *Chinosorn*, 243 B.R. at 692–93 (collecting cases). States also divided over whether tenancy by the entirety encompassed real property and personal property, or just real property. *Id.* at 693. The Illinois judiciary found that the state's Married Women's Act abolished tenancy by the entirety but, in 1990, the legislature codified tenancy by the entirety for real estate owned by spouses who were using the property as their homestead. 765 ILCS 1005/1c.

Jurisdictions that recognize tenancy by the entirety, however, are not uniform in their approach to creditors' rights against the estate:

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> A creditor's right to levy on a married person's property is complex, and varies by state and the type of debt and property. Every state allows satisfaction of a debt which has been jointly incurred by a husband and wife against jointly held property, even if that property is held in a tenancy by the entirety ... . Some states allow the satisfaction of an individual spouse's debt against entireties property, but most do not.

Creditors' Rights Against Entireties Property In and Out of Bankruptcy, 1983 Ann. Surv. of Bankr. Law Part II (September 1983). With this kaleidoscopic background in mind, we turn to the bankruptcy aspect of this case.

[5] A debtor's bankruptcy estate must include "all legal or equitable interests of the debtor in property as of the commencement of the case." 11 U.S.C. § 541(a). This includes an individual debtor's interest in property held as a tenant by the entirety. *In re Hunter*, 970 F.2d 299, 303 (7th Cir. 1992); *Napotnik v. Equibank & Parkvale Savings Association*, 679 F.2d 316 (3d Cir. 1982). All property in the estate is liquidated by the bankruptcy trustee and the proceeds are distributed to creditors based on their priority. 11 U.S.C. § 704. But the Bankruptcy Code allows debtors to exempt certain estate property. Exempt property is removed from the estate and retained by the debtor. Section 522(b)(3)(B) exempts:

> [a]ny interest in property in which the debtor had, immediately before the commencement of the case, an interest as a tenant by the entirety or joint tenant to the extent that such interest as a tenant by the entirety or joint tenant is exempt from process under applicable nonbankruptcy law.

The law of co-tenancies is almost exclusively a matter of state law since there is no general federal property law, therefore, the "applicable nonbankruptcy law" is Illinois law. The question here is to what extent § 522(b)(3)(B) exempts Jaffe's contingent future interest in the tenancy property. There is no dispute that a lien that attached to Jaffe's *tenancy interest* would be exempt. However, the nub of this case lies in the exemption of the lesser interests that are not exempted under Illinois law.

***4** The district court interpreted § 522(b)(3)(B) to exempt Jaffe's contingent future interest in the entireties property, despite the fact that Illinois provides no exemption for these interests. In reaching this conclusion the district court partitioned the statutory language into four elements:

> § 522(b)(3)(B) exempts: (i) any interest in property; (ii) in which the debtor had an interest as a tenant in the entirety; (iii) at the time the bankruptcy petition was filed; (iv) to the extent that state law exempts an interest as tenant in the entirety from legal process.

Jaffe v. Williams, No. 1:17-cv-4662, slip op. at *4, 2018 WL 2324351 (N.D. Ill. May 22, 2018). The district court noted that Jaffe had an interest as a tenant by the entirety (as well as contingent future interests) at the time the bankruptcy petition was filed (satisfying the first three elements). The district court then concluded that any interest he held (contingent future interests included) was exempt to the extent that the *tenancy interest* was exempt under Illinois law. And since Illinois exempts the tenancy interest, more specifically the forced sale of the tenancy property to collect a debt against just one tenant, all other interests Jaffe had as a tenancy by the entirety were exempt completely.

But the fourth element of the district court's analysis left out a key word—"such." Section 522(b)(3)(B) exempts certain interests "to the extent that *such* interest as a tenant by the entirety" is exempt under state law. By not giving sufficient weight to the word "such," the district court interpreted the statute to mean that any property interest is exempt to the extent that the entirety interest is exempt. But identifying what

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"such" refers to is the main interpretive issue in this case. If "such" refers just to "any interest," as Jaffe argues, the district court's conclusion is correct because the statute would exempt "any interest" the debtor had to the extent that any tenancy interest is exempt from state law. However, if "such interest" refers to something more limited, like the precise interests the debtor was seeking to exempt, the district court's interpretation is incorrect.

Section 522(b)(3)(B) begins broadly by stating it exempts "any interest in property." The provision goes on to state that the debtor must have an interest in the property "*as a tenant by the entirety*" in order to claim an exemption, thus cabining "any interest in property." This means that if, for example, a tenant by the entirety transferred her interest in the income the property generated, the transferee could not claim an exemption under § 522(b)(3)(B) since she does not hold the interest *as a tenant by the entirety*. The provision goes on to state that the exemption applies "to the extent that such interests as a tenant by the entirety," meaning the precise interests that the debtor holds as a tenant by the entirety, are exempt under state law.

[6] We read this provision to establish two things. First, the opening language indicates the interests that may qualify for exemptions—any interest the debtor has, so long as she holds that interest as a tenant by the entirety. The provision then defines which of those qualifying interests are exempt—all of the debtor's qualifying interests to the extent that they are exempt under applicable nonbankruptcy law. Our reading of the statute yields a simple result—interests a debtor holds as a tenant by the entirety are exempt to the extent that those interests the debtor holds as a tenant by the entirety are exempt under state law.

***5** The statutory language does not support the argument that "such interest as a tenant by the entirety" is referring more broadly to "any interest in property" as Jaffe argues. It is much more sensible to read "such interest" as referring to the complete introductory phrase, which identifies the debtor's specific interests that potentially qualify for an exemption. Additionally, the signifier ("such interest") and referent ("interest as a tenant by the entirety") use mirroring language indicating that the latter is referring to the former: "property in which the debtor had ... an *interest as a tenant by the entirety* ... to the extent that such *interest as a tenant by the entirety*" is exempt. This buttresses the conclusion that "such interest" was meant to refer to the specific interests that the debtor held as a tenant by the entirety, rather than only referring to "any interest."

Given the variety of rights, interests, and exemptions in tenancy by the entirety, it is likely that Congress enacted § 522(b)(3)(B) to reflect the full spectrum of different approaches states have taken. *See* *Chinosorn*, 243 B.R. at 700 ("the apparent intent of the provision is to provide, in bankruptcy, a level of protection from claims of creditors identical to the protection that owners of entireties property would have in collection proceedings outside of bankruptcy, under applicable state law."). "Any interest in property in which the debtor had ... an interest" is broad, inclusive language that signals that all state exemptions for tenants by the entirety will be honored in federal bankruptcy court. But the district court's reading would mean that no matter how nuanced state exemptions for tenants by the entirety are, all interests would be exempt if the state exempts the entirety interest. This means that if Illinois decided to explicitly exempt the contingent future interests that Williams's lien attached to, such an exemption would be given no effect by a bankruptcy statute that relies on state law. This interpretation leads to an absurd result and could not be what Congress intended.

Additionally, our reading of the statute is in line with each of our sister circuits that have considered the issue. While it does not appear that those cases involved arguments by the parties that required similar exegesis of the statutory text, the fact that the no party argued otherwise implies that the statute is naturally read as we read it today. *See e.g.*, *In re Arango*, 992 F.2d 611, 613 (6th Cir. 1993) ("[W]e must first look to Tennessee law to classify Arango's interests in entireties property. We then determine which of those interest is exempt from his bankruptcy estate by determining whether *each particular interest* is subject to execution under Tennessee law" (emphasis added)); *Ragsdale v. Genesco, Inc.*, 674 F.2d 277, 279 (4th Cir. 1982) ("The phrase 'to the extent such interest ... is exempt from process under applicable nonbankruptcy law' is of decisive importance. If the Ragsdales' residential real property could be reached to satisfy a state court judgment in Virginia, it could not be successfully claimed as exempt"); *Napotnik v. Equibank & Parkvale Sav. Ass'n*, 679 F.2d 316, 322–23 (3d Cir. 1982) ("Since the debtor's interest in the real property owned with his wife as tenants by the entirety is not exempt from process in Pennsylvania because they are joint obligors, he

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is not entitled to exempt that portion of his equity subject to Equibank's judicial lien, and cannot avoid that lien under Section 522(f)").

[7] Here, Williams obtained a judgment lien on Jaffe's contingent future interest that existed when Jaffe filed his bankruptcy petition. The first determination that must be made is whether Jaffe's interest is the kind that potentially qualifies for an exemption under § 522(b)(3)(B). Any interest can qualify so long as it is an interest one holds "as a tenant by the entirety." Jaffe held his interest as a tenant by the entirety so we must determine whether the interest is exempt. This requires looking to Illinois law to determine whether contingent future interests are exempt from process.

***6** **[8]** **[9]** The main protection that Illinois law provides tenants by the entirety is that a creditor is unable to force the sale of the property to collect a debt against only one of the tenants. 735 ILCS 5/12-112 (2014). Illinois law does not make all interests held by tenants by the entirety immune from process and we need not look hard for a state that does—Indiana law exempts "any interest the judgment has in real estate as a tenant by the entireties." Ind. Code § 34-2-28-1(a)(5); *In re Paeplow*, 972 F.2d 730, 737 (7th Cir. 1992). Illinois law explicitly refuses to exempt income from entirety properties and fails to provide an exemption for the contingent future interests. 765 ILCS 1005/1c; *see also* *Yotis*, 518 B.R. at 489–90 (holding that "any future interest that may be held by either tenant alone, such as the contingent future interest, is not exempt at all"). Accordingly, we find that Jaffe is not entitled to an exemption of his contingent future interest. The district court's conclusion otherwise was erroneous.

III. CONCLUSION

Because the statute exempts an individual's tenancy interest to the extent that state law exempts that interest, we reverse the decision of the district court and remand for further proceedings consistent with this opinion.

All Citations

--- F.3d ----, 2019 WL 3540420

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601 B.R. 660
United States Bankruptcy Appellate
Panel of the Eighth Circuit.

IN RE: Teresa Cedreca EDWARDS, Debtor
Teresa Cedreca Edwards Plaintiff-Appellant
v.
The City of Ferguson, a municipal
corporation Defendant-Appellee

No. 18-6032
|
Submitted: June 18, 2019
|
Filed: July 3, 2019

Synopsis

Background: Chapter 13 debtor brought adversary proceeding to recover for city's alleged violation of automatic stay, and debtor and city cross-moved for summary judgment. The United States Bankruptcy Court for the Eastern District of Missouri, Kathy A. Surratt-States, Chief Judge, 2018 WL 6920374, granted city's motion and denied debtor's, and debtor appealed.

Holdings: The Bankruptcy Appellate Panel, Saladino, Chief Judge, held that:

[1] while recall of warrant that city had issued for motorist's arrest, based on her failure to pay a fine imposed for her speeding, might be safest way to ensure that she was not arrested in violation of automatic stay, city was not required to do so, and

[2] city was under no obligation, following motorist's bankruptcy filing, to issue letter of compliance for fine that motorist had not paid.

Affirmed.

Procedural Posture(s): On Appeal; Motion for Summary Judgment.

West Headnotes (5)

[1] Bankruptcy
Conclusions of law; de novo review

Bankruptcy Appellate Panel reviews bankruptcy court's grant of summary judgment de novo, using the same standard applied by bankruptcy court.

Cases that cite this headnote

[2] Bankruptcy
Proceedings, Acts, or Persons Affected

There are circumstances in which mere inaction by creditor can, by itself, constitute a violation of the automatic stay, such as where there is postpetition turnover obligation, and where inaction will result in the continuation of a prepetition wage garnishment. 11 U.S.C.A. § 362(a).

Cases that cite this headnote

[3] Bankruptcy
Proceedings, Acts, or Persons Affected

Automatic stay prevented city from arresting Chapter 13 debtor as a means of attempting to collect her debt for unpaid speeding fine. 11 U.S.C.A. § 362(a).

Cases that cite this headnote

[4] Bankruptcy
Administrative Proceedings and Governmental Action

While recall of warrant that city had issued for motorist's arrest, based on her failure to pay a fine imposed for her speeding, might be safest way to ensure that she was not arrested in violation of automatic stay that arose as of commencement of her Chapter 13 case, recall of arrest warrant was not something which city had to do to avoid violating automatic stay, as long as it took no action to enforce arrest warrant or to compel

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payment of fine postpetition. 11 U.S.C.A. § 362(a).

Cases that cite this headnote

[5] **Bankruptcy**
Administrative Proceedings and Governmental Action

City that, prior to commencement of motorist's Chapter 13 case, had issued warrant for her arrest based on her failure to pay fine imposed for her speeding was under no obligation, following her bankruptcy filing, to issue letter of compliance for fine that motorist had not paid, and that had not yet been discharged in bankruptcy, in order to assist motorist in obtaining renewal of her driver's license by the State; city's failure to issue letter of compliance was not violative of automatic stay. 11 U.S.C.A. § 362(a).

Cases that cite this headnote

***661** Appeal from United States Bankruptcy Court for the Eastern District of Missouri - St. Louis

Attorneys and Law Firms

Christopher D. Lee, Michael Jay Watton, Watton Law Group, Milwaukee, WI, for Plaintiffs-Appellants.

Joel O. Christensen, Behr & McCarter, Saint Louis, MO, for Defendant-Appellee.

Before SALADINO, Chief Judge, NAIL and SANBERG, Bankruptcy Judges.

Opinion

SALADINO, Chief Judge.

The Appellant, Teresa Cedreca Edwards, appeals the order of the bankruptcy court [1] granting defendant City of Ferguson's motion for summary judgment and denying Appellant's motion for summary judgment in an adversary proceeding alleging, among other allegations, that the defendant willfully violated the automatic stay provisions of 11 U.S.C. § 362(a)(1), (a)(6) and (k)(1); and for discrimination under 11 U.S.C. § 525(a). We have jurisdiction over this appeal. *See* 28 U.S.C.§ 158(b). For the reasons that follow, we affirm.

***662** STANDARD OF REVIEW

[1] We review a bankruptcy court's grant of summary judgment de novo, *Mwesigwa v. DAP, Inc.*, 637 F.3d 884, 887 (8th Cir. 2011) (citing *Anderson v. Durham D & M, L.L.C.*, 606 F.3d 513, 518 (8th Cir. 2010)). When an appellate court reviews a trial court's entry of summary judgment de novo, it uses the same standard applied by the trial court pursuant to Federal Rule of Civil Procedure 56(c). *Bremer Bank v. John Hancock Life Ins. Co.*, 601 F.3d 824, 829 (8th Cir. 2010). Under Rule 56(c), summary judgment is proper if the pleadings, affidavits, and other evidence show there is no genuine issue of material fact and the moving party is entitled to judgment as a matter of law. Fed. R. Civ. P. 56(c); Fed. R. Bankr. P. 7056. Once the moving party has met this initial burden of proof, the non-moving party must set forth specific facts sufficient to raise a genuine issue for trial and may not rest on its pleadings; self-serving allegations or mere assertions of disputed fact are insufficient to defeat the motion. *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 586-87, 106 S.Ct. 1348, 89 L.Ed.2d 538 (1986); *Bass v. SBC Commc'n, Inc.*, 418 F.3d 870, 872-73 (8th Cir. 2005).

FACTUAL BACKGROUND

The relevant facts are not in dispute. Appellant was issued a traffic citation on April 16, 2010, by the City of Ferguson for driving thirty-nine miles per hour in a twenty-five miles per hour school zone. Appellant failed to appear for her court date so the municipal judge issued a warrant for her arrest on June 18, 2010. Appellant was subsequently arrested and released on her own recognizance on March 26, 2015, and a new court date was set. Appellant appeared in court on May 7, 2015, pleaded guilty to speeding in a school zone, and agreed to pay a fine of $149.00.

Appellant did not pay the fine, and the court re-issued a warrant for her arrest. The City of Ferguson also notified the proper Missouri entities of the outstanding fine, which Appellant contends is impeding her ability to renew her

driver's license.[2] Since the re-issuance of the arrest warrant on July 15, 2015, the City of Ferguson has not taken any affirmative action to enforce the warrant or collect the fine.

On February 24, 2016, appellant filed a voluntary petition under Chapter 13 of the United States Bankruptcy Code and listed the City of Ferguson as a creditor in her bankruptcy schedules. On February 25, 2016, Appellant's attorney notified the City of Ferguson's Municipal Court of the bankruptcy filing and included a letter requesting release of the arrest warrant and issuance of a compliance letter to reinstate Appellant's driver's license. On February 26, 2016, a municipal prosecutor for the City of Ferguson responded to Appellant's attorney stating the Municipal Judge had the authority to recall the warrant and suggested that counsel file an entry of appearance and an appropriate motion.

Appellant did not seek relief from the Ferguson Municipal court. Instead, she filed an adversary proceeding against the ***663** City of Ferguson. The complaint alleged the City of Ferguson willfully violated the automatic stay by refusing to release the warrant for Appellant's arrest and refusing to release Appellant's driver's license without payment of the fine. Appellant also asserted that since she is insolvent and unable to pay the fine, the City of Ferguson is discriminating unfairly against her due to her bankruptcy filing and is denying her a fresh start. Appellant sought actual damages, attorney fees, and punitive damages.

The parties filed cross-motions for summary judgment, and on November 7, 2018, the bankruptcy court granted the City of Ferguson's motion and denied Appellant's motion.

DISCUSSION

Section 362(a) of the Bankruptcy Code provides that upon the filing of a petition in bankruptcy, a stay is imposed upon the commencement or continuation of an action or proceeding against the debtor that was or could have been commenced before the commencement of the bankruptcy case. It also prohibits any act to collect, assess, or recover a claim against the debtor that arose before the commencement of the case. 11 U.S.C. § 362(a)(1) and (6). This is known as the automatic stay.

Appellant describes the issue on appeal as follows: "Is coercion by a municipality to collect a civil debt during a bankruptcy a willful violation of the automatic stay?" If that were truly the issue on appeal, a result in Appellant's favor might seem obvious. However, that sentence is not a proper statement of the issue on appeal—it is more akin to an argument. The actual issue on appeal is whether the bankruptcy court erred in granting summary judgment in favor of the City and finding that the City did not violate the automatic stay under 11 U.S.C. § 362(a)(1) and 362(a)(6) when it failed to take post-petition actions to rescind its arrest warrant and issue a compliance letter to assist in reinstatement of Appellant's driver's license.[3]

Appellant takes the position that by failing to take affirmative action to rescind the arrest warrant and issue a compliance letter, the City has willfully violated the automatic stay through coercion by continuing a process to collect a debt that arose before the commencement of the case. The City disagrees and notes the bankruptcy court findings that all of the City's actions (issuance of the warrant and any notices regarding the driver's license) took place well before the bankruptcy case, and that the City has not taken any action in furtherance of the warrant since the bankruptcy filing.

[2] In her brief, Appellant attempts to argue the question of whether mere inaction can, by itself, constitute a violation of the automatic stay. The answer to that question is really not in dispute. *See* *United States v. Whiting Pools, Inc.*, 462 U.S. 198, 103 S.Ct. 2309, 76 L.Ed.2d 515 (1983) (property seized but not yet sold before the filing of the bankruptcy petition is property of the estate subject to turnover requirements of § 542); *Knaus v. Concordia Lumber Co., Inc. (In re Knaus)*, 889 F.2d 773 (8th Cir. 1989) (creditor's failure to turn over assets seized pre-petition violated automatic stay); *In re See*, 301 B.R. 549 (Bankr. N.D. Iowa 2003) (post-petition garnishment violates automatic stay). The case law is clear that under certain circumstances—such ***664** as where there is a post-petition turnover obligation and where inaction will clearly result in a stay violation (by continuation of a wage garnishment, for example)—some action needs to be taken by a creditor to prevent a violation of the automatic stay. The question is whether those circumstances exist here.

Regarding the arrest warrant, the only factual finding in the record is that the City has not taken any action to enforce the warrant post-petition. Appellant does not dispute that finding. Instead, Appellant argues—without factual support—that the failure of the City to recall the warrant will eventually result

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in her arrest which is an attempt to coerce her to pay the fine. We have not been presented with any evidence in the record to establish whether that is a true statement. In fact, all we know is that the City has not acted on it. Unlike a garnishment (which *will* result in wages being withheld unless withdrawn), nothing will happen as a result of an arrest warrant until it is actually enforced.

[3] The parties are in agreement that the automatic stay prevents the City from arresting Appellant as a way of attempting to collect her debt. But, there is a significant difference between *staying* enforcement of the warrant and *recalling or rescinding* it in its entirety. This adversary proceeding arose in a Chapter 13 bankruptcy case, which can last as long as five years after plan confirmation. If the bankruptcy case gets dismissed before completion (as many do), Appellant will *not* receive a discharge of her debts. Upon such a dismissal, collection of the fine and enforcement of the warrant would no longer be stayed, and the City could proceed with enforcement as if the bankruptcy never happened. But, if the warrant were rescinded as Appellant requests, the City would then have to go through additional legal and procedural steps to be in the same position it was in prior to bankruptcy filing.

[4] Unfortunately, we have no evidence in the record as to what steps the City has available to it or has actually taken to ensure that enforcement of the warrant is actually stayed. All we know is that the City has not acted to enforce the warrant. Appellant argues that if the warrant is not recalled, she may be arrested if she encounters a police officer—whether in the City or even in another jurisdiction. We have no evidence to support that argument and will not speculate as to whether it is a true statement. Certainly, recalling the warrant would be the safest route for the City to ensure that it does not cause a violation of the automatic stay—but Appellant has not shown us any compelling authority supporting the proposition that the City is *required* to do so.[4] Enforcement of the warrant is simply stayed while the automatic stay is in effect. Appellant has failed to identify any post-petition action by the City that would be in violation of the stay.

[5] For similar reasons, we agree with the bankruptcy court that the City is not required to issue a compliance letter regarding ***665** Appellant's driver's license. There is no dispute that the fine has not been paid. There is nothing in the Bankruptcy Code requiring a municipality to write a letter saying a debtor has paid a fine or otherwise complied with its municipal code when the debtor has not done so. The answer may be different once a debtor actually pays a fine or obtains discharge of a debt—but those facts are not present here. Appellant admittedly has not paid the fine and is years away from having it discharged.

Appellant asserts that failing to submit the compliance letter is an attempt to coerce her into paying the debt so that she can get her driver's license renewed. As indicated above, the Bankruptcy Code simply does not require a statement that a debtor has complied when the debtor has not done so. Further, Appellant (through counsel) admitted at oral argument that the City does not issue driver's licenses—that is a state function. The State of Missouri is not a party to this adversary proceeding and there is no evidence in the record as to (i) whether Appellant has even asked the State to issue her license; (ii) whether the State has refused to do so and its stated reasons for the refusal; and (iii) what requirements the State may impose for issuance of a license under the facts of this case. As such, Appellant has failed to show that the City's inaction regarding the compliance letter has somehow led to her inability to obtain a driver's license.

Finally, appellant argues in her brief that the bankruptcy court considered an irrelevant factor—whether a driver's license is property of the estate. We agree with the City that the reference in the bankruptcy court's order to a driver's license being property of the estate was taken out of context by appellant and was not a factor in the bankruptcy court's decision. Appellant also argues the City prosecutor's response to her attorney's inquiry was somehow a violation of the automatic stay. We agree with the bankruptcy court that the response was just that—a response to an inquiry. It was not an attempt to collect a debt.

CONCLUSION

For the foregoing reasons, we affirm the judgment of the bankruptcy court.

All Citations

601 B.R. 660

Footnotes

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1 The Honorable Kathy A. Surratt-States, Chief United States Bankruptcy Judge for the Eastern District of Missouri.

2 This statement is the finding of fact made by the bankruptcy court. In her brief, Appellant asserts that "Upon her failure to pay the fine, Appellee placed Ms. Edwards in warrant status and issued a notice to the Missouri Department of Revenue to place a restriction which suspends Ms. Edwards' driver's license." It is unclear to us whether Appellant's driver's license has actually been suspended by the issuing agency or whether it simply is refusing to renew it. In any event, by oral argument, Appellant was focused on demanding that the City of Ferguson issue some sort of "compliance letter" to allow her license to be renewed despite the non-payment of the traffic fine.

3 During this appeal, Appellant has not argued the question of whether the City violated 11 U.S.C. § 525(a). Therefore, those issues are abandoned on appeal. *Schlehuber v. Fremont Nat'l Bank & Trust Co. (In re Schlehuber)*, 489 B.R. 570, 572 n.2 (8th Cir. BAP 2013).

4 The only case cited by appellant that appears on point is a bankruptcy court decision—*In re Walters*, 219 B.R. 520 (Bankr. W.D. Ark. 1998). In that case the bankruptcy court did opine that upon notice of a bankruptcy filing, a municipality should cancel any outstanding warrants for the debtor's arrest that may have been issued pre-petition for an unpaid fine or restitution obligation. *Id.* at 527. We disagree with that conclusion and note that *Walters* involved some fairly egregious acts by the police officers involved. The debtor was actually arrested post-petition and misrepresentations were made to her by the officers. The *Walters* court did not discuss why a simple stay of the enforcement of the warrant would not be sufficient.

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602 B.R. 60
United States Bankruptcy Appellate Panel of the Eighth Circuit.

IN RE: Michael G. QUEEN, also known as Mike Queen, also known as Bi-State Acoustics, LLC; Denise D. Queen, Debtors
Gary Francis Abel; Metro Acoustics, LLC, Plaintiffs - Appellants
v.
Denise D. Queen; Michael G. Queen, Defendants - Appellees

No. 18-6023
|
Submitted: June 18, 2019
|
Filed: July 19, 2019

Synopsis

Background: Creditors brought adversary proceeding against Chapter 7 debtors seeking to determine dischargeability of debt arising from state court default judgment. The United States Bankruptcy Court for the Eastern District of Missouri directed entry of summary judgment in favor of debtors. Creditors appealed.

[Holding:] The Bankruptcy Appellate Panel, Nail, J., held that creditors abandoned their claim that the state court default judgment should be given preclusive effect in nondischargeability proceeding, and thus, creditors' claim could not be considered on appeal.

Affirmed.

Procedural Posture(s): On Appeal; Motion for Summary Judgment.

West Headnotes (3)

[1] Bankruptcy
Conclusions of law; de novo review

Bankruptcy Appellate Panel (BAP) reviews the bankruptcy court's legal determinations de novo.

Cases that cite this headnote

[2] Bankruptcy
Clear error

Bankruptcy Appellate Panel (BAP) reviews the bankruptcy court's factual determinations for clear error.

Cases that cite this headnote

[3] Bankruptcy
Presentation of grounds for review

Creditors abandoned their claim that state court default judgment against Chapter 7 debtors should be given preclusive effect in nondischargeability proceeding, and thus creditors' claim could not be considered by the Bankruptcy Appellate Panel (BAP) on appeal, by withdrawing their motion for partial summary judgment and submitting the matter to the bankruptcy court on an agreed record without renewing their claim that the state court default judgment should be given preclusive effect.

Cases that cite this headnote

***61** Appeal from United States Bankruptcy Court for the Eastern District of Missouri - St. Louis

Attorneys and Law Firms

Counsel who presented argument on behalf of the appellant was Angela Redden-Jansen, of Maplewood, MO.

Counsel who presented argument on behalf of the appellee was James B. Day, of Chesterfield, MO.

Before SALADINO, Chief Judge, NAIL and SANBERG, Bankruptcy Judges.

Opinion

NAIL, Bankruptcy Judge.

****1** Gary Francis Abel and Metro Acoustics, LLC appeal the August 22, 2018 order of the bankruptcy court [1] directing the entry of summary judgment in favor of Michael G. Queen and

Denise D. Queen on Abel and Metro's complaint to determine the dischargeability of their claims against the Queens. We have jurisdiction over this appeal pursuant to 28 U.S.C. § 158(b). We affirm.

BACKGROUND

Abel and Denise Queen formed Metro, which installed and replaced acoustic ceiling tiles and wall panels. Michael Queen was an employee of the company.

The business ultimately failed, and Abel and Metro filed suit against the Queens in Missouri state court, alleging fraudulent misrepresentation, breach of contract, breach of fiduciary duty, and conversion. The Queens answered, and the case bumped along for several years.

When the Queens failed to comply with their discovery requests, Abel and Metro filed several motions for sanctions. The third such motion led to the entry of a self-described judgment in which the state court granted Abel and Metro's motion, struck the Queens' pleadings, entered a default judgment for Abel and Metro on all counts of their complaint, and scheduled a hearing to determine damages.

Before that hearing could be held, however, the Queens filed a petition for relief under chapter 7 of the bankruptcy code, staying further proceedings in state court. Abel and Metro timely filed an adversary complaint to determine the dischargeability of their claims against the Queens under 11 U.S.C. § 523(a)(2), (4), and (6).

In the course of the adversary proceeding, Abel and Metro filed a motion for partial summary judgment on the issue of liability, arguing the state court default judgment precluded the Queens from re-litigating the issue of liability or the issue of the dischargeability of Abel and Metro's claims against them. The Queens objected. ***62** Following a hearing,[2] the bankruptcy court stamped a copy of Abel and Metro's motion "DENIED" and "WITHDRAWN" and entered it as an order.

A trial was scheduled, but shortly before the appointed date, the parties communicated to the bankruptcy court their belief that the dischargeability of Abel and Metro's claims against the Queens could be determined by summary judgment, with the issue of damages reserved for later determination, if necessary. The bankruptcy court concurred and entered an order to that effect.

****2** The parties agreed the lone issue to be decided by the bankruptcy court was whether Abel and Metro's claims against the Queens were dischargeable under § 523(a)(4).[3] The matter was submitted on stipulated exhibits, stipulated facts, and the parties' respective briefs, and the bankruptcy court entered an order for summary judgment in favor of the Queens. In a section headed "PRELIMINARY MATTERS," the bankruptcy court stated:

> The state court entered a prepetition default judgment against Defendants on claims based on facts similar to those asserted here. However, that judgment was only a default judgment and, to any degree, did not become final. The state court default judgment does not establish any fact for purposes of determining whether summary judgment is proper on the § 523(a)(4) claims raised in this matter.

Abel and Metro appealed.[4]

STANDARD OF REVIEW

[1] **[2]** On appeal, Abel and Metro raise two issues: (1) whether the Queens were collaterally estopped by the state court default judgment from asserting they did not breach a fiduciary duty to Abel and Metro; and (2) whether a fiduciary relationship existed between either or both Michael Queen and Denise Queen on the one hand and either or both Abel and Metro on the other. Were we to reach these issues, we would review the former *de novo* and the latter for clear error. *See Islamov v. Ungar (In re Ungar)*, 633 F.3d 675, 679 (8th Cir. 2011) ("We review the bankruptcy court's factual determinations for clear error, and its legal determinations *de novo*.").

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DISCUSSION

[3] Abel and Metro's appeal is premised on the bankruptcy court's perceived error in not giving preclusive effect to the state court default judgment.[5] However, for the reasons discussed below, that issue was no longer before the bankruptcy court, despite the bankruptcy court's passing reference to the state court default ***63** judgment.[6] Consequently, we do not reach either of the issues raised by Abel and Metro. *Rucker v. Belew* (*In re Belew*), 588 B.R. 875, 876 (8th Cir. BAP 2018) (issue not raised before the bankruptcy court cannot be considered on appeal). *Cf. Superpumper, Inc. v. Nerland Oil, Inc.* (*In re Nerland Oil, Inc.*), 303 F.3d 911, 920 n.8 (8th Cir. 2002) (any argument on appeal requiring additional factual findings is considered waived); *Twin City Fed. Sav. and Loan Ass'n v. Transamerica Ins. Co.*, 491 F.2d 1122, 1126-27 (8th Cir. 1974) (trial court erred when it decided a question of law the parties had not submitted to it on a motion for summary judgment). *See* *Christian Legal Soc. Chapter of the University of California, Hastings College of the Law v. Martinez*, 561 U.S. 661, 676-78, 130 S.Ct. 2971, 177 L.Ed.2d 838 (2010) (the court will not consider a party's argument that contradicts a stipulation entered at the outset of the litigation).

****3** The record demonstrates Abel and Metro abandoned their claim that the state court default judgment should be given preclusive effect, long before the bankruptcy court entered its order for summary judgment in favor of the Queens. As noted above, Abel and Metro raised the issue in their motion for partial summary judgment. However, the order entered by the bankruptcy court following the hearing on that motion indicates their motion was both "DENIED" and "WITHDRAWN." No one has offered a satisfactory explanation for this seeming incongruity or provided a transcript of the hearing from which such an explanation might be gleaned. Under the circumstances, we can only take the bankruptcy court's order at face value and conclude Abel and Metro withdrew their motion for partial summary judgment.

The parties then submitted the issue of the dischargeability of Abel and Metro's claims against the Queens to the bankruptcy court on stipulated exhibits and stipulated facts. Abel and Metro relied on that record–not the state court default judgment–in the brief they submitted to the bankruptcy court. They did not renew their claim that the state court default judgment should be given preclusive effect. In fact, they made no mention whatsoever of the state court default judgment in that brief.

Abel and Metro did not address–much less explain away–the withdrawal of their motion for partial summary judgment in their opening brief herein. The Queens raised the issue in their opening brief, but Abel and Metro did not file a reply brief, eschewing a second opportunity to offer such an explanation. And they glossed over the problem at oral argument.[7]

CONCLUSION

By withdrawing their motion for partial summary judgment and submitting the matter to the bankruptcy court on an agreed record–without renewing their claim that the state court default judgment should be given preclusive effect–Abel and Metro abandoned that claim. The issue was thus not before the bankruptcy court and affords no basis for the instant appeal. Consequently, we affirm the bankruptcy court's order for summary judgment in favor of the Queens.

All Citations

602 B.R. 60, 2019 WL 3242035

Footnotes

1 The Honorable Charles E. Rendlen, III, United States Bankruptcy Judge for the Eastern District of Missouri.

2 While this hearing is not reflected on the bankruptcy docket, the parties agree it was held.

3 That section excepts from a debtor's discharge any debt "for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny[.]" 11 U.S.C. § 523(a)(4).

4 While the bankruptcy docket indicates judgment was entered for the Queens, the judgment was not set out in a separate document. *See* Fed.R.Bankr.P. 7058 and Fed.R.Civ.P. 58(a). However, this does not affect the validity of Abel and Metro's appeal. Fed.R.Bankr.P. 8002(a)(5)(B).

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5 Abel and Metro briefly argue the Queens owed them a fiduciary duty under Missouri law, but they do not clearly identify how the bankruptcy court erred in its analysis of the requirement of a fiduciary relationship under § 523(a)(4). In any event, to prevail under that code section, Abel and Metro also needed to establish fraud or defalcation. In arguing they did so, they again rely solely on the state court default judgment.

6 We express no opinion regarding the bankruptcy court's assessment of the state court default judgment.

7 In fairness to Abel and Metro's appellate counsel, we note she did not represent them before the bankruptcy court.

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2019 WL 3366654
United States Court of Appeals, Eighth Circuit.

IN RE: VEG LIQUIDATION, INC., formerly known as Allens, Inc.; All Veg, LLC, Debtors.
R. Ray Fulmer, II, Appellant,
v.
Fifth Third Equipment Finance Company; Ryder Integrated Logistics, Inc.; International Paper Company; URS Real Estate, LP; Ball Metal Food Container, LLC; Syngenta Seeds, Inc.; Teneo Securities, LLC; Andrew Torgove; Lazard Middle Market LLC; Lazard Freres & Co. LLC; Alvarez & Marsal, North America, LLC; Alvarez & Marsal Private Equity Performance Improvement, LLC; Jonathan Hickman; Sager Creek Vegetable Company, formerly known as Sager Creek Acquisition Corp., now known as 412, Inc.; 1903 Onshore Funding, LLC; Cortland Capital Market Services, LLC; Sankaty Credit Opportunities, IV, L.P.; Sankaty Credit Opportunities, IV, L.P. (Caymanian), correctly named as, Sankaty Credit Opportunities, (Offshore Master) IV; Sankaty Middle Market Opportunities Fund, L.P.; Sankaty Middle Market Opportunities Fund, L.P. (Caymanian), correctly named as, Sankaty Middle Market Opportunities Fund, (Offshore Master), L.P.; Does 1-100; Alvarez & Marsal Holdings, LLC; 412, Inc., formerly known as Sager Creek Vegetable Company, formerly known as Sager Creek Acquisition Corp.; Sankaty Credit Opportunities, (Offshore Master) IV; Sankaty Middle Market Opportunities Fund, (Offshore Master), L.P., Appellees.

No. 18-1786
|
Submitted: January 17, 2019
|
Filed: July 26, 2019

Synopsis

Background: In case converted from Chapter 11 to Chapter 7, Chapter 7 trustee filed adversary complaint against estate professionals, members of unsecured creditors committee, and junior lienholders, alleging that higher price could have been obtained upon pre-conversion sale of estate assets had certain disclosures been made to court and to creditors prior to sale. Following dismissal of two causes of action, defendants moved to dismiss remaining causes of action. The United States Bankruptcy Court for the Western District of Arkansas, Ben T. Barry, J., 572 B.R. 725, granted defendants' motion and denied trustee's incorporated request for leave to file second amended complaint. Trustee appealed. The Bankruptcy Appellate Panel (BAP), Thomas L. Saladino, Chief Judge, 583 B.R. 203, affirmed. Trustee appealed.

Holdings: The Court of Appeals, Colloton, Circuit Judge, held that:

[1] trustee's claims constituted an impermissible collateral attack on the "free and clear" sale order, and so were barred;

[2] trustee failed to state a plausible claim for fraud on the court, as would have warranted relief from the sale order;

[3] trustee was not entitled to relief from the sale order on the basis that the judgment was void; and

[4] defendants' alleged secret agreement did not amount to a deprivation of due process.

Affirmed.

Procedural Posture(s): On Appeal; Motion to Dismiss for Failure to State a Claim; Motion to Amend the Complaint.

West Headnotes (22)

[1] Bankruptcy
Manner and Terms

In bankruptcy, a "stalking horse purchaser" is the potential purchaser whose opening bid would set the floor at auction. 11 U.S.C.A. § 363.

Cases that cite this headnote

[2] Bankruptcy
Scope of review in general

In an appeal from a decision of the Bankruptcy Appellate Panel (BAP), the Court of Appeals is a second reviewing court.

Cases that cite this headnote

[3] **Bankruptcy**
Conclusions of law; de novo review

Court of Appeals reviews de novo both the bankruptcy court's grant of a motion to dismiss for failure to state a claim, and the court's denial of leave to amend that rests on a legal conclusion of futility. Fed. R. Civ. P. 12(b)(6); Fed. R. Bankr. P. 7012(b).

Cases that cite this headnote

[4] **Bankruptcy**
Collateral attack

Because a proceeding under the section of the Bankruptcy Code governing sale of estate property is an in rem proceeding, transferring property rights which are rights good against the world, not just against parties to a judgment or persons with notice of the proceeding, plaintiffs are barred from bringing claims that amount to collateral attacks on the validity of such a sale. 11 U.S.C.A. § 363.

Cases that cite this headnote

[5] **Bankruptcy**
Collateral attack

Chapter 7 trustee's claims against estate professionals, members of unsecured creditors committee, and junior lienholders, which, at bottom, asserted that winning bidder won auction for debtor's assets with overvalued bid that was supported by undisclosed agreement between unsecured creditor and second lienholders who formed winning bidder, constituted an impermissible collateral attack on the bankruptcy court's "free and clear" sale order, and so were barred; in the order, the bankruptcy court determined that all acquired assets were subject to a competitive and good faith bidding process, that winning bidder had submitted the highest or otherwise best bid, and that the consideration to be provided by winning bidder was the highest and otherwise best offer, and to sustain trustee's claims, a court would have had to contradict those determinations and adversely alter the bargained-for exchange of the parties. 11 U.S.C.A. §§ 363, 363(b), 363(f).

Cases that cite this headnote

[6] **Bankruptcy**
Adequate protection; sale free of liens

Sale "free and clear" under the section of the Bankruptcy Code governing sale of estate property is a judgment that is good as against the world, not merely as against parties to the proceedings. 11 U.S.C.A. § 363.

Cases that cite this headnote

[7] **Bankruptcy**
Collateral attack

Even assuming that the bar on collateral attacks against bankruptcy courts' "free and clear" sale orders is limited to those that challenge "integral" provisions of a sale, a provision of a sale order is "integral" to the sale when modifying or reversing the provision would adversely alter the parties' bargained-for exchange. 11 U.S.C.A. § 363.

Cases that cite this headnote

[8] **Bankruptcy**
Collateral attack

Rule of finality governing asset sales does not foreclose all suits related to sales of a debtor's assets; for example, a claim that a fiduciary's conduct kept a prospective bidder from securing adequate funding to make a more competitive bid does not necessarily call into question a bankruptcy court's determination that the successful bid was the best offer on the table. 11 U.S.C.A. § 363.

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Cases that cite this headnote

[9] **Bankruptcy**
Collateral attack

Rule of finality governing asset sales does not bar a claim against a fiduciary for conduct related to a sale where the transaction was not subject to approval by the bankruptcy court under that section of the Code. 11 U.S.C.A. § 363.

Cases that cite this headnote

[10] **Bankruptcy**
Collateral attack

Rule of finality governing asset sales precludes allegations that second-guess the bankruptcy court's determination that the buyer submitted the best bid for the assets. 11 U.S.C.A. § 363.

Cases that cite this headnote

[11] **Judgment**
Nature of action or other proceeding

Finality of a bankruptcy court's orders at the conclusion of direct review ordinarily stands in the way of challenging their enforceability.

Cases that cite this headnote

[12] **Bankruptcy**
Review of Appellate Panel

Chapter 7 trustee's freestanding challenge to sale order as unenforceable because the required elements of a sale were not adequately proven, while permissible on direct appeal, could not be raised on further appeal to the Court of Appeals. 11 U.S.C.A. § 363.

Cases that cite this headnote

[13] **Federal Civil Procedure**
Fraud; misconduct

Federal court has inherent equitable power to vacate a judgment that is obtained by fraud on the court.

Cases that cite this headnote

[14] **Federal Civil Procedure**
Fraud; misconduct

Finding of fraud on the court, as would warrant vacating a judgment obtained by such fraud, is justified only by the most egregious misconduct directed to the court itself, such as bribery of a judge or jury or fabrication of evidence by counsel.

Cases that cite this headnote

[15] **Federal Civil Procedure**
Fraud; misconduct

Category of "fraud on the court" that would warrant vacating a judgment obtained by such fraud is narrowly defined, and does not include fraud between the parties or fraudulent documents, false statements, or perjury.

Cases that cite this headnote

[16] **Bankruptcy**
Collateral attack

In case converted from Chapter 11 to Chapter 7, Chapter 7 trustee failed to state a claim for fraud on the court, as would have warranted relief from bankruptcy court's pre-conversion sale order; few, if any, of the alleged facts involved conduct directed at the court in the sale proceedings, trustee instead asserted that winning bidder won auction for debtor's assets with overvalued bid that was supported by undisclosed agreement between unsecured creditor and the second lienholders who formed winning bidder, and such nondisclosure, even of side agreement affecting outcome of asset sale, did not rise to the level of fraud on the court. 11 U.S.C.A. § 363.

Cases that cite this headnote

[17] **Bankruptcy**
Collateral attack

Nondisclosure, even of a side agreement affecting the outcome of a sale of assets under the

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section of the Bankruptcy Code governing sale of estate property, does not rise to the level of "fraud on the court," as would warrant vacating of bankruptcy court's sale order. 11 U.S.C.A. § 363.

Cases that cite this headnote

[18] Bankruptcy
Collateral attack

In case converted from Chapter 11 to Chapter 7, Chapter 7 trustee was not entitled to relief from the pre-conversion sale order on the basis that the judgment was void; whatever force the Bankruptcy Code's priority rules might have had at a sale approval hearing or on direct review of a sale under the section of the Code governing sale of estate assets, deviation from those rules did not render final judgment "void." 11 U.S.C.A. § 363; Fed. R. Civ. P. 60(b)(4), 60(c)(1); Fed. R. Bankr. P. 9024.

Cases that cite this headnote

[19] Constitutional Law
Bankruptcy

Due process in bankruptcy generally entitles a party to receive the notice specified in the Bankruptcy Code and the Federal Rules of Bankruptcy Procedure. U.S. Const. Amend. 5.

Cases that cite this headnote

[20] Bankruptcy
Judgment or Order

Judgment is void if the bankruptcy court acted in a manner inconsistent with due process. U.S. Const. Amend. 5; Fed. R. Civ. P. 60(b)(4).

Cases that cite this headnote

[21] Bankruptcy
Manner and Terms

Constitutional Law
Bankruptcy

In case converted from Chapter 11 to Chapter 7, alleged undisclosed agreement between unsecured creditor and second lienholders who formed winning bidder at auction sale of debtor's assets did not amount to a deprivation of due process; terms of winning bid were stated on the record at auction hearing, other interested parties received timely notice of auction and subsequent sale approval hearing, the record before the bankruptcy court contained auction transcript and final versions of purchase agreements, and interested parties were permitted to file objections in the approval hearing, such that the proceedings afforded interested parties adequate notice and opportunity to be heard with respect to their claims. U.S. Const. Amend. 5; 11 U.S.C.A. § 363.

Cases that cite this headnote

[22] Bankruptcy
Pleading; dismissal

Bankruptcy
Collateral attack

In case converted from Chapter 11 to Chapter 7, the bankruptcy court did not err in concluding that proposed amendment to Chapter 7 trustee's complaint, challenging bankruptcy court's pre-conversion sale order, would have been futile; trustee's claims in proposed amendment, like those in his dismissed complaint, would have undercut principal findings of bankruptcy court's sale order because they were premised on the alleged inferiority of winning bidder's bid, such that claims were barred by the finality rule governing asset sales under the Bankruptcy Code, and, as for trustee's contention that there was fraud on the court, his proposed complaint did not point to any affirmative misrepresentation on a defendant's part that was directed to bankruptcy court. 11 U.S.C.A. § 363.

Cases that cite this headnote

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Appeal from the United States Bankruptcy Appellate Panel for the Eighth Circuit

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Before SMITH, Chief Judge, COLLOTON and ERICKSON, Circuit Judges.

Opinion

COLLOTON, Circuit Judge.

***1** R. Ray Fulmer, II, a Chapter 7 bankruptcy trustee, sued a number of parties involved in the sale of a bankruptcy estate's assets under 11 U.S.C. § 363. The bankruptcy court [1] dismissed Fulmer's claims on the ground that they were either impermissible collateral attacks on an earlier order approving the sale or without merit. The court also denied Fulmer leave to file a second amended complaint. The Bankruptcy Appellate Panel affirmed. Fulmer appeals to this court, and we affirm.

I.

The dispute arises from bankruptcy proceedings for Allens, Inc., an Arkansas food canning enterprise. After encountering financial difficulties, Allens filed for Chapter 11 bankruptcy in October 2013. The bankruptcy court authorized bidding procedures for the sale of substantially all of Allens's assets. Allens then moved to sell the assets under 11 U.S.C. § 363(b) and (f), which authorize the sale of a bankruptcy debtor's assets when certain conditions are met.

[1] Allens identified Seneca Foods Corporation as the "Stalking Horse" purchaser—that is, the potential purchaser

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whose opening bid would set the floor at the auction—and prepared a "stalking horse asset purchase agreement" between Allens and Seneca Foods. The bankruptcy court granted the motion for sale after notice and a hearing. Allens then served a "Notice of Bid Procedures, Sale Hearing and Objection Deadlines" for the auction on more than 5,000 creditors and parties in interest through a noticing agent.

The auction occurred between February 3 and 6, 2014. At the auction, a marketing firm retained by Allens estimated the net value of each bid submitted. The marketing firm ultimately valued Seneca's opening bid at approximately $117 million, whereas the unadjusted price in the stalking horse asset purchase agreement had been $148 million. Sager Creek Acquisition Corp., an entity formed by a group of second lienholders, also submitted a bid, which the marketing firm valued at $160 million. Allens ultimately deemed Sager Creek the successful bidder for the estate's assets, but the final asset purchase agreement reflected a sale price of just under $125 million. After a hearing, the bankruptcy court issued a detailed order approving the sale to Sager Creek. No appeals were taken, and the sale closed on February 28, 2014.

Within a few months, the bankruptcy court converted the proceeding to a Chapter 7 bankruptcy and appointed Fulmer as trustee of the bankruptcy estate. Fulmer brought this action in February 2016, and filed a first amended complaint in April 2016.

In his amended complaint, Fulmer names more than twenty defendants allegedly connected in various ways to the sale of the Allens assets. He groups them into three categories: the "Committee Defendants," who were members of the unsecured creditors committee in the Chapter 11 proceeding; the "Fiduciary Defendants," who were retained by Allens to serve as financial advisors in the proceeding; and the "Sager Creek Defendants," who held interests in Allens as second lienholders. The amended complaint asserts fourteen causes of action, all arising from the defendants' alleged conduct in connection with the sale proceedings. The defendants moved to dismiss the complaint for failure to state a claim. *See* Fed. R. Bankr. P. 7012(b).

***2** The bankruptcy court dismissed the complaint and denied as futile Fulmer's request for leave to file a second amended complaint. The court determined that Fulmer did not plead a plausible claim of fraud on the court, collusion among bidders under 11 U.S.C. § 363(n), or for post-judgment relief from the sale order under Federal Rule of Civil Procedure 60(b). The court concluded that the trustee's other claims were barred by the finality of the order approving the asset sale under § 363, and that the proposed amended complaint would be futile. The Bankruptcy Appellate Panel (BAP) affirmed.

[2] **[3]** In an appeal from a decision of the BAP, we are a second reviewing court. We review *de novo* both the bankruptcy court's grant of a motion to dismiss for failure to state a claim, and the court's denial of leave to amend that rests on a legal conclusion of futility. *In re Archdiocese of Saint Paul & Minneapolis*, 888 F.3d 944, 950 (8th Cir. 2018); *In re Senior Cottages of Am., LLC*, 482 F.3d 997, 1001 (8th Cir. 2007).

II.

A.

The first issue on appeal is whether Fulmer's claims constitute an impermissible collateral attack on an asset sale in bankruptcy that was consummated under 11 U.S.C. § 363. To evaluate this contention, it is necessary to review Fulmer's allegations in the first amended complaint.

As Fulmer tells it, the Committee Defendants and the Sager Creek Defendants—all of them creditors of Allens—were at risk of receiving less than full repayment as bankruptcy loomed in 2013. The Sager Creek Defendants' loans were only partially secured, and Seneca's stalking horse bid, if successful, would have relegated $30 million of those defendants' claims to unsecured creditor status. The Committee Defendants, for their part, held at least $72 million in unsecured claims for accounts receivable. The Committee Defendants had also received more than $18 million from Allens in the ninety days preceding the bankruptcy, such that a trustee potentially could avoid those transfers under 11 U.S.C. § 547(b).

Fulmer alleges that before the initial bankruptcy filing, one of the Committee Defendants, Ball Metal Food Container Corp., executed an undisclosed agreement with the Sager Creek Defendants. The agreement, according to Fulmer, provided that Ball would receive a lucrative contract with a new entity

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formed by the Sager Creek Defendants (*i.e.*, Sager Creek Acquisition Corp.) if that entity was the successful bidder in a § 363 sale for Allens's assets. Ball ultimately had one of the largest claims as a member of the unsecured creditors' committee in the Chapter 11 proceedings.

Fulmer then claims that the Fiduciary Defendants, who were aware of the agreement between Ball and the Sager Creek Defendants, manipulated the valuations of the bids at the auction. The terms of Seneca's bid, Fulmer explains, would have left $32.9 million in real estate and $74 million in ninety-day avoidance claims with the Allens estate. The terms of Sager Creek's final bid, by contrast, gave Sager Creek all of those assets, with a covenant not to pursue the avoidance claims. Yet despite these differences, the Fiduciary Defendant assisting Allens at the auction valued Seneca's bid at $117 million and valued Sager Creek's bid at $160 million. Fulmer contends that as a result of these actions, the defendants collectively divested the Allens estate of at least $74 million in avoidance claims and up to $32.9 million in real estate and personal property.

Based on this episode, Fulmer brought numerous claims against the defendants, including allegations of breach of fiduciary duty, fraudulent transfer, conversion, inducing breach of contract, intentional interference with contractual relations and prospective economic relations, negligent interference with prospective economic relations, deceptive trade practices, and an equitable claim for rescission and reformation. Fulmer argues that the bankruptcy court erred by characterizing these claims as a collateral attack on the February 2014 sale order, and by misapplying principles of *res judicata* and collateral estoppel.

***3** **[4]** Fulmer's contention brings to the fore this court's decision in *Regions Bank v. J.R. Oil Co.*, 387 F.3d 721 (8th Cir. 2004). *Regions Bank*, following *In re Met-L-Wood Corp.*, 861 F.2d 1012 (7th Cir. 1988), held that an order authorizing a sale free and clear of liens under § 363 "is shielded from collateral attack ... by virtue of the nature of rights transferred under 11 U.S.C. § 363." 387 F.3d at 732. This is so because "[a] proceeding under section 363 is an *in rem* proceeding. It transfers property rights, and property rights are rights good against the world, not just against parties to a judgment or persons with notice of the proceeding." *Id.* (quoting *In re Met-L-Wood*, 861 F.2d at 1017). Plaintiffs are therefore barred from bringing claims that amount to collateral attacks on the validity of a § 363 sale. In *Regions Bank*, we applied that rule where a plaintiff brought RICO claims premised on the defendants' alleged fraud in connection with a § 363 sale in a bankruptcy to which the plaintiff was not a party. *Id.* at 731-32. This court held that the claims were barred "to the extent [they] relate to the sale." *Id.* at 731.

[5] In this case, the bankruptcy court's February 2014 order approved the sale of the Allens assets to Sager Creek free and clear of all liens under 11 U.S.C. § 363(b) and (f). At bottom, Fulmer's complaint is that Sager Creek won the auction for the Allens assets with an overvalued bid that was supported by an undisclosed agreement between an unsecured creditor and the second lienholders who formed Sager Creek. Fulmer's contention amounts to an impermissible collateral attack on the February 2014 sale order under the reasoning of *Regions Bank*. In the order, the bankruptcy court determined that "all of the Acquired Assets were subject to a competitive and good faith bidding process," and that Sager Creek had "submitted the highest or otherwise best bid for the Acquired Assets offered at the Auction." The court also concluded that the consideration to be provided by Sager Creek was "the highest and otherwise best offer for the Acquired Assets." To sustain Fulmer's claims, a court would have to contradict those determinations. The finality accorded to asset sales under § 363 bars Fulmer's line of attack.

[6] Fulmer's arguments to the contrary are unconvincing. He first contends that his complaint does not collaterally attack the February 2014 sale order, because the defendants were not parties to the order, and he does not seek reversion of title to the property sold. A sale free and clear under § 363, however, is "a judgment that is good as against the world, not merely as against parties to the proceedings." *Id.* at 732. The claims barred in *Regions Bank* likewise did not seek reversion of title; they were claims for damages under RICO. *Id.* at 727-28, 731; *see* 18 U.S.C. § 1964(c). The Seventh Circuit similarly described a suit seeking "heavy damages" from parties involved in a § 363 sale as a "thinly disguised collateral attack on the judgment confirming the sale." *In re Met-L-Wood Corp.*, 861 F.2d at 1018.

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Fulmer also argues that the provisions of the sale order that conflict with his claims were not "integral" to the sale, so his complaint does not attack the sale order's validity. He imports this requirement from 11 U.S.C. § 363(m), which provides that reversal or modification of a § 363(b) sale on direct appeal does not "affect the validity of a sale" unless the sale order was stayed pending appeal. 11 U.S.C. § 363(m). This court reasoned in *In re Trism, Inc.*, 328 F.3d 1003 (8th Cir. 2003), that an appeal could "affect the validity of a sale" under § 363(m) only if it challenged a provision of the sale order that was "integral to the sale of the estate's assets." *Id.* at 1007.

[7] *Regions Bank* did not address whether the bar on collateral attacks is limited to those that challenge "integral" provisions of a § 363 sale. But if there were such a limitation, it would be satisfied here. Undermining the sale order's finding that Sager Creek's consideration was "the highest and otherwise best offer for the Acquired Assets" would "adversely alter the parties' bargained-for exchange." *Id.* When modifying or reversing a provision of the sale order would have that effect, the provision is "integral" to the sale. *Id.*

***4** **[8]** **[9]** **[10]** This is not to say that the rule of finality governing asset sales under § 363 forecloses all suits related to sales of a debtor's assets. For example, a claim that a fiduciary's conduct kept a prospective bidder from securing adequate funding to make a more competitive bid does not necessarily call into question a bankruptcy court's determination that the successful bid was the best offer on the table. *See* *Brown Media Corp. v. K&L Gates, LLP*, 854 F.3d 150, 155, 162-63 (2d Cir. 2017). Nor does the finality rule bar a claim against a fiduciary for conduct related to a sale where the transaction was not subject to approval by the bankruptcy court under § 363. *See* *In re Brook Valley VII, Joint Venture*, 496 F.3d 892, 899 (8th Cir. 2007); *In re Brook Valley IV*, 347 B.R. 662, 670-71 (B.A.P. 8th Cir. 2006). Where a lawsuit "poses no threat to the finality of the bankruptcy court's orders," *Brown Media Corp.*, 854 F.3d at 163, it does not conflict with the principles enunciated in *Regions Bank* and *In re Met-L-Wood*. But the finality rule precludes allegations like Fulmer's that second-guess the bankruptcy court's determination that the buyer submitted the best bid for the assets.

[11] **[12]** Fulmer also argues that the sale order is simply unenforceable because the required elements for a sale were not adequately proven. But the finality of a bankruptcy court's orders at the conclusion of direct review "[o]rdinarily ... stand[s] in the way of challenging their enforceability." *United Student Aid Funds, Inc. v. Espinosa*, 559 U.S. 260, 269, 130 S.Ct. 1367, 176 L.Ed.2d 158 (2010) (internal quotation and brackets omitted). We agree with the BAP that Fulmer's freestanding challenge to the sale order, while permissible on direct appeal, cannot be raised at this stage. *See* *In re Met-L-Wood*, 861 F.2d at 1018.

B.

[13] **[14]** **[15]** Fulmer argues alternatively that he is entitled to relief from the sale order because it was obtained through fraud on the court. A federal court has inherent equitable power to vacate a judgment that is obtained by fraud on the court. *Hazel-Atlas Glass Co. v. Hartford-Empire Co.*, 322 U.S. 238, 248, 64 S.Ct. 997, 88 L.Ed. 1250 (1944). A finding of fraud on the court, however, "is justified only by the most egregious misconduct directed to the court itself, such as bribery of a judge or jury or fabrication of evidence by counsel." *Landscape Props., Inc. v. Vogel*, 46 F.3d 1416, 1422 (8th Cir. 1995). The category is narrowly defined, and does not include "fraud between the parties or fraudulent documents, false statements or perjury." *United States v. Smiley*, 553 F.3d 1137, 1144 (8th Cir. 2009) (internal quotation omitted).

[16] **[17]** Fulmer's amended complaint falls short of meeting this demanding standard. Few, if any, of the alleged facts involve conduct directed at the court in the sale proceedings. Fulmer instead repeats his account of the undisclosed agreement between Ball and the Sager Creek Defendants, and the Fiduciary Defendants' alleged role in helping Sager Creek win the auction with an overvalued bid. He then states that "[n]ot a candid word of the scheme was disclosed to the Court at the 2/12/14 sale hearing." But nondisclosure, even of a side agreement affecting the outcome of a § 363 sale, does not rise to the level of fraud on the court. We rejected such a claim in *Landscape Properties*,

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holding that a bankruptcy attorney's failure to disclose a potentially collusive agreement between prospective bidders "d[id] not even come close to meeting that standard." 46 F.3d at 1422. Fulmer's amended complaint thus fails to state a plausible claim for fraud on the court.

***5** **[18]** Fulmer next contends that he should be granted relief from the sale order under Federal Rule of Civil Procedure 60. That rule, made applicable to bankruptcy cases by Federal Rule of Bankruptcy Procedure 9024, sets out grounds upon which a court may relieve a party from a final judgment or order. Fulmer cites Rule 60(b)(4), which allows relief when a "judgment is void," so long as a motion for relief is filed "within a reasonable time." Fed. R. Civ. P. 60(c)(1).

Fulmer argues that the sale order is "void" in light of *Czyzewski v. Jevic Holding Corp.*, —— U.S. ——, 137 S. Ct. 973, 197 L.Ed.2d 398 (2017). In *Jevic*, the Supreme Court considered whether a bankruptcy court may approve the dismissal of a Chapter 11 case that would distribute assets to creditors in violation of the priority rules that govern normal distribution plans, without the consent of the affected creditors. *Id.* at 983. The Court held that such structured dismissals are not permitted. *Id.* Fulmer asserts that the § 363 sale of the Allens assets violated the Bankruptcy Code's priority rules in a similar way—that is, that certain creditors with unsecured claims received value while others with identical priority did not.

Jevic does not win the day for Fulmer. For one thing, *Jevic* involved a structured dismissal and did not hold that § 363 sales must conform to normal priority rules. In fact, the Court noted that some courts in other contexts have approved priority-violating distributions where they serve "significant Code-related objectives," such as maximizing the value of the bankruptcy estate. *Id.* at 985. But even if the reasoning of *Jevic* on priority rules were extended to § 363 sales, it would not apply in the context of a consummated sale. Whatever force the Bankruptcy Code's priority rules might have at a sale approval hearing or on direct review of a § 363 sale, *see* *id.* at 986, a deviation from those rules does not render final judgments "void." *See* *Espinosa*, 559 U.S. at 273-76, 130 S.Ct. 1367 (holding confirmed bankruptcy plan was not void for purposes of Rule 60(b)(4) despite failing to comply with statutory requirement); *cf.* *In re Old Cold LLC*, 879 F.3d 376, 388 (1st Cir. 2018) (holding that *Jevic* did not add an exception to the text of § 363(m) concerning validity of a sale).

C.

[19] **[20]** Fulmer also contends that the bankruptcy court erred by denying as futile his motion for leave to amend his complaint. In the proposed amendment, Fulmer sought to raise a claim under Rule 60(b)(4) that the § 363 sale was void for lack of due process. Due process in bankruptcy generally entitles a party to receive the notice specified in the Bankruptcy Code and the Federal Rules of Bankruptcy Procedure, and a judgment is void if the bankruptcy court acted in a manner inconsistent with due process. *Baldwin v. Credit Based Asset Servicing & Securitization*, 516 F.3d 734, 737 (8th Cir. 2008).

[21] Fulmer's proposed due process claim is premised on his assertion that the defendants secretly agreed to transfer value from Allens to Sager Creek in the form of avoidance claims and real estate that were purchased for no additional consideration. Fulmer's proposed amendment alleges that notice was lacking because the alleged agreement remained undisclosed. This nondisclosure, he asserts, deprived the other interested parties of the ability and incentive to scrutinize Sager Creek's final bid.

The terms of the Sager Creek bid to which Fulmer principally objects, however, were stated on the record at the auction hearing. The other interested parties, including more than 5,000 known creditors, received timely notice of the auction and the subsequent sale approval hearing. The record before the bankruptcy court contained the auction transcript and the final versions of the purchase agreements. And interested parties were permitted to file objections in the approval hearing. These proceedings thus afforded interested parties adequate notice and opportunity to be heard with respect to their claims on the Allens estate. If any wrong was perpetrated by the maintenance of a secret agreement among the defendants, it was not a deprivation of due process in the

bankruptcy court. The February 2014 sale order is not void for lack of due process, and such a claim would have been futile.

***6** Fulmer's proposed amendment also adds details about the disputed transactions, but the alleged acts remain the same. Fulmer asserts that the Sager Creek Defendants and Ball had much to lose if Seneca ended up as the successful bidder for Allens's assets. The Sager Creek Defendants and Ball made an agreement to support Sager Creek Acquisition Corp., Fulmer claims, and they did not adequately disclose that agreement. The Fiduciary Defendants allegedly played a role by overvaluing Sager Creek's last-minute bid. Fulmer contends that although the bankruptcy court approved the sale, the court acted without an adequate understanding of how the bids compared to one another.

[22] Fulmer's claims in the proposed amendment, like those in the complaint that was dismissed, would undercut the principal findings of the February 2014 sale order, because they are premised on the alleged inferiority of Sager Creek's bid. They are thus barred by the finality rule governing asset sales under § 363. *See* *Regions Bank*, 387 F.3d at 731-32; *In re Met-L-Wood*, 861 F.2d at 1017-18. As for fraud on the court, despite new conclusory language, the proposed complaint does not point to any affirmative misrepresentation on a defendant's part that was directed to the bankruptcy court. The bankruptcy court thus did not err in concluding that the proposed amendment would be futile.

* * *

The judgment of the bankruptcy court is affirmed.

All Citations

--- F.3d ----, 2019 WL 3366654, 67 Bankr.Ct.Dec. 140

Footnotes

1 The Honorable Ben T. Barry, Chief Judge, United States Bankruptcy Court for the Eastern and Western Districts of Arkansas.

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601 B.R. 529
United States Bankruptcy Appellate Panel of the Ninth Circuit.

IN RE: Paul HURLEY, Debtor.
Paul Hurley, Appellant,
v.
United States of America; Accesslex Institute dba Access Group, Appellees.

BAP No. WW-18-1259-BKuF
|
Bk. No. 2:16-bk-13155-TWD
|
Adv. No. 2:17-ap-01025-TWD
|
Submitted Without Oral Argument on May 23, 2019
|
Filed June 26, 2019

Synopsis

Background: Chapter 7 debtor brought adversary proceeding for determination that he was entitled to "undue hardship" discharge of his student loan debt. The United States Bankruptcy Court for the Western District of Washington, Timothy W. Dore, J., granted defendants' motion for summary judgment, and debtor appealed.

[Holding:] The Bankruptcy Appellate Panel, Brand, J., held that debtor failed to make requisite good faith effort to repay the student loan debt of more than $250,000 that he had incurred to attend law school and to obtain both a J.D. degree and L.L.M. in tax, and was not entitled to "undue hardship" discharge of this debt.

Affirmed.

Procedural Posture(s): On Appeal; Motion for Summary Judgment.

West Headnotes (10)

[1] Bankruptcy
Conclusions of law; de novo review

Bankruptcy Appellate Panel reviews de novo a bankruptcy court's summary judgment ruling.

1 Cases that cite this headnote

[2] Bankruptcy
Conclusions of law; de novo review

Bankruptcy Appellate Panel reviews de novo the legal standard applied by bankruptcy court in determining whether a student loan debt is dischargeable as an "undue hardship." 11 U.S.C.A. § 523(a)(8).

Cases that cite this headnote

[3] Bankruptcy
Conclusions of law; de novo review

Whether debtor has satisfied each of the three prongs of the *Brunner* test for whether he is entitled to "undue hardship" discharge of student loan debt, including the "good faith" prong, is mixed question of law and fact, that requires de novo review. 11 U.S.C.A. § 523(a)(8).

Cases that cite this headnote

[4] Bankruptcy
Conclusions of law; de novo review

Bankruptcy
Particular cases and issues

Bankruptcy Appellate Panel reviews for clear error the factual underpinnings of bankruptcy court's determination as to whether debtor has made requisite good faith effort to repay his student loan debt, but reviews de novo the bankruptcy court's ultimate "good faith" conclusion in applying *Brunner* test to determine whether the debtor is entitled to "undue hardship" discharge of his student loan debt. 11 U.S.C.A. § 523(a)(8).

Cases that cite this headnote

[5] Bankruptcy
Educational loans

In student loan dischargeability proceeding, the burden of proving "undue hardship" is on debtor. 11 U.S.C.A. § 523(a)(8).

Cases that cite this headnote

[6] Bankruptcy
Hardship

In order to obtain an "undue hardship" discharge of his student loan debt, debtor must satisfy all three elements of the *Brunner* test; if debtor does not satisfy any one of *Brunner*'s three prongs, then bankruptcy court's inquiry must end there with a finding of no dischargeability. 11 U.S.C.A. § 523(a)(8).

Cases that cite this headnote

[7] Bankruptcy
Hardship

Whether debtor has made "good faith" effort to repay his student loans, as required by final prong of the *Brunner* test for whether debtor is entitled to "undue hardship" discharge of this debt, is measured by debtor's efforts to obtain employment, maximize income, and minimize expenses. 11 U.S.C.A. § 523(a)(8).

Cases that cite this headnote

[8] Bankruptcy
Hardship

Among factors which bankruptcy court may consider in deciding whether debtor has made "good faith" effort to repay his student loans, as required by final prong of the *Brunner* test for whether debtor is entitled to "undue hardship" discharge of student loan debt, are the following: (1) whether debtor has made any payments on the loans prior to filing for bankruptcy, though a history of making or not making payments, by itself, is not dispositive; (2) whether debtor has sought loan deferments or forbearances; (3) the timing of the debtor's attempt to have the loan discharged; and (4) whether the debtor's financial condition resulted from factors beyond his reasonable control. 11 U.S.C.A. § 523(a)(8).

Cases that cite this headnote

[9] Bankruptcy
Hardship

While not dispositive, important factor for court to consider in deciding whether debtor has made "good faith" effort to repay his student loans, as required by final prong of the *Brunner* test for whether debtor is entitled to "undue hardship" discharge of this debt, focuses upon debtor's efforts to negotiate a repayment plan. 11 U.S.C.A. § 523(a)(8).

Cases that cite this headnote

[10] Bankruptcy
Hardship not found

Chapter 7 debtor failed to make requisite good faith effort to repay the student loan debt of more than $250,000 that he had incurred to attend law school and to obtain both a J.D. degree and L.L.M. in tax, and was not entitled to "undue hardship" discharge of this debt, despite his multiple payments on his student loans, diligent efforts to obtain deferments and forbearances, and participation in income-based repayment plan, where debtor, by soliciting a bribe from taxpayer after learning that his employment with the IRS was about to be terminated, had deliberately engaged in criminal conduct that resulted in his incarceration and disbarment, and that drastically affected his ability to obtain employment upon being released from prison; debtor was licensed attorney who had to know that his conduct was wrongful and could serious consequences. 11 U.S.C.A. § 523(a)(8).

Cases that cite this headnote

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***531** Appeal from the United States Bankruptcy Court for the Western District of Washington, Honorable Timothy W. Dore, Bankruptcy Judge, Presiding

Attorneys and Law Firms

Appellant Paul Hurley pro se on brief;

Annette L. Hayes and Pooja Faldu Davé on brief for Appellee the United States of America;

Joseph Ward McIntosh of McCarthy & Holthus, LLP on brief for Appellee Accesslex Institute dba Access Group.

Before: BRAND, KURTZ and FARIS, Bankruptcy Judges.

OPINION

BRAND, Bankruptcy Judge:

INTRODUCTION

Appellant Paul Hurley appeals a summary judgment order in favor of the United States and Accesslex Institute, dba Access Group (together, "Defendants"). The bankruptcy court determined that, given Hurley's legal background and the nature of his criminal conduct, he was unable to establish good faith under *Brunner* [1] and therefore was not entitled to a hardship discharge of his student loans under § 523(a)(8). [2] We AFFIRM.

I. FACTUAL BACKGROUND AND PROCEDURAL HISTORY

A. Prepetition events

Hurley received his law degree in 2004 and his L.L.M. in tax in 2006. He received federal and private student loans to fund his legal education and bar examination costs. Hurley was admitted to practice law in the state of Washington in November 2006 but changed his license to inactive status in January 2010.

Hurley has made payments on both his federal and private student loans. He consolidated his federal student loans in 2010 and entered into an Income Based Repayment Plan. He has also been diligent in his efforts to obtain deferments and forbearances. Hurley was not in default on his student loans at the time he filed for bankruptcy.

In June 2009, Hurley was hired as a revenue agent for the Internal Revenue Service. Hurley conducted audits of taxpayers' federal tax returns.

In July 2015, Hurley began auditing the 2013 and 2014 tax returns for Have a Heart Compassion Care, Inc., a medical ***532** marijuana dispensary. [3] Hurley met with Ryan Kunkle, the representative for Have a Heart, on several occasions to discuss the tax returns. After the men had completed the audit process and signed the necessary forms, they went outside to have a discussion "off the record." As part of that discussion, Hurley told Kunkle that he had saved Have a Heart over $1 million in taxes. Hurley then solicited a bribe of $20,000 from Kunkle, which Hurley stated he needed to help pay his student loan debt. Fearing that Hurley would not present the signed audit documents to his superiors to complete the matter, Kunkle agreed to make the payment. Kunkle immediately reported the incident to law enforcement, who arrested Hurley after Hurley was recorded accepting two cash payments of $5,000 and $15,000 from Kunkle. Subsequently, Hurley resigned from the IRS, and he was indicted for federal offenses in connection with this conduct.

On May 13, 2016, Hurley was convicted for the crimes of Receiving a Bribe by a Public Official and Receiving an Illegal Gratuity by a Public Official, both felonies. He was sentenced to thirty months' imprisonment and three years' supervised release. Following his conviction, Hurley was disbarred from the practice of law by order of the Washington Supreme Court. Hurley was released from prison in June 2018 and is living in a halfway house in Seattle.

B. Postpetition events

Hurley filed a chapter 7 bankruptcy case one month after his conviction. His debts consist almost entirely of his student loan debt. Hurley represented that, as of the petition date, his student loan debt totaled approximately $256,000. Hurley was granted a discharge on September 14, 2016.

1. Hurley's § 523(a)(8) complaint

In February 2017 and while incarcerated, Hurley filed a complaint against Defendants, [4] seeking to discharge his entire student loan debt under § 523(a)(8). In support of his undue hardship claim, Hurley noted his conviction,

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incarceration, disbarment from the practice of law, and resulting financial circumstances. Hurley stated that due to his disbarment and felony record, he would be unable to return to his former profession or be employed at the same income level, even if he could find any substantive employment following his release. Therefore, requiring him to pay his student loan debt would impose an undue hardship on him and his dependents. At the time Hurley sought his hardship discharge, he was 45 years old and had a 3-year-old son. Hurley did not note any medical or other condition that prevented him from working in the future.

2. Defendants' motion for summary judgment

Defendants moved for summary judgment on Hurley's complaint ("MSJ"). Specifically, Defendants argued that Hurley was unable to satisfy the third prong of the *Brunner* test: that the debtor has made good faith efforts to repay the loans. Defendants argued that, despite Hurley's prior efforts to pay and stay current on his student loan debt, his present ***533** financial misfortune was self-imposed: Hurley willfully engaged in criminal activity that directly resulted in his current financial circumstances. Defendants argued that Hurley's intentional, egregious conduct outweighed his prior repayment efforts and prevented him from establishing good faith under *Brunner*.

In opposition, Hurley argued that one past bad act should not be dispositive of good faith under *Brunner* as Defendants contended. Instead, the court should consider present-tense factors which indicate whether or not a debtor has reasonable control over his or her current situation that now imposes the undue hardship. Hurley contended that he has no control over his criminal record, that he has no law license, that he has little prospect for good employment, and that he has no savings. His present circumstances were a result of societal factors preventing a felon from ever gaining employment at an income similar to his or her previous employment. Hurley said he had submitted more than 40 job applications since his release, which resulted in only one physical interview and no job offers.

3. The bankruptcy court's ruling on the MSJ

At the MSJ hearing, Hurley's counsel agreed with the court that there were no material facts in dispute; the issue was whose interpretation of the good-faith prong in *Brunner* was the correct one and whether it could be met on the facts for summary judgment purposes.

After hearing argument from the parties, the bankruptcy court announced its oral ruling granting the MSJ, finding that the facts relevant to the good-faith prong of the *Brunner* test were not in dispute and that no reasonable trier of fact could find for Hurley on good faith. Recognizing that there is no per se rule that past criminal conduct defeats good faith, the court found that the criminal conduct in this case was "very significant" and "outweigh[ed]" Hurley's earlier, good-faith efforts to repay his student loans. Precisely, the court noted that:

> As a lawyer, the Debtor had to know that, if he committed the crime that he did, he would lose his ability to practice law. As such, the Debtor suffers from both a failure to maximize his income and having willfully or negligently caused his financial condition.
>
> The Debtor's financial condition is a direct result of factors that were within his reasonable control. His financial condition was self-inflicted by his decision to commit a crime that would significantly impact his financial situation in a very negative way. The Debtor's situation is far more egregious than in some other cases within the Ninth Circuit where the debtor was found not to meet the good-faith prong for failing to maximize income or to take other action within the debtor's reasonable control.

Hr'g Tr. (Sept. 7, 2018) 20:1-15. Hurley timely appealed the bankruptcy court's later written order.

II. JURISDICTION

The bankruptcy court had jurisdiction under 28 U.S.C. §§ 1334 and 157(b)(2)(I). We have jurisdiction under 28 U.S.C. § 158(b). [5]

*534 III. ISSUE

Did the bankruptcy court err in determining that Hurley could not establish good faith under *Brunner*?

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IV. STANDARD OF REVIEW

[1] We review de novo the bankruptcy court's summary judgment ruling. *Salven v. Galli (In re Pass)*, 553 B.R. 749, 756 (9th Cir. BAP 2016).

[2] **[3]** **[4]** We review de novo the bankruptcy court's application of the legal standard in determining whether a student loan debt is dischargeable as an undue hardship. *Rifino v. United States (In re Rifino)*, 245 F.3d 1083, 1087 (9th Cir. 2001). Whether the debtor has satisfied each of the three prongs of the *Brunner* test, including the good-faith prong, is a mixed question of law and fact requiring de novo review. *Roth v. Educ. Credit Mgmt. Corp. (In re Roth)*, 490 B.R. 908, 916 (9th Cir. BAP 2013). We review the factual underpinnings of the bankruptcy court's good faith determination for clear error, but we review de novo the bankruptcy court's ultimate good faith conclusion. *Id.*

V. DISCUSSION

A. Summary judgment standards

Summary judgment should be granted when there are no genuine issues of material fact and when the movant is entitled to prevail as a matter of law. Civil Rule 56(a) (made applicable in adversary proceedings by Rule 7056). In resolving a summary judgment motion, the court does not weigh evidence, but rather determines only whether a material factual dispute remains for trial. *Covey v. Hollydale Mobilehome Estates*, 116 F.3d 830, 834 (9th Cir. 1997). A material fact is one that, "under the governing substantive law ... could affect the outcome of the case." *Caneva v. Sun Cmtys. Operating Ltd. P'ship (In re Caneva)*, 550 F.3d 755, 760 (9th Cir. 2008). "A genuine issue of material fact exists when 'the evidence is such that a reasonable jury could return a verdict for the nonmoving party.' " *Id.* at 761 (quoting *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 248, 106 S.Ct. 2505, 91 L.Ed.2d 202 (1986)).

At the hearing on the MSJ, Hurley's counsel conceded that there were no material facts in dispute and that a trial would not produce any different testimony than the parties had already presented. Thus, neither party disputed the bankruptcy court's ability to resolve this matter on summary judgment.

B. The bankruptcy court did not err in determining that Hurley could not establish good faith under *Brunner* and thus did not err in granting the MSJ.

[5] **[6]** Generally, student loan obligations are presumed to be excepted from a debtor's discharge under § 727, unless repaying those loans would "impose an undue hardship on the debtor and the debtor's dependents." § 523(a)(8). [6] ***535** In *Pena*, 155 F.3d at 1111-12, the Ninth Circuit adopted the three-pronged test set forth in *Brunner*, to determine whether the undue hardship standard has been met. The burden of proving undue hardship is on the debtor, and the debtor must prove all three elements before discharge can be granted. *In re Rifino*, 245 F.3d at 1087-88. If the debtor does not satisfy any one of these requirements, the bankruptcy court's inquiry must end there, with a finding of no dischargeability. *Id.* at 1088.

[7] The issue here is whether the bankruptcy court erred in reaching its conclusion on the third *Brunner* prong: whether the debtor made "good faith efforts to repay the loans." *In re Pena*, 155 F.3d at 1111; *In re Brunner*, 831 F.2d at 396. [7] "Good faith is measured by the debtor's efforts to obtain employment, maximize income, and minimize expenses." *In re Roth*, 490 B.R. at 917 (quoting *Educ. Credit Mgmt. Corp. v. Mason (In re Mason)*, 464 F.3d 878, 884 (9th Cir. 2006)); *Pa. Higher Educ. Assistance Agency v. Birrane (In re Birrane)*, 287 B.R. 490, 499 (9th Cir. BAP 2002).

[8] **[9]** This Panel has assembled the following list of factors courts have considered in making a good faith determination:

> (1) whether the debtor has made any payments on the loan prior to filing for discharge, although a history of making or not making payments is, by itself, not dispositive; (2) whether the debtor has sought deferments or forbearances; (3) the timing of

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> the debtor's attempt to have the loan discharged; and (4) whether the debtor's financial condition resulted from factors beyond her reasonable control, as a debtor may not willfully or negligently cause her own default.

In re Roth, 490 B.R. at 917 (citations and internal quotation marks omitted). *See also* *In re Brunner*, 46 B.R. at 756 (debtor must make an effort to repay the loans or show "that the forces preventing repayment are truly beyond his or her reasonable control"). While also not dispositive, another important "good faith" factor focuses upon the debtor's efforts to negotiate a repayment plan. *In re Roth*, 490 B.R. at 917 (citing *In re Birrane*, 287 B.R. at 499 and *Educ. Credit Mgmt. Corp. v. Jorgensen (In re Jorgensen)*, 479 B.R. 79, 89 & n.4 (9th Cir. BAP 2012)).

[10] Hurley did many things that a debtor should do to establish good faith: he consistently made payments on his student loans prior to his bankruptcy filing; he sought forbearance and hardship deferments prior to and during his incarceration; he enrolled in an Income Based Repayment Program; and he has been diligent in his job hunting efforts since his release from prison. Despite his efforts, however, the bankruptcy court reasoned that Hurley's financial condition was a result of factors within his reasonable control. His current condition was self-inflicted by his willful, criminal conduct, and this outweighed his earlier good-faith efforts of repayment.

We agree that the court could consider Hurley's past criminal conduct in the good faith analysis. Other courts have concluded ***536** that a debtor's future employment limitations or lack of earning potential caused by the debtor's choice to engage in criminal conduct and subsequent incarceration were not factors beyond the debtor's reasonable control, and that such factors can preclude a finding of good faith under *Brunner*. *See Chenault v. Great Lakes Higher Educ. Corp. (In re Chenault)*, 586 B.R. 414, 421 (6th Cir. BAP 2018) (debtor's past criminal record affecting his ability to find adequate future employment was a condition of his own making and would not satisfy the second and third prongs of the *Brunner* test); *Watson v. Sallie Mae (In re Watson)*, No. 11-5138, 2012 WL 5360949, at *2-3 (Bankr. D. Kan. Oct. 30, 2012) (concluding that debtor's inability to repay student loans due to his felony record and resulting incarceration were factors within his reasonable control and defeated good faith; these factors also defeated the second prong of the *Brunner* test); *Looper v. U.S. Dep't of Educ. (In re Looper)*, No. 06-3042, 2007 WL 1231700, at *7-8 (Bankr. E.D. Tenn. Apr. 25, 2007) (holding same; undue hardship discharge request denied). *But see Koll v. U.S. Dep't of Educ. (In re Koll)*, No. 01-8068, 2002 WL 32001509, at *5 (Bankr. C.D. Ill. May 3, 2002) (refusing to adopt a bright-line test that precludes debtors with a criminal conviction from obtaining an undue hardship discharge when otherwise warranted).

Hurley argues that his criminal conviction should not serve as a "categorical bar" to a finding for good faith under *Brunner*. Although still an open question in this circuit, we would not endorse a bright-line rule that a debtor with a criminal past can never establish good faith. However, we do not think that the bankruptcy court so held. Based on the facts, the court simply concluded that Hurley's willful criminal behavior tipped the balance against good faith. While this may be a close call given Hurley's significant good-faith efforts to repay, we are not able to conclude that the bankruptcy court erred. Hurley is a highly educated and capable person. More importantly, he was a licensed attorney, who knew or had to know that his conduct could result not only in a criminal conviction but also the loss of his license to practice law, and that this would negatively affect his financial situation. Further, Hurley relied entirely on his conviction, incarceration, disbarment and felony record as the basis for an undue hardship discharge. He did not cite any medical or other condition — something beyond his reasonable control — that was a contributing factor for his inability to find adequate employment and repay his student loans. *See Harvey v. Educ. Credit Mgmt. Corp. (In re Harvey)*, No.11–1958, 2013 WL 4478926, at *4 (Bankr. D. Colo. Aug. 20, 2013) (co-debtor wife's medical condition, not her prior felony conviction, prevented her from seeking employment to repay student loans). [8]

The timing of Hurley's request also weighs against good faith. *See* *In re Roth*, 490 B.R. at 917 (timing of debtor's attempt to have loan discharged can be considered in good faith analysis). He was still incarcerated at the time, as were the debtors in *Watson* and *Looper*, who were also denied an undue hardship discharge. *See also In re Harvey*, 2013 WL 4478926, at *4 (distinguishing *Watson* and *Looper* because co-debtor wife was seeking undue hardship discharge not while incarcerated but sometime afterwards). Therefore,

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while his job prospects appear bleak now, that may ***537** change in the future. He still has nearly twenty years to work before retiring. Thus, his request for a hardship discharge under § 523(a)(8) seems premature.

Hurley also argues that the bankruptcy court erred when it determined that he failed to maximize his income by losing his ability to practice law considering that he had an inactive bar license since 2010. We disagree. Hurley specifically relied on his inability to practice law to establish good faith under *Brunner* in his briefing before the bankruptcy court. Furthermore, Hurley presumably put his license on inactive status in 2010 only because he did not need an active license during his employment with the IRS. In any case, even an inactive law license gave Hurley an advantage over other applicants for many jobs and likely could have supported a higher salary. That advantage is now gone solely because of his willful conduct. Therefore, the court did not err in determining that Hurley failed to maximize his income by losing his law license.

Finally, Hurley argues that the bankruptcy court erred by not considering that he had been enrolled in an Income Based Repayment Program. The court explicitly considered this fact. It simply concluded that, given all of the factors establishing good faith, Hurley could not meet his burden of proof and that no material factual dispute remained for trial.

VI. CONCLUSION

Because Hurley was unable to establish good faith under *Brunner* for an undue hardship discharge of his student loans under § 523(a)(8), the bankruptcy court did not err in granting Defendants summary judgment. Accordingly, we AFFIRM.

All Citations

601 B.R. 529, 367 Ed. Law Rep. 495, 2019 Daily Journal D.A.R. 6091

Footnotes

1 *Brunner v. N.Y. State Higher Educ. Servs. Corp. (In re Brunner)*, 46 B.R. 752, 756 (S.D.N.Y. 1985), *aff'd*, 831 F.2d 395, 396 (2d Cir. 1987) (adopted by this circuit in *United Student Aid Funds, Inc. v. Pena (In re Pena)*, 155 F.3d 1108, 1111-12 (9th Cir. 1998)).

2 Unless specified otherwise, all chapter and section references are to the Bankruptcy Code, 11 U.S.C. §§ 101-1532, all "Rule" references are to the Federal Rules of Bankruptcy Procedure, and all "Civil Rule" references are to the Federal Rules of Civil Procedure.

3 The United States alleged in Hurley's criminal case that, just days before he began his audit of Have a Heart, Hurley had received a letter from his superior stating that the IRS was proposing to terminate him or otherwise discipline him based on his unauthorized access of taxpayer data on three occasions in 2014 and his lack of candor in the investigation of his unauthorized access.

4 Hurley sued additional parties but they were either voluntarily dismissed or a default judgment was entered against them.

5 Although the order on appeal resolved all claims against the remaining two defendants — the United States and Accesslex — the bankruptcy court did not enter a separate judgment disposing of the adversary proceeding. The parties also have not sought entry of a separate judgment despite being given the opportunity to do so. Therefore, the separate judgment requirement under Rule 7058 has been waived. *See* *Bankers Tr. Co. v. Mallis*, 435 U.S. 381, 98 S.Ct. 1117, 55 L.Ed.2d 357 (1978); *Casey v. Albertson's, Inc.*, 362 F.3d 1254, 1256 (9th Cir. 2004).

6 Section 523(a)(8) provides, in relevant part, that a discharge under § 727 does not discharge an individual debtor from any debt for:

> an educational benefit overpayment or 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, or an obligation to repay funds received as an educational benefit, scholarship, or stipend, or any other educational loan that is a qualified education loan ... incurred by a debtor who is an individual[,] ... unless excepting such debt from discharge under this paragraph would impose an undue hardship on the debtor and the debtor's dependents.

It is undisputed that the student loans at issue are of the kind which § 523(a)(8) generally excepts from discharge.

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7 Under *Brunner*/*Pena*, the debtor must also establish: (1) that she cannot maintain, based on current income and expenses, a minimal standard of living for herself and her dependents if forced to repay the loans; and (2) that additional circumstances exist indicating that this state of affairs is likely to persist for a significant portion of the repayment period of the student loans. *In re Pena*, 155 F.3d at 1111; *In re Brunner*, 831 F.2d at 396.

8 To the extent Hurley argues that the good-faith prong of the *Brunner* test has been inappropriately expanded to include consideration of a debtor's past bad conduct, we are bound by our circuit's adoption of *Brunner* and the factors that a court may consider for determining undue hardship, including a debtor's past acts, good or bad.

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927 F.3d 1223
United States Court of Appeals, Eleventh Circuit.

IN RE: Keith A. YERIAN, Debtor.
Keith A. Yerian, Defendant-Appellant,
v.
Richard B. Webber II, as Trustee, Plaintiff-Appellee.

No. 18-10944
|
(June 26, 2019)

Synopsis

Background: Chapter 7 trustee objected to Florida state law exemption claimed by debtor for his interest in individual retirement account (IRA). The United States Bankruptcy Court for the Middle District of Florida, No. 6:15-bkc-01720-KSJ, entered order sustaining objection and denying exemption, and debtor appealed. The District Court, No. 6:17-cv-00459, affirmed, and debtor appealed.

[Holding:] The Court of Appeals, Grant, Circuit Judge, held that, while debtor may have set up his IRA properly at the start, such that it qualified for tax exempt status, his later multiple prohibited transactions resulted in loss of the IRA's tax-exempt status and disqualified him from claiming Florida exemption for his interest in IRA.

Affirmed.

Procedural Posture(s): On Appeal; Objection to Claimed Exemptions.

West Headnotes (14)

[1] Bankruptcy
Operation and effect

Exempt assets are withdrawn from bankruptcy estate, and hence from creditors, for benefit of the debtor. 11 U.S.C.A. § 522(b).

Cases that cite this headnote

[2] Bankruptcy
Claim of Exemption or Lien Avoidance

Once debtor invokes an exemption, court may not refuse to honor the exemption absent a valid statutory basis for doing so.

Cases that cite this headnote

[3] Bankruptcy
Scope of review in general

On appeal from district court's decision in its bankruptcy appellate capacity, the Court of Appeals sits as a second court of review and thus examines independently the factual and legal determinations of bankruptcy court, employing the same standards of review as district court.

Cases that cite this headnote

[4] Bankruptcy
Conclusions of law; de novo review

Bankruptcy
Clear error

On appeal from district court's decision in its bankruptcy appellate capacity, the Court of Appeals reviews bankruptcy court's findings of fact for clear error and its conclusions of law de novo. Fed. R. Bankr. P. 8013.

Cases that cite this headnote

[5] Bankruptcy
Scope of review in general

On appeal in bankruptcy case, the Court of Appeals may affirm the judgment below on any ground supported in the record.

Cases that cite this headnote

[6] Bankruptcy
Exemptions

Exemptions
Construction of exemption laws in general

Generally, courts construe bankruptcy exemption statutes, both state and federal, liberally in favor of bankruptcy debtors.

Cases that cite this headnote

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[7] **Bankruptcy**
Proceedings

Burden is on the party objecting to debtor's claimed exemptions to prove, by preponderance of the evidence, that exemption cannot properly be claimed. Fed. R. Bankr. P. 4003(c).

Cases that cite this headnote

[8] **Exemptions**
Pension and retirement funds and accounts

Three requirements must be met in order for debtor to be entitled to claim the exemption provided under Florida law for debtor's interest in tax-exempt individual retirement account (IRA): (1) IRA's plan or governing instrument must have been initially determined by IRS to be exempt from taxation under provision of the Internal Revenue Code; (2) over time, the IRA must have been maintained in accordance with that plan or governing instrument; and (3) there must have been no final and nonappealable proceeding subsequently determining that the plan or governing instrument is no longer exempt from taxation under that provision of the Internal Revenue Code. 26 U.S.C.A. § 408; Fla. Stat. Ann. § 222.21(2)(a)(2).

Cases that cite this headnote

[9] **Bankruptcy**
Date of determination

Claim of exemption from bankruptcy estate is to be determined as of the petition date.

Cases that cite this headnote

[10] **Exemptions**
Pension and retirement funds and accounts

In order for debtor to be entitled to claim the exemption provided under Florida law for debtor's interest in tax-exempt individual retirement account (IRA), the IRA, over time, must be maintained in accordance, not with provision of the Internal Revenue Code governing the plan's tax-exempt status, but with plan or governing instrument that has been determined by the IRS to be exempt from taxation. 26 U.S.C.A. § 408; Fla. Stat. Ann. § 222.21(2)(a)(2).

Cases that cite this headnote

[11] **Exemptions**
Pension and retirement funds and accounts

While Chapter 7 debtor may have set up his individual retirement account (IRA) properly at the start, such that it qualified for tax exempt status under provision of the Internal Revenue Code, his later infractions in engaging in multiple prohibited transactions in violation of the IRA's governing instrument and of tax statute itself, such as in taking title to car purchased with IRA funds and staying in the IRA's condominium, resulted in loss of the IRA's tax-exempt status and disqualified him from claiming Florida exemption for his interest in IRA. 26 U.S.C.A. § 408; Fla. Stat. Ann. § 222.21(2)(a)(2).

Cases that cite this headnote

[12] **Statutes**
Statute as a Whole; Relation of Parts to Whole and to One Another

It is duty of court, when interpreting statute, to give effect, if possible, to every clause and word of statute.

Cases that cite this headnote

[13] **Statutes**
Unintended or unreasonable results; absurdity

Courts apply an exacting standard to find absurdity, such as will permit them to construe a statute contrary to the plain meaning of its language, lest they impose their policy predilections on legitimate legislative choices.

Cases that cite this headnote

[14] **Bankruptcy**

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Validity and effect of opt-out legislation

In the Bankruptcy Code, Congress has specifically authorized states to craft their own exemptions for bankruptcy debtors, which exemptions may be as generous or as austere as the state deems appropriate. 11 U.S.C.A. § 522(b).

Cases that cite this headnote

Attorneys and Law Firms

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Kevin Patrick Robinson, Bradley J. Anderson, Zimmerman Kiser & Sutcliffe, PA, ORLANDO, FL, for Defendant - Appellee.

Appeal from the United States District Court for the Middle District of Florida, D.C. Docket Nos. 6:17-cv-00459-RBD; 6:15-bkc-01720-KSJ

Before MARCUS, GRANT, and HULL, Circuit Judges.

Opinion

GRANT, Circuit Judge:

****1** Keith Yerian made some interesting choices with respect to the management of his individual retirement account. These choices included titling IRA-owned cars in his own name and his wife's name, as well as purchasing a condo in Puerto Rico with IRA funds and then using the condo for his personal travel needs. Yerian concedes that he incurred over one hundred thousand dollars in tax penalties for abusing his IRA. Ordinarily, that abuse would disqualify him from claiming the wide range of favorable treatment and exemptions typically offered to IRAs. But Yerian—now in bankruptcy proceedings—nonetheless seeks to shield the IRA from distribution to his creditors. He argues that Florida has exempted IRAs from bankruptcy administration so long as they were originally established with proper documentation. Fortunately for Yerian's creditors, and unfortunately for him, his interpretation of the text cannot be supported; he forfeited his exemption when he engaged in self-dealing transactions prohibited by the IRA's governing instruments. We therefore affirm the district court's order, which in turn upheld the bankruptcy court's decision to deny the exemption.

I.

A.

[1] **[2]** When a debtor files for Chapter 7 bankruptcy, his assets become property of the bankruptcy estate, to be distributed among his creditors. *See* 11 U.S.C. § 541(a)(1). The debtor may, however, exempt ***1226** certain types of property from the estate. 11 U.S.C. § 522(b). Exempt assets are "withdrawn from the estate (and hence from the creditors) for the benefit of the debtor." *Owen v. Owen*, 500 U.S. 305, 308, 111 S.Ct. 1833, 114 L.Ed.2d 350 (1991). A Chapter 7 debtor is not required to turn over exempt assets to the trustee and can keep them after the bankruptcy case is finished. And these carve-outs are sturdy; once a debtor invokes an exemption, a "court may not refuse to honor the exemption absent a valid statutory basis for doing so." *Law v. Siegel*, 571 U.S. 415, 134 S. Ct. 1188, 1196, 188 L.Ed.2d 146 (2014).

The bankruptcy code provides a list of federal exemptions, but also permits a state to opt out and replace the federal blueprint with an exemption scheme of its own. 11 U.S.C. § 522(b). Florida, as an opt-out state, has accepted that invitation to substitute its own set of exemptions. *See* Fla. Stat. § 222.20; *In re Valone*, 784 F.3d 1398, 1400 n.1 (11th Cir. 2015). One of those exemptions applies to "pension money and certain tax-exempt funds or accounts"—including IRAs—so long as a debtor meets certain statutory requirements. Fla. Stat. § 222.21. It is this exemption that we consider here.

B.

The relevant facts are not in dispute. In 2012, Keith Yerian opened a self-directed IRA with IRA Services Trust Company. The IRA's primary asset was an LLC through which Yerian purchased, among other things, real estate and two used cars. Yerian established this account as an IRA, "but then treated the money as his own." He used IRA funds to buy a condominium in Puerto Rico, for example, then impermissibly stayed there "for an un-IRA-related purpose."

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He and his wife also took title to two cars, a Smart Car and a Suburban, both purchased with IRA funds. Yerian then spent thousands of IRA dollars on car repairs, and he allowed his wife to drive the Suburban "as her vehicle." [1] He does not contest that these acts of self-dealing constituted "prohibited transactions" under the Internal Revenue Code and thus made his IRA ineligible for federal tax-exempt status as of January 1, 2014.

**2 On February 27, 2015, Yerian filed for Chapter 7 bankruptcy. After failing to disclose his IRA on the asset schedules originally accompanying his petition, Yerian eventually amended his filings to disclose the IRA—and also to claim a Florida-law exemption for it. Richard Webber, the bankruptcy Trustee, objected to the claim of exemption and initiated an adversary proceeding to resolve the issue. [2] After a two-day trial in late 2016, the bankruptcy court issued oral findings of fact and conclusions of law. Concluding that Florida law does not allow a debtor to claim an exemption for an IRA operated in violation of the federal tax code, the bankruptcy court issued a written order sustaining the Trustee's objection and directing the Trustee to seize the IRA on behalf of Yerian's creditors. Yerian sought review of the order *1227 denying his claim for the IRA exemption, and the district court affirmed. This appeal followed.

II.

[3] [4] [5] In a bankruptcy appeal, this Court "sits as a second court of review and thus examines independently the factual and legal determinations of the bankruptcy court and employs the same standards of review as the district court." *In re Hood*, 727 F.3d 1360, 1363 (11th Cir. 2013) (internal quotation marks and citation omitted). Accordingly, we "review the bankruptcy court's findings of fact for clear error and its conclusions of law de novo." *Id.* We may affirm the judgment below on any ground supported in the record. *See* *Jackson v. Bank of Am., N.A.*, 898 F.3d 1348, 1356 (11th Cir. 2018).

[6] [7] "Generally speaking, courts construe bankruptcy exemption statutes—both state and federal—liberally in favor of bankruptcy debtors." *In re McFarland*, 790 F.3d 1182, 1186 (11th Cir. 2015). The "burden is on the party objecting to exemptions to prove, by a preponderance of evidence," that the exemption cannot be claimed. *Id.* (citing Fed. R. Bankr. P. 4003(c)). It is therefore the Trustee's burden to prove that Yerian was not entitled to shield his IRA under Florida law.

III.

Yerian contends that section 222.21(2)(a)(2) of the Florida Statutes places his IRA beyond the reach of his creditors. Under that provision, a debtor may exempt from bankruptcy administration any money in "a fund or account" that is

> [m]aintained in accordance with a plan or governing instrument that has been determined by the Internal Revenue Service to be exempt from taxation under s. 401(a), s. 403(a), s. 403(b), s. 408, s. 408A, s. 409, s. 414, s. 457(b), or s. 501(a) of the Internal Revenue Code of 1986, as amended, unless it has been subsequently determined that the plan or governing instrument is not exempt from taxation in a proceeding that has become final and nonappealable.

Fla. Stat. § 222.21(2)(a)(2) (footnote omitted).

Section 408 of the Internal Revenue Code is the relevant provision in this case. That statute, among other things, sets out the requirements for an IRA to receive tax-exempt status under federal law. *See* 26 U.S.C. § 408. Section 408 first sets out six minimum requirements for the terms of the "written governing instrument" that legally establishes the IRA. *See* *id.* § 408(a). These requirements are important, but may read as rather arcane to the uninitiated. They range from permitting only cash contributions (and only in an amount corresponding to the limit in effect for that taxable year), to mandating particular rules relating to incidental death benefits. *See* *id.* § 408(a)(1)–(6). We will not belabor these requirements, however, because none of them are directly at issue here. [3] The upshot is that an IRA is only *1228 tax exempt in the first place if it satisfies "a number of requirements imposed by the Internal Revenue Code."

Rousey v. Jacoway, 544 U.S. 320, 322, 125 S.Ct. 1561, 161 L.Ed.2d 563 (2005).

**3 Section 408 also sets out rules for how an IRA must be operated in order to *keep* its tax-exempt status. One way an IRA can lose its tax-exempt status is for the IRA owner to engage in "prohibited transactions"—a category that includes "abuses" placing the plan at risk of loss before retirement, as well as various acts of "self-dealing." 26 U.S.C. § 408(e)(2); *Comm'r v. Keystone Consol. Indus., Inc.*, 508 U.S. 152, 160, 113 S.Ct. 2006, 124 L.Ed.2d 71 (1993); *Ellis v. Comm'r*, 787 F.3d 1213, 1217 (8th Cir. 2015).[4] This provision turns out to be relevant here.

Turning to the conduct in this case, Yerian does not contest that he engaged in prohibited transactions—for instance, taking title to the IRA's car and staying in the IRA's condominium—and that when he did so, his IRA lost its tax-exempt status under § 408. Nevertheless, Yerian argues that his IRA is still *creditor* exempt under section 222.21(2)(a)(2). In his view, the Florida exemption statute shields even an IRA operated in violation of the federal tax code, so long as the form of the IRA's governing instrument satisfies the requirements of § 408(a) on paper. The Trustee disagrees, and so do we. And because we have not had occasion to interpret section 222.21(2)(a)(2) since it was amended to include the language at issue, we take this opportunity to explain the mechanics of the statute in some detail.

We start with an observation about the statute's structure. Section 222.21 of the Florida Statutes imposes different exemption requirements on different IRAs, depending on whether and how the Internal ***1229** Revenue Service has signed off on the IRA's terms. Section 222.21(2)(a)(1) applies if the IRA's terms have been "*preapproved* by the Internal Revenue Service as exempt from taxation." Section 222.21(2)(a)(2) applies if the IRA's terms have been "*determined* by the Internal Revenue Service to be exempt from taxation." And if the IRS has neither preapproved nor determined that the IRA's terms comply with the tax code, the debtor must seek an exemption under section 222.21(2)(a)(3). Fla. Stat. § 222.21(2)(a)(1)–(3) (emphases added).

[8] We are tasked with interpreting only section 222.21(2)(a)(2), the second of these three provisions. Under Florida law, Yerian would be entitled to claim an exemption for his IRA under section 222.21(2)(a)(2) if three requirements were met:

**4 (1) The IRA's plan or governing instrument was initially "determined by the [IRS] to be exempt from taxation" under § 408;

(2) Over time, the IRA has been "maintained in accordance with" that plan or governing instrument; and

(3) No final and nonappealable proceeding has "subsequently determined" that the plan or governing instrument is no longer exempt from taxation under § 408.

As to the first requirement, the record does not indicate whether Yerian ever obtained an IRS determination that his IRA's governing instrument satisfied § 408. But it is the Trustee who must demonstrate that an exemption is inapplicable, and the Trustee has not challenged the exemption on that ground. *See McFarland*, 790 F.3d at 1186. We reiterate, however, that different subsections of section 222.21(2)(a) apply to funds that have been "determined by the [IRS] to be exempt from taxation," Fla. Stat. § 222.21(2)(a)(2), "preapproved by the [IRS] as exempt from taxation," *id.* § 222.21(2)(a)(1), or neither, *id.* § 222.21(2)(a)(3). This classification matters because a fund in the third category—that is, one that has neither been determined nor preapproved by the IRS to be tax exempt—must satisfy a different set of requirements in order to be eligible for a creditor exemption. But again, because the parties here agree that Yerian properly invoked section 222.21(2)(a)(2), we examine the matter no further.

[9] The third requirement—that no final and nonappealable proceeding has declared that Yerian's IRA is no longer tax-exempt—is satisfied as well. It is settled law that a "claim of exemption is to be determined as of the petition date." *In re Fodor*, 339 B.R. 519, 521 (Bankr. M.D. Fla. 2006). And it is clear from the record before us that, prior to Yerian's bankruptcy petition date, no final and nonappealable proceeding—before the IRS or any court—had determined that his IRA's governing instrument was no longer exempt under the tax code.[5]

[10] **[11]** Accordingly, Yerian's claim for exemption turns on whether the second requirement is satisfied—that is, whether his IRA was "maintained in accordance with" the "plan or governing instrument" that the IRS had determined was exempt from taxation under § 408's requirements.[6]

***1230** We pause here to note a misstep in the opinion of the district court. Echoing the bankruptcy court, the district court interpreted the statute to require that an IRA be "maintained in accordance with IRC § 408" in order to be exempt from creditors. But rather than focusing on congruity with federal statutory requirements, the Florida statute says that to be exempt, an IRA must be "maintained in accordance with *a plan or governing instrument* that has been determined by the [IRS] to be exempt from taxation under ... s. 408." Fla. Stat. § 222.21(2)(a)(2) (emphasis added). So the object of the phrase "maintained in accordance with" is "a plan or governing instrument"—not § 408 of the Internal Revenue Code. The Florida exemption thus turns on whether the IRA has been maintained in accordance *with its own governing instrument*, not on whether the IRA has been maintained in compliance with § 408 in the first instance.

****5** **[12]** This will often be a distinction without a difference where (as we will see is the case here) the IRA owner engages in behavior that turns out to be prohibited by both the governing instrument and the tax code. But it is "the duty of the court to give effect, if possible, to every clause and word of a statute." *In re Failla*, 838 F.3d 1170, 1175 (11th Cir. 2016) (quoting *Montclair v. Ramsdell*, 107 U.S. 147, 152, 2 S.Ct. 391, 27 L.Ed. 431 (1883)). Moreover, the distinction drawn by Florida law can be a meaningful one. We provide a few examples to highlight the practical implications of our statutory reading, as well as to properly direct our own inquiry.

On the one hand, federal laws governing retirement accounts change frequently, meaning that amendments to the tax code may require changes to a retirement plan's terms. The Tax Reform Act of 1986, for example, required employers to remove a formerly "common" type of "benefit formula" from their pension plans by January 1, 1989. *See* *Scott v. Admin. Comm. of the Allstate Agents Pension Plan*, 113 F.3d 1193, 1195 (11th Cir. 1997). If a pensioner's employer had refused to change its plan and continued to dole out improper benefits, the pensioner would have been a participant in a fund maintained in accordance with its own plan or governing instruments, but *not* maintained in accordance with § 401(a) of the Internal Revenue Code. The Florida exemption statute would likely allow such a pensioner to shield his retirement fund from creditors, even though the fund was not maintained in compliance with the tax code—at least until it was "subsequently determined" that the governing instrument was not exempt. Fla. Stat. § 222.21(2)(a)(2). The Florida exemption thus contains somewhat of a safe harbor, allowing IRAs to maintain creditor-exempt status for a period of time after the law changes.

Conversely, because an IRA's plan or governing instrument may contain requirements that go *beyond* the law, an IRA could be operated in a way that satisfies the tax code, yet violates additional restrictions set out in its own governing instruments. For example, "IRAs are, as a statutory matter, permitted to hold real property." *Dabney v. Comm'r*, 107 T.C.M. (CCH) 1535, 2014 WL 2535110, at *4 (2014). But an IRA custodian is not required to offer "the option to invest IRA funds in *any* asset that is not prohibited by statute," and has "the power to prohibit the purchase and holding of real property" through the terms of the governing instrument. *Id.* (emphasis added). In other words, IRA governing instruments can impose ***1231** requirements that go beyond the law—and section 222.21(2)(a)(2) demands compliance with those additional requirements. Florida law thus would not shield an IRA owner who violated the terms of his governing instrument, even in the absence of a tax code violation.

Our sole task, then, is to determine whether Yerian maintained his IRA in accordance with its own plan or governing instruments. The parties have identified as the governing instruments of this IRA two contracts between Yerian and IRA Services Trust Company: a Traditional IRA Agreement, and an IRA LLC Agreement. [7] The Trustee argues that Yerian violated the terms of the latter document, and we agree. The IRA LLC Agreement was the contract under which IRA Services Trust Company permitted Yerian to make his own IRA investments through an LLC. The Agreement, which Yerian signed on June 1, 2012, contained the following language: "I acknowledge that I have not and will not engage in any prohibited transactions within my retirement account or its asset holdings." The Agreement further stated, in bold: "A prohibited transaction is a transaction between a plan (the LLC) and a disqualified person that is prohibited by law." It explained that a prohibited transaction included any "act of a fiduciary by which plan income or assets are used for his or her own interest," and any "transfer of plan income or assets to, or use of them by or for the benefit of, a disqualified person." A "disqualified person," in turn, explicitly included "the owner" of the IRA as well as the owner's "spouse."

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**6 Yerian admits that he engaged in self-dealing transactions "prohibited by law." Yerian used the condominium in Puerto Rico, an asset of the IRA LLC, for his own benefit. He and his wife took title to two cars purchased by the IRA LLC, and even drove one of them as a personal vehicle. It is plain to us that Yerian violated the express terms of the IRA LLC Agreement. Based on these facts, it is similarly plain that he failed to maintain his IRA in accordance with its governing instrument—and as a consequence forfeited his creditor exemption under section 222.21(2)(a)(2).

Yerian tries to avoid the statute's "maintained in accordance with" requirement, but his efforts are in vain. First, Yerian argues that every section 222.21(2)(a)(2) inquiry should turn on whether an IRA has lost its tax-exempt status in an unfavorable final and nonappealable proceeding. He asserts that once "it is established that an account is governed by proper documents, the account is exempt from creditors unless and until the account is determined to have lost its tax-exempt status" in a final proceeding. Not so. Recall that the statute contains three requirements: (1) an initial determination by the IRS that the terms of a plan or governing instrument established a tax-exempt IRA; (2) maintenance of the IRA in accordance with those terms; and (3) no subsequent determination in a final proceeding that the terms did *not* establish a lawful exemption. Fla. Stat. § 222.21(2)(a)(2). An unfavorable final proceeding and an owner's failure to properly maintain his IRA are two *different* ways to forfeit a section 222.21(2)(a)(2) exemption. Yerian's argument fails to give any effect at all to the requirement that an IRA be "maintained in accordance with" its governing documents.

*1232 Alternatively, Yerian argues that an IRA satisfies the "maintained in accordance with" prong so long as it continues to exist after being "opened pursuant to an approved plan" or governing instrument. He would thus have us confine our inquiry to the moment he signed the governing instruments and read "*maintained* in accordance with" a proper governing instrument to mean "*established* in accordance with" a proper governing instrument. But those words of course are not interchangeable. To "establish" is to "set up (a government, nation, business, etc.); found; institute." Webster's New World College Dictionary 497 (5th ed. 2014). To "maintain," by contrast, is to "continue" or "keep in a certain condition." *Id.* at 880; Black's Law Dictionary 1097 (10th ed. 2014). So the words in the statute compel us to look beyond the moment of establishment to examine how Yerian operated his IRA over time. Although Yerian may have set up his IRA properly at the start, his later infractions disqualified him from claiming the exemption.

[13] [14] Finally, as the analysis in this opinion shows, our decision is not guided by the Trustee's argument that it would be "absurd" or "inconsistent with the principles behind the bankruptcy code" for Florida law to have the effect of shielding even some IRAs operated in violation of federal tax law. This Court applies an "exacting standard for finding absurdity," *CBS Inc.* v. *PrimeTime 24 Joint Venture*, 245 F.3d 1217, 1228 (11th Cir. 2001), lest we impose "the policy predilections of judges" on legitimate legislative choices, *Merritt v. Dillard Paper Co.*, 120 F.3d 1181, 1188 (11th Cir. 1997). And in any event, Congress has specifically authorized states to craft their own creditor exemptions—which may be as generous or as austere as the state deems appropriate. *See* 11 U.S.C. § 522(b); *In re Gamble*, 168 F.3d 442, 444 (11th Cir. 1999). It is not our role to second-guess the mercy Florida chooses to show its debtors, and we will decline the invitation to do so. We rest our decision on the plain text of the statute alone.

IV.

7 Yerian failed to maintain his IRA in accordance with its governing instruments, which explicitly prohibited the acts of self-dealing he engaged in with his IRA funds. As a consequence, he is not entitled to claim a creditor exemption for his IRA under section 222.21(2)(a)(2). The judgment of the district court is **AFFIRMED.

All Citations

927 F.3d 1223, 2019 WL 2610751, 123 A.F.T.R.2d 2019-2341, 67 Bankr.Ct.Dec. 93, 27 Fla. L. Weekly Fed. C 2093

Footnotes

1 According to his wife, Yerian would sometimes drive the Suburban as well. As for the Smart Car, Yerian claims that he "bought it totaled" and was never able to drive it.

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2 The bankruptcy court also addressed two other issues at trial: whether the Trustee could avoid and recover as a fraudulent transfer any part of a $ 256,000 payment that Yerian made to his wife from their joint e-trading account, and whether Yerian's discharge should be denied because he acted with fraudulent intent in his bankruptcy proceedings. The fraudulent transfer is the subject of a separate appeal brought by Yerian's wife. *See Pak v. Webber* (*In re Yerian*), 2018 WL 4836776 (Bankr. M.D. Fla. Sept. 28, 2018). The bankruptcy court denied Yerian's bankruptcy discharge, and he has not challenged that decision in this appeal.

3 For those who are curious, the "written governing instrument" creating the IRA must include the following six requirements:

> (1) Except in the case of a rollover contribution described in subsection (d)(3) or in section 402(c), 403(a)(4), 403(b)(8), or 457(e)(16), no contribution will be accepted unless it is in cash, and contributions will not be accepted for the taxable year on behalf of any individual in excess of the amount in effect for such taxable year under section 219(b)(1)(A).
> (2) The trustee is a bank (as defined in subsection (n)) or such other person who demonstrates to the satisfaction of the Secretary that the manner in which such other person will administer the trust will be consistent with the requirements of this section.
> (3) No part of the trust funds will be invested in life insurance contracts.
> (4) The interest of an individual in the balance in his account is nonforfeitable.
> (5) The assets of the trust will not be commingled with other property except in a common trust fund or common investment fund.
>
> (6) Under regulations prescribed by the Secretary, rules similar to the rules of section 401(a)(9) and the incidental death benefit requirements of section 401(a) shall apply to the distribution of the entire interest of an individual for whose benefit the trust is maintained.
>
> 26 U.S.C. § 408(a).

4 Section 408 provides that if,

> during any taxable year of the individual for whose benefit any individual retirement account is established, that individual or his beneficiary engages in any transaction prohibited by section 4975 with respect to such account, such account ceases to be an individual retirement account as of the first day of such taxable year.
>
> 26 U.S.C. § 408(e)(2)(A). Section 4975, in turn, defines a "prohibited transaction" as any direct or indirect—
> (A) sale or exchange, or leasing, of any property between a plan and a disqualified person;
> (B) lending of money or other extension of credit between a plan and a disqualified person;
> (C) furnishing of goods, services, or facilities between a plan and a disqualified person;
> (D) transfer to, or use by or for the benefit of, a disqualified person of the income or assets of a plan;
> (E) act by a disqualified person who is a fiduciary whereby he deals with the income or assets of a plan in his own interest or for his own account; or
> (F) receipt of any consideration for his own personal account by any disqualified person who is a fiduciary from any party dealing with the plan in connection with a transaction involving the income or assets of the plan.
>
> 26 U.S.C. § 4975(c)(1).

5 The parties spar over whether an unfavorable determination by a bankruptcy court, as opposed to by "the IRS or a tax court," could disqualify a debtor under this prong. Because the bankruptcy court made no such determination before the petition date, we leave that hypothetical question for another day.

6 The tax code uses the word "plan" in the context of some types of funds and accounts, and "governing instrument" in the context of others. Section 408, which sets out the requirements for IRAs, refers to a "governing instrument." 26 U.S.C. § 408(a).

7 Because the parties do not dispute that these two documents are the IRA's governing instruments, we do not attempt to define the term "governing instrument" as used in section 222.21(2)(a)(1)–(3).

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