2019 WL 2611115
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RULINGS BY SUMMARY ORDER DO NOT HAVE PRECEDENTIAL EFFECT. CITATION TO A SUMMARY ORDER FILED ON OR AFTER JANUARY 1, 2007, IS PERMITTED AND IS GOVERNED BY FEDERAL RULE OF APPELLATE PROCEDURE 32.1 AND THIS COURT'S LOCAL RULE 32.1.1. WHEN CITING A SUMMARY ORDER IN A DOCUMENT FILED WITH THIS COURT, A PARTY MUST CITE EITHER THE FEDERAL APPENDIX OR AN ELECTRONIC DATABASE (WITH THE NOTATION "SUMMARY ORDER"). A PARTY CITING A SUMMARY ORDER MUST SERVE A COPY OF IT ON ANY PARTY NOT REPRESENTED BY COUNSEL.
United States Court of Appeals, Second Circuit.

FEDERAL TRADE COMMISSION, Plaintiff-Appellee,
v.
Joseph K. RENSIN, Defendant-Appellant,
Bluehippo Funding, LLC, Bluehippo Capital, LLC, Defendants.

17-669-cv (L)
|
17-1587-cv (CON)
|
June 26, 2019

Appeals from March 6 and March 28, 2017 orders of the United States District Court for the Southern District of New York (Crotty, *J.*).

UPON DUE CONSIDERATION, IT IS HEREBY ORDERED, ADJUDGED, AND DECREED that the district court's orders are **VACATED**.

Attorneys and Law Firms

For Appellant: Jeffrey J. Molinaro, Fuerst Ittleman David & Joseph, PL, Miami, FL (Joseph A. DiRuzzo, III, on the brief, Joseph A. DiRuzzo, III, P.A., Ft. Lauderdale, FL)

For Appellee: Imad D. Abyad, (Theodore (Jack) Metzler, attorney, Michele Arington, attorney, on the brief), Assistant General Counsel, Federal Trade Commission, Washington, DC

Present: BARRINGTON D. PARKER, PETER W. HALL, RAYMOND J. LOHIER, JR., Circuit Judges.

SUMMARY ORDER

Joseph Rensin appeals from two orders entered by the United States District Court for the Southern District of New York (Crotty, *J.*). The March 6, 2017 order determined that the automatic bankruptcy stay imposed by Rensin's Chapter 7 bankruptcy did not apply to efforts to enforce the district court's orders under the "governmental unit" exception of 11 U.S.C. § 362(b)(4) and that the district court was, therefore, not barred from deciding whether to hold Rensin in contempt. The March 28, 2017 order holds Rensin in contempt for his failure to comply with a final judgment of the district court imposing compensatory contempt sanctions in the amount of $13,400,627.60. The two appeals were consolidated for disposition by order of this Court dated January 16, 2019. We assume the parties' familiarity with the issues and arguments on appeal.

Rensin challenges the district court's determination with respect to the automatic stay, asserting that the contempt proceedings constitute the enforcement of a money judgment and therefore fall outside of the "governmental unit" exception to the automatic stay. *See* 11 U.S.C. § 362(b)(4). As a result, Rensin asserts, the contempt order is void because it violates the automatic bankruptcy stay, and in the alternative, violates a temporary stay issued by our court on March 27, 2017.

We conclude that the district court's order of March 6, 2017, finding that the automatic bankruptcy does not apply to the contempt proceeding, is final and therefore reviewable. The only issue in this case is whether the district court's disposition of the Federal Trade Commission's (FTC's) attempt to pursue a contempt order, holding Rensin in coercive incarceration until he pays the $13.4 million judgment, amounts to the "enforcement of a ... money judgment" and therefore falls outside of the governmental unit exception and violates the automatic stay.[1] We conclude that it does. *See* *SEC v. Brennan*, 230 F.3d 65, 71 (2d Cir. 2000) ("[While] the governmental unit exception of § 362(b)(4) permits the *entry* of a money judgment against a debtor ... *anything beyond the mere entry of a money judgment* against a debtor is prohibited by the automatic stay.").

The "governmental unit" exception to the automatic stay provides:

> The filing of a petition under section 301, 302, or 303 of this title ... does not operate as a stay ... of the commencement or continuation of an action or proceeding by a governmental unit ... to enforce such governmental unit's or organization's police and regulatory power, including the enforcement of a judgment other than a money judgment, obtained in an action or proceeding by the governmental unit to enforce such governmental unit's or organization's police or regulatory power[.]

***2** 11 U.S.C. § 362(b)(4). Here, the purpose in seeking the entry of the contempt order was simply to enforce a money judgment that had already been entered against Rensin.

We have noted that "[w]e did not intend in *Brennan* to impose a one-factor timing test whereby ... orders entered (or with continuing force) post-judgment are always subject to the stay," but we have also said that "the timing of the order's entry constitutes a crucial factor in our analysis." *SEC v. Miller*, 808 F.3d 623, 633 (2d Cir. 2015). Here, not only was the FTC's request for a contempt order filed after entry of judgment, it also had no other purpose than to enforce the money judgment against Rensin. Although it is clear the FTC filed its request for an order of contempt before Rensin filed his bankruptcy petition, once the automatic stay was in place, the district court was prohibited from disposing of that request while Rensin's bankruptcy remained pending. For that reason, the district court's conclusion that it could, and indeed did, decide the contempt issue under the governmental unit exception was erroneous because the contempt proceeding was an attempt to enforce the money judgment.

In disposing of the appeals as we have, we express no view as to the FTC's ability to collect the $13.4 million judgment against Rensin after the conclusion of his bankruptcy proceedings. Accordingly, the district court's orders are **VACATED**.

All Citations

--- Fed.Appx. ----, 2019 WL 2611115 (Mem)

Footnotes

1 We note that the FTC requested that the district court stay enforcement of coercive incarceration until after Rensin's bankruptcy proceedings had completed. That stay would make no difference in our analysis. The issue in this case is whether the district court could, without violating the automatic stay, enter the contempt order in the first place, regardless of whether it then stayed enforcement of that order.

927 F.3d 862
United States Court of Appeals, Fifth Circuit.

In the MATTER OF: LINN ENERGY, L.L.C.; Berry Petroleum Company, L.L.C.; LinnCo, L.L.C.; Linn Acquisition Company, L.L.C.; Linn Energy Finance Corporation; Linn Energy Holdings, L.L.C.; Linn Exploration & Production Michigan, L.L.C.; Linn Exploration Midcontinent, L.L.C.; Linn Midstream, L.L.C.; Linn Midwest Energy, L.L.C.; Linn Operating, Incorporated; Mid-Continent I, L.L.C.; Mid-Continent II, L.L.C.; Mid-Continent Holdings I, L.L.C.; Mid-Continent Holdings II, L.L.C., Debtors
Oklahoma State Treasurer, Unclaimed Property Division, Appellee
v.
Linn Operating, Incorporated, Appellant

No. 18-40575
|
FILED June 19, 2019

Synopsis
Background: Chapter 11 debtors objected to proofs of claim filed by the Oklahoma State Treasurer, asserting interest in unclaimed mineral royalties in bankrupt oil and gas producer's possession, and the Treasurer responded by commencing adversary proceeding for turnover of these royalties. Debtors filed motion to dismiss. The United States Bankruptcy Court for the Southern District of Texas granted dismissal motion, and the Treasurer appealed. The District Court, Kenneth M. Hoyt, J., 2018 WL 1535354, reversed, and appeal was taken.

[Holding:] The Court of Appeals, Edith H. Jones, Circuit Judge, held that res judicata effect of confirmed plan and plan confirmation order prevented the Treasurer from belatedly asserting right to unclaimed royalties.

Reversed; bankruptcy court's decision reinstated.

Procedural Posture(s): On Appeal; Motion to Dismiss.

West Headnotes (6)

[1] **Bankruptcy**
Scope of review in general

Court of Appeals reviews decision of district court sitting as a bankruptcy appellate court by applying the same standards of review to bankruptcy court's findings of fact and conclusions of law as were applied by district court.

Cases that cite this headnote

[2] **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 acts as a second review court and reviews bankruptcy court's conclusions of law de novo and its findings of fact for clear error. Fed. R. Bankr. P. 8013.

Cases that cite this headnote

[3] **Judgment**
Courts or Other Tribunals Rendering Judgment
Judgment
Nature and elements of bar or estoppel by former adjudication
Judgment
Matters which might have been litigated

"Final orders" of bankruptcy court, i.e., orders that are affirmed upon direct review or are not appealed or contested, become res judicata to the parties and those in privity with them, not only as to every matter which was offered and received to sustain or defeat the claim or demand, but as to any other admissible matter which might have been offered for that purpose.

Cases that cite this headnote

[4] Judgment
Courts or Other Tribunals Rendering Judgment

Final bankruptcy court orders are entitled to res judicata effect regardless of whether they were proper exercises of bankruptcy court jurisdiction and power at the time that they became final.

Cases that cite this headnote

[5] Bankruptcy
Conclusiveness

When parties to Chapter 11 case have been given fair opportunity to challenge bankruptcy court's subject matter jurisdiction, or a provision of plan approved by bankruptcy court during the case, and fail to do so, they cannot challenge the court's order later through a collateral attack. 11 U.S.C.A. § 1141.

Cases that cite this headnote

[6] Bankruptcy
Conclusiveness

Failure on part of the Oklahoma State Treasurer to object to bankrupt oil and gas producers' proposed Chapter 11 plan, with regard to plan's treatment of unclaimed mineral royalties, and the Treasurer's failure, despite having the requisite notice and a fair opportunity to object, either to participate in plan confirmation hearing or to appeal plan confirmation order, prevented the Treasurer from belatedly asserting right to these unclaimed royalties contrary to provisions of confirmed plan, despite the Treasurer's contention that debtor had no interest in royalties, which thus never entered the estate and could not be disposed of in plan; such objections should have been pursued earlier at plan confirmation hearing. 11 U.S.C.A. § 1141.

Cases that cite this headnote

***863** Appeal from the United States District Court for the Southern District of Texas, Kenneth M. Hoyt, U.S. District Judge

Attorneys and Law Firms

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Before DAVIS, JONES, and DENNIS, Circuit Judges.

Opinion

EDITH H. JONES, Circuit Judge:

****1 *864** The district court held that the bankruptcy court erred in dismissing a post-confirmation attempt by the Oklahoma State Treasurer ("Treasurer") to obtain the right to unclaimed royalty payments owed by the oil and gas debtor. Because the Treasurer sat on its rights during the entire Chapter 11 process, res judicata bars its claim. We REVERSE the district court judgment and reinstate the bankruptcy court's DISMISSAL of the Treasurer's case.

I. BACKGROUND

Linn Energy, LLC ("Linn") is an oil and gas company that operates in Texas and Oklahoma. In May 2016, Linn and fourteen affiliated entities filed voluntary petitions for relief under Chapter 11 of the Bankruptcy Code. The bankruptcy court set a deadline requiring all "Proofs of Claims" from "[a]ll governmental units holding claims ... that arose ... prior to the Petition Date" to be filed by November 7, 2016. The Treasurer timely filed three proofs of claim on August 29 for "unknown/contingent" amounts, which it described as "unsecured." The Treasurer stated that it had filed the claim pursuant to Oklahoma's "unclaimed property law," and that it was "acting as a conservator or custodian on behalf of the classes of persons ... who have failed to claim property owing to them for the statutory period of abandonment."

In November 2016, Linn filed a report with the Treasurer indicating that it possessed $ 956,212.72 in unclaimed property but did not transfer those assets to the Treasurer. The Treasurer contends that Linn was required by state law to deliver the unclaimed-property funds when it filed the report, but it did not then file an adversary complaint demanding that Linn turn over the funds. Significantly, on December 5, the Texas Comptroller filed an adversary complaint against Linn for unclaimed property owed to Texas residents after Linn disclosed $ 1.5 million in unclaimed-property holdings to that agency. *See* Complaint for Turnover and Payment of Unclaimed Property and Related Relief, *In re Linn Energy, LLC*, No. 16-06023 (Bankr. S.D. Tex. Dec. 5, 2016), ECF No. 1.

On December 19, Linn sent all claimants in the bankruptcy case—including the Treasurer and the Texas Comptroller—a ballot for voting on its proposed Plan of Reorganization ("the Plan"). The Treasurer did not vote, but the Texas Comptroller filed an objection to confirmation because the Plan purported to distribute the unclaimed property assets of Texas residents, as unsecured assets, among parties other than the Comptroller. [1] On January 27, 2017, the bankruptcy court entered an order confirming the Plan, but the order expressly authorized the Texas Comptroller ***865** to pursue its claims for unclaimed property.

Several features of the Plan are critical here. First, a section titled "Preservation of Royalty and Working Interests" provided that "any right to payment from a Royalty and Working interest, if any, shall be treated as a Linn General Unsecured Claim under this Plan and shall be subject to any discharge and/or release provided hereunder." Second, the vesting clause stated that, except as otherwise provided in the Plan, "all property in each Estate, all Causes of Action, and any property acquired by any of the Linn Debtors pursuant to the Plan shall vest in [Linn], free and clear of all Liens, Claims, charges, Interests, or other encumbrances" once the Plan became final. Finally, the Plan's discharge provision stated that, pursuant to Section 1141(d) of the Bankruptcy Code, and except as otherwise stated by the Plan, "the distributions, rights, and treatment that are provided in the Plan shall be in complete satisfaction, discharge, and release, effective as of the Effective Date[ ] of Claims[,] ... Interests, and Causes of Action of any nature whatsoever." That section of the Plan further enjoins any parties to the proceedings from commencing or continuing a claim related to the bankruptcy estate after the Plan received final approval.

****2** All parties to the bankruptcy case had fourteen days in which to appeal the order, *see* Fed. R. Bankr. P. 8002, and on the final day of the appeal period, a group of claimants moved for reconsideration and relief from the order. [2] After the claimants agreed to a stipulation with Linn, the motion for reconsideration was withdrawn with prejudice on March 6. [3] Thereafter, no claimant appealed the order or moved for reconsideration, and the confirmation became final on March 20.

About two months later, Linn objected to the Treasurer's proofs of claim for "unknown contingent" unclaimed property, asserting that it was not liable for such claims and that the Bankruptcy Code preempted state unclaimed property laws. The Treasurer responded to the objection and then filed an adversary complaint against Linn. The Treasurer asserted that Linn possessed, but did not own, $ 965,216.72 in unclaimed property consisting of investors' mineral royalties from Linn's Oklahoma oil and gas operations and that Linn was required by Oklahoma law to turn over the funds to the Treasurer.

Linn moved to dismiss the Treasurer's adversary complaint pursuant to Bankruptcy Rule 7012(b)(6), analogous to Fed. R. Civ. P. 12(b)(6), asserting that the claim violated the Plan's injunction, vesting, and discharge provisions and was barred by the principles of res judicata and preemption. The Treasurer re-emphasized that the unclaimed property never belonged to Linn. Consequently, it never became part of the bankruptcy estate and could not be governed by the Plan. After a hearing, the bankruptcy court sided with Linn. Granting the motion to dismiss, the court concluded that the Treasurer had "received more than adequate due process," and that ***866** its complaint amounted to a prohibited "collateral attack" on the confirmed Plan.

The Treasurer appealed to the district court, which reversed the bankruptcy court's dismissal on the grounds that the unclaimed property never became part of the bankruptcy estate, and therefore the bankruptcy court did not have jurisdiction to adjudicate its status. Linn moved for rehearing, but the district court denied the motion. Linn timely appealed.

II. STANDARD OF REVIEW

[1] **[2]** This court reviews "the decision of a district court sitting as an appellate court in a bankruptcy case by applying the same standards of review to the bankruptcy court's findings of fact and conclusions of law as applied by the district court." *In re Lopez*, 897 F.3d 663, 668 (5th Cir. 2018) (internal quotation marks and citations omitted). As such, this court acts "as a second review court" and reviews the bankruptcy court's conclusions of law de novo and its findings of fact for clear error. *Id.* (internal quotation marks and citations omitted).

III. DISCUSSION

Linn advances four arguments challenging the district court's decision. First, Linn argues that, contrary to the district court's determination, the unclaimed property is part of the bankruptcy estate and subject to the Plan.[4] Second, Linn argues that the bankruptcy court correctly determined that the Plan and ensuing Confirmation Order constitute a final judgment that the Treasurer may not collaterally attack, and that the principles of res judicata bar the Treasurer's untimely adverse complaint. Third, Linn argues that the Treasurer had no "right to payment" under Oklahoma's unclaimed property laws as of the date of the bankruptcy petition and, therefore, the Bankruptcy Code barred the Treasurer's claims. Finally, Linn argues that, to the extent that the Bankruptcy Code and Oklahoma's unclaimed property law are in tension with one another, the Bankruptcy Code preempts Oklahoma state law.

****3** This court need not address the merits of Linn's first, third, and fourth arguments because Linn's second argument is correct—the bankruptcy court's approval of the Plan and the ensuing confirmation order constitute a final judgment that may not be collaterally attacked.

[3] **[4]** In *Travelers Indemnity Co. v. Bailey*, the Supreme Court held that final bankruptcy orders (*i.e.*, orders that are affirmed upon direct review, or, as in this case, not appealed or contested) become "res judicata to the parties and those in privity with them, not only as to every matter which was offered and received to sustain or defeat the claim or demand, but as to any other admissible matter which might have been offered for that purpose." ***867** 557 U.S. 137, 152, 129 S. Ct. 2195, 2205, 174 L.Ed.2d 99 (2009) (internal quotation marks and citation omitted). The Court explicitly held that this principle applies "whether or not [the orders were] proper exercises of bankruptcy court jurisdiction and power" at the time they became final. *Id.*

[5] Thus, when parties to a bankruptcy case have been given "a fair chance to challenge [a] [b]ankruptcy [c]ourt's subject-matter jurisdiction" or a provision of a plan approved by the bankruptcy court during the case and fail to do so, they cannot challenge the court's order later through a collateral attack. *Id.* at 153, 129 S. Ct. at 2206. This court has repeatedly recognized the collateral bar established by *Travelers*. *See, e.g.*, *In re Davis Offshore, L.P.*, 644 F.3d 259, 265 (5th Cir. 2011) ("*Travelers* held that a bankruptcy court's plan confirmation order cannot, after it becomes final, be collaterally attacked by parties to the case or those in privity with them on grounds that it exceeded the bankruptcy court's jurisdiction.").

[6] Here, the Plan submitted by Linn to claimants clearly stated that unclaimed mineral royalties would be treated as unsecured debt, that upon the Plan's approval all remaining property would vest in Linn, and that no parties could bring further claims against Linn after the Plan became final. Despite ample opportunity provided by the Bankruptcy Code and the court's procedures, the Treasurer neither voted on the Plan nor contested its treatment of the unclaimed property in question. That the Treasurer had a fair chance to challenge the Plan's disposition of unclaimed property in Oklahoma is highlighted by the fact that a similarly-situated party, the Texas Comptroller, did object to the Plan's treatment of unclaimed property in Texas and successfully excluded that property from the Plan.

The Treasurer cites *Pearlman v. Reliance Insurance Co.*, 371 U.S. 132, 135–36, 83 S. Ct. 232, 234, 9 L.Ed.2d 190 (1962), which held that the former Bankruptcy Act does not permit bankruptcy trustees to distribute the property of other persons. While that proposition is sound as a general principle, the Treasurer's reliance on *Pearlman* in this case is misplaced. *Pearlman* evaluated the legality of a bankruptcy plan on direct review; here, the Treasurer had an opportunity to challenge the Plan in the normal course of proceedings (as the Texas Comptroller did) but did not avail itself of that opportunity. *Travelers*, decided decades after *Pearlman*, explicitly precludes collateral attacks on final bankruptcy orders by parties to the proceedings "whether or not [they] were proper exercises of bankruptcy court jurisdiction and power" in the first instance.[5] 557 U.S. at 152, 129 S. Ct. at 2205. To hold otherwise would upend the need for finality in the judicial system, because "this sort of collateral attack cannot be squared with res judicata and the practical necessity served by that rule. It is just as important that there should be a place to end as that there should be a place to begin litigation." *Id.* at 154, 129 S. Ct. at 2206 (internal quotation marks and citation omitted).

****4** In short, the Treasurer asks this court to "tunnel back" into a completed proceeding "for the purposes of reassessing prior jurisdiction de novo." *Id.* (internal quotation marks and citation omitted). We decline to do so. Because the Treasurer ***868** failed to participate in the bankruptcy case and object to or appeal the Plan's disposition of the Oklahoma unclaimed property in the normal course, its challenge is too late now. The bankruptcy court's dismissal of the Treasurer's adversary complaint based on res judicata was correct

IV. CONCLUSION

For the foregoing reasons, this court **REVERSES** the district court's reversal of the judgment entered by the bankruptcy court. The bankruptcy court's decision to **DISMISS** the Treasurer's complaint is reinstated.

All Citations

927 F.3d 862, 2019 WL 2520074, 67 Bankr.Ct.Dec. 91

Footnotes

1 *See* Texas Comptroller of Public Accounts Objection to Confirmation of the Linn Plan [Dkt. No. 1333] and the Berry Plan [Dkt. No. 1390], *In re Linn Energy, LLC*, No. 16-60040 (Bankr. S.D. Tex. Jan. 17, 2017), ECF No. 1548.

2 *See* James H. Niven's, Charles E. Hinkle's, and Bianchi Family Ltd. Partnership's Motion for Reconsideration of Purported Disallowance of Claims; Relief from the Confirmation Order; or, in the Alterative, to Alter or Amend Cure Amount in the Confirmation Order, *In re Linn Energy, LLC*, No. 16-60040 (Bankr. S.D. Tex. Feb. 10, 2017), ECF No. 1691.

3 *See* Stipulation and Agreed Order Between Debtors James H. Niven, Charles E. Hinkle, and Bianchi Family Ltd. Partnership, *In re Linn, LLC*, No. 16-60040 (Bankr. S.D. Tex. Mar. 6, 2017), ECF No. 1779.

4 The Treasurer spends a significant portion of its brief asserting that Linn waived this argument because, allegedly, Linn did not raise the issue until its motion for rehearing in the district court. That argument is belied both by Linn's briefs and by the Treasurer's own briefs in the bankruptcy court. In response to Linn's motion to dismiss the Treasurer's adversary complaint, for example, the Treasurer argued that judicial estoppel should prevent Linn from claiming that the unclaimed property was part of the bankruptcy estate because "only after" the bankruptcy court entered the confirmation order "did [Linn] change positions and claim that the Admitted Unclaimed Property is property of the estate." Whatever the history of Linn's positions in the bankruptcy proceedings before the final order was entered, it is clear that Linn has argued from the outset in this litigation that the unclaimed property funds were property of the bankruptcy estate. Accordingly, the argument is not waived.

5 This court has no occasion to rule on the propriety of the bankruptcy plan to the extent it purported to distribute unclaimed property that the debtor held as a trustee for others, but as the treatment of the Texas unclaimed property rights demonstrates, there is reason for skepticism.

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926 F.3d 447
United States Court of Appeals, Seventh Circuit.

IN RE: Harold WADE and Lorraine Wade, Debtors-Appellants.

No. 18-2564
|
Argued February 6, 2019
|
Decided June 14, 2019

Synopsis
Background: Chapter 13 debtors, whose prior joint Chapter 13 case had been voluntarily dismissed less than a year before their current petition was filed, sought sanctions against judgment creditor for violating the automatic stay by obtaining and recording a postpetition state-court judgment against their personal residence on a prepetition debt owed by one of the debtors. Judgment creditor moved to confirm that the automatic stay had terminated as to the residence. The United States Bankruptcy Court for the Northern District of Illinois, LaShonda A. Hunt, J., 592 B.R. 672, granted judgment creditor's motion to confirm, and denied debtors' motion for sanctions. Debtors appealed.

[Holding:] The Court of Appeals, Sykes, Circuit Judge, held that debtors' failure to file a petition for permission to take a direct appeal to the Court of Appeals required dismissal of debtors' appeal, overruling *In re Turner*, 574 F.3d 349; *Marshall v. Blake*, 885 F.3d 1065.

Affirmed.

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

West Headnotes (2)

[1] Bankruptcy
Petition for leave; appeal as of right; certification

Bankruptcy rule requiring that appellant file a petition for permission to take a direct appeal to the Court of Appeals is a mandatory claim-processing rule, and if properly invoked, it must be enforced; overruling In re Turner, 574 F.3d 349; Marshall v. Blake, 885 F.3d 1065. Fed. R. Bankr. P. 8006(g).

1 Cases that cite this headnote

[2] Bankruptcy
Petition for leave; appeal as of right; certification

Chapter 13 debtors' failure to file a petition for permission to take a direct appeal to the Court of Appeals, upon certification of appeal for direct appeal to Court of Appeals, required dismissal of debtors' appeal of bankruptcy court's order denying their motion for sanctions against judgment creditor. Fed. R. Bankr. P. 8006(g).

Cases that cite this headnote

***448** Appeal from the United States Bankruptcy Court for the Northern District of Illinois, Eastern Division. No. 15-BK-01035—**LaShonda A. Hunt**, *Bankruptcy Judge*.

Attorneys and Law Firms

Michael A. Miller, Attorney, Semrad Law Firm, LLC, Chicago, IL, for Debtors-Appellants.

Melanie Pennycuff, Attorney, Kreisler Law P.C., Chicago, IL, for Appellee

Tara A. Twomey, Attorney, National Consumer Law Center, Boston, MA, for Amici Curiae.

Before Kanne, Sykes, and Hamilton, Circuit Judges.

Opinion

Sykes, Circuit Judge.

Debtors Harold and Lorraine Wade moved for sanctions against Kreisler Law, P.C., alleging that the law firm violated the automatic stay arising from their bankruptcy petition by filing a lien against Lorraine's home. The couple had voluntarily dismissed a prior bankruptcy petition just a few months earlier, so the bankruptcy judge denied their motion based on 11 U.S.C. § 362(c)(3), which lifts the automatic stay after 30 days in the case of a successive petition. But the bankruptcy courts are divided over the proper interpretation of § 362(c)(3), so the judge certified her order for direct appeal to this court under 28 U.S.C. § 158(d)(2)(A). A timely notice of appeal followed.

But the Wades never filed a petition for permission to appeal as required by Rule 8006(g) of the Federal Rules of Bankruptcy Procedure. Kreisler moved to dismiss the appeal based on this omission. We provisionally accepted the appeal and directed the parties to address the effect of the procedural violation in their merits briefs.

We now dismiss the appeal. Rule 8006(g) is a mandatory claim-processing rule, and if properly invoked, it must be enforced. *See* *Hamer v. Neighborhood Hous. Servs. of Chi.*, ––– U.S. ––––, 138 S. Ct. 13, 17, 199 L.Ed.2d 249 (2017). Because Kreisler properly objected, the appeal must be dismissed.

I. Background

The Wades filed a Chapter 13 bankruptcy petition in January 2015, which automatically stayed any collection actions against their property. *See* 11 U.S.C. § 362(a). But the petition was successive—they had voluntarily dismissed a different petition two months earlier—and § 362(c)(3) states that if a prior petition "was pending within the preceding 1-year period but was dismissed," the automatic stay "shall terminate with respect to the debtor on the 30th day after the filing of the later case."

Just how much of the stay was lifted became relevant after the Wades discovered that Kreisler recorded a lien against Lorraine's home in April 2015. Because their bankruptcy case was active at that time, the Wades moved in the bankruptcy court to sanction Kreisler for violating the stay.

The parties disagreed about the meaning of § 362(c)(3). Kreisler contended that it lifts the entire stay. The Wades argued ***449** that the phrase "with respect to the debtor" limits the statute's effect so that it lifts the stay only for *non-estate* property. In their view the stay still prevented Kreisler from recording the lien because Lorraine's house was estate property.

The bankruptcy judge denied the Wades' motion, concluding that the entire stay lifted in February 2015, which validated Kreisler's April 2015 lien. The Wades appealed to the district court. But they also asked the bankruptcy judge to certify her order for direct appeal to this court under § 158(d)(2)(A). The judge granted that request and issued a certification order. The Wades then filed a notice of appeal, but they never filed a petition for permission to appeal as required by Rule 8006(g) of the Federal Rules of Bankruptcy Procedure. Kreisler moved to dismiss based on this procedural oversight. We provisionally accepted the appeal but instructed the parties to brief the dismissal motion with the merits.

II. Discussion

We begin (and end) with the question whether the failure to file a petition for permission to appeal requires dismissal of this appeal. We are permitted to consider a direct appeal from an order of the bankruptcy court if the bankruptcy judge certifies the order for appeal and we "authorize[ ] the direct appeal." 28 U.S.C. § 158(d)(2)(A). The Federal Rules of Bankruptcy and Appellate Procedure jointly set forth the procedural steps to obtain authorization for a direct appeal.

As relevant here, Bankruptcy Rule 8006(g) mandates that "[w]ithin 30 days after the [bankruptcy court's] certification becomes effective ..., a request for permission to take a direct appeal to the court of appeals must be filed with the circuit clerk." Ignoring this rule short-circuits our approval process, which is detailed in Rule 5 of the Federal Rules of Appellate Procedure. Rule 5 states that "[t]o request permission to appeal ..., a party must file a petition for permission to appeal." FED. R. APP. P. 5(a)(1). Rule 5(b)(1) specifies the required contents of the petition, which include a statement of "the reasons why the appeal should be allowed and is authorized by a statute or rule." Rule 5(b)(2) provides a ten-day window for other parties to oppose the petition or file a cross-petition. Whether opposed or not, under Rule 5(b)(3) the petition for leave to appeal is decided "without oral argument unless the court of appeals orders otherwise."

Because Rule 8006(g) is a "time limitation ... found in a procedural rule, not a statute, it is properly classified as a nonjurisdictional claim-processing rule." *Nutraceutical Corp. v. Lambert*, ––– U.S. ––––, 139 S. Ct. 710, 714, 203 L.Ed.2d 43 (2019). The question here is whether Rule 8006(g) is a "mandatory" claim-processing rule, which "[i]f properly invoked ... must be enforced." *Hamer*, 138 S. Ct. at 17.

The Supreme Court's recent decision in *Nutraceutical Corp.* is instructive on this point. There the Supreme Court considered Rule 23(f) of the Federal Rules of Civil Procedure, which permits an interlocutory appeal of a class-certification order if the appellant files a petition for permission to appeal "within 14 days after the order is entered." The Court held that Rule 23(f) is a mandatory claim-processing rule, noting that "the Federal Rules of Appellate Procedure single out Civil Rule 23(f) for inflexible treatment," *Nutraceutical*, 139 S. Ct. at 715, because Rule 26(b)(1) bars courts from "extend[ing] the time to file ... a petition for permission to appeal," FED. R. APP. P. 26(b).

[1] That reasoning applies with equal force here. Like Rule 23(f), Rule 8006(g) speaks in mandatory terms. *See* ***450** FED. R. BANKR. P. 8006(g) (petition "must be filed" before the deadline). And like Rule 23(f), Rule 8006(g) requires a petition for permission to appeal, so Rule 26(b)(1) "singles [it] out ... for inflexible treatment." *Nutraceutical Corp.*, 139 S. Ct. at 715. Rule 8006(g) is thus a mandatory claim-processing rule. Because Kreisler properly invoked the rule, it "must be enforced." *Hamer*, 138 S. Ct. at 17.

In response the Wades rely on the lead opinion in *In re Turner*, 574 F.3d 349 (7th Cir. 2009), and our decision in *Marshall v. Blake*, 885 F.3d 1065 (7th Cir. 2018). In both cases the appellants obtained certification from the bankruptcy court for a direct appeal but failed to file a petition for permission to appeal as required by the Bankruptcy and Appellate Rules. In both cases we declined to dismiss the appeal, but the decisions rested on slightly different grounds.

The lead opinion in *Turner*, representing only the author's views, concluded that the record transmitted from the bankruptcy court contained the information that a petition for leave to appeal would have provided. *See* 574 F.3d at 352 (Posner, J.). Invoking the Supreme Court's decision in *Torres v. Oakland Scavenger Co.*, the lead opinion concluded that the record sent by the bankruptcy court brought

> the case within the principle that "if a litigant files papers in a fashion that is technically at variance with the letter of a procedural rule, a court may nonetheless find that the litigant has complied with the rule if the litigant's action is the functional equivalent of what the rule requires."

Id. (quoting *Torres v. Oakland Scavenger Co.*, 487 U.S. 312, 316–17, 108 S.Ct. 2405, 101 L.Ed.2d 285 (1988)). In the lead opinion's view, dismissal was unwarranted because treating the bankruptcy-court record as the "functional equivalent" of a petition would not prejudice the appellee. *Id.*; *see also* *id.* at 356 (Van Bokkelen, J., concurring in the judgment).

In *Marshall* we dropped any reliance on functional equivalence and instead emphasized *Turner*'s discussion of harmlessness. *See* 885 F.3d at 1073 ("[W]e have excused the failure to file a Rule 5 petition if the party filed a timely notice of appeal and 'no one is harmed by the failure.' " (quoting *Turner*, 574 F.3d at 354)). *Marshall* found that the failure to comply with Rule 8006(g) was harmless in that case.

Turner was decided before *Hamer* clarified the effect of mandatory claim-processing rules. The lead opinion presumed that as long as a rule is not jurisdictional, courts could create equitable exceptions. *See* 574 F.3d at 354 ("[T]he failure to comply with a rule that is not jurisdictional ... is not fatal if no one is harmed by the failure...."). And *Marshall* postdates *Hamer* but does not mention the case. There the litigants framed the Rule 8006(g) objection in jurisdictional terms, and our opinion treated the issue accordingly, concluding that "we have jurisdiction to hear the direct appeal" after rejecting the appellee's Rule 8006(g) objection. *Marshall*, 885 F.3d at 1074.

Marshall and *Turner* are irreconcilable with the Supreme Court's recent decisions on the effect of noncompliance with mandatory claim-processing rules. *Marshall*'s harmless-error analysis cannot coexist with the Court's decision in *Manrique v. United States*, ––– U.S. ––––, 137 S. Ct. 1266, 1274, 197 L.Ed.2d 599 (2017), which held that "mandatory claim-processing rules ... are not subject to harmless-error analysis." More broadly, the Court's recent decisions in this area have consistently compelled enforcement of mandatory claim-processing rules. *See, e.g.*, *Nutraceutical Corp.*, 139 S. Ct. at 714 (stating that mandatory claim-processing rules are "unalterable"); ***451** *Hamer*, 138 S. Ct. at 17 (stating that mandatory claim-processing rules "must be enforced"); *Manrique*, 137 S. Ct. at 1272 ("[T]he court's duty to dismiss the appeal was mandatory.") (quotation marks omitted). Adopting a harmless-error exception, as *Marshall* did, necessarily alters an "unalterable" claim-processing rule.

The approach of *Turner*'s lead opinion is also unsustainable in light of the Court's recent cases. The Wades note that *Torres* remains on the books. True, but we're not persuaded that we may accept the bankruptcy court's certification order as the functional equivalent of a petition for permission to appeal.

To start, it's unclear if *Torres* itself ever extended that far. *See* 487 U.S. at 315–16, 108 S.Ct. 2405 ("Permitting imperfect but substantial compliance with a technical requirement is not the same as waiving the requirement altogether...."). Regardless, the Court has now clearly rejected the reasoning of the lead opinion in *Turner*. In *Manrique* a criminal defendant failed to file a second notice of appeal after the lower court issued an amended judgment, as Rule 4 of the Federal Rules of Criminal Procedure requires. The dissent reasoned that "the clerk's transmission of the amended judgment to the Court of Appeals [was] an adequate substitute for a second notice of appeal." *Manrique*, 137 S. Ct. at 1275 (Ginsburg, J., dissenting). But the Court didn't agree. It treated Rule 4 as a mandatory claim-processing rule and held that the court of appeals "may not overlook the failure to file a notice of appeal at all." *Id.* at 1274 (majority opinion). Because that omission ran afoul of Rule 4, the appeal had to be dismissed. *Id.*

[2] The same result is required here. We cannot overlook the Wades' failure to file a petition for permission to appeal. Because Kreisler properly objected to the violation of Rule 8006(g), our "duty to dismiss the appeal [is] mandatory." *Id.* at 1272 (quotation marks omitted). Based on the clear conflict with *Nutraceutical Corp.*, *Hamer*, and *Manrique*, we overrule *Turner* and *Marshall* to the extent that they approved exceptions to compliance with Bankruptcy Rule 8006(g) and Rule 5(a)(1) of the Federal Rules of Appellate Procedure—whether based on the functional-equivalence doctrine, the harmless-error doctrine, or both. [1] The Wades must pursue their appeal through the ordinary process, which starts with the district court.

APPEAL DISMISSED.

All Citations

926 F.3d 447, 67 Bankr.Ct.Dec. 79

Footnotes

1 Because this opinion overrules circuit precedent, we circulated it to all judges in active service. *See* 7TH CIR. R. 40(e). No judge favored rehearing en banc.

600 B.R. 415
United States Bankruptcy Appellate Panel of the Ninth Circuit.

IN RE: Augustine PENA, III, Debtor.
Augustine Pena, III, Appellant.

BAP No. EC-18-1098-SLB
|
Bk. No. 1:12-bk-13170
|
Argued and Submitted on January 24, 2019 at Sacramento, California
|
Filed – May 21, 2019

Synopsis
Background: Chapter 7 debtor filed application to recover unclaimed rents from deed of trust properties abandoned by Chapter 7 trustee. The United States Bankruptcy Court for the Eastern District of California, Fredrick E. Clement, J., denied application, and debtor appealed.

Holdings: The Bankruptcy Appellate Panel, Spraker, J., held that:

[1] trustee's notice that he was abandoning deed of trust properties owned by debtor did not result in abandonment of rents that trustee had collected from deed of trust properties;

[2] debtor had no right to unclaimed rents from his deed of trust properties after deed of trust creditors failed to cash their disbursement checks; and

[3] designation of debtor's Chapter 7 case as "no asset" case provided debtor with no interest in unclaimed rents.

Affirmed.

Procedural Posture(s): On Appeal; Other.

West Headnotes (16)

[1] **Bankruptcy**
Scope of review in general

On appeal, the Bankruptcy Appellate Panel could take judicial notice of court filings and the other papers filed in debtor's bankruptcy case.

Cases that cite this headnote

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

Bankruptcy court's determinations on issues of statutory construction are legal conclusions, which the Bankruptcy Appellate Panel reviews de novo.

Cases that cite this headnote

[3] **Bankruptcy**
Distribution

When deed of trust creditors with right to rents that Chapter 7 trustee had collected from debtor's deed of trust properties failed to cash disbursement checks sent to them by trustee, trustee properly treated these collected rents as unclaimed property, voided the disbursement checks, and deposited the rents into registry of court. 11 U.S.C.A. § 347(a); Fed. R. Bankr. P. 3011.

Cases that cite this headnote

[4] **Bankruptcy**
Distribution

In order to be entitled to unclaimed funds, consisting of rents that had been collected by Chapter 7 trustee from debtor's deed of trust properties and that had been deposited into registry of court after deed of trust creditors failed to cash their disbursement checks, creditors would have to prove that they had a present entitlement to the unclaimed funds sought. 28 U.S.C.A. § 2041.

Cases that cite this headnote

[5] **Bankruptcy**
Distribution

Secured creditor would not have a present entitlement to unclaimed funds deposited by

Chapter 7 trustee into registry of court, if creditor's original secured claim had been brought current or satisfied, either through payment or foreclosure. 28 U.S.C.A. § 2041.

Cases that cite this headnote

[6] **Bankruptcy**
Effect

Chapter 7 trustee's notice that he was abandoning deed of trust properties owned by debtor, which trustee identified by street address, upon ground that properties were burdensome and of inconsequential value to estate, did not result in abandonment of rents that trustee had collected from deed of trust properties, which trustee did not refer to in this notice, and which he was attempting, unsuccessfully, to distribute to deed of trust creditors; rents were separate property, which trustee, after deed of trust creditors failed to cash their disbursement checks, had deposited into registry of court.

Cases that cite this headnote

[7] **Bankruptcy**
Effect

Bankruptcy
Reversion of surplus to debtor

Chapter 7 debtor had no right to unclaimed rents from his deed of trust properties after deed of trust creditors failed to cash their disbursement checks, given that rents had not been abandoned as assets of estate upon trustee's abandonment of deed of trust properties themselves, given that time for deed of trust creditors to claim rents from registry of court where they were deposited had not yet passed, and given unsecured creditors' superior interest therein pursuant to the Chapter 7 distribution scheme. 11 U.S.C.A. § 726(a).

Cases that cite this headnote

[8] **Bankruptcy**
Abandonment

"Abandonment" is the formal relinquishment of property at issue from bankruptcy estate. 11 U.S.C.A. § 554.

Cases that cite this headnote

[9] **Bankruptcy**
Effect

Upon abandonment of estate property, debtor's interest in the property is restored nunc pro tunc as of the filing of bankruptcy petition. 11 U.S.C.A. § 554.

Cases that cite this headnote

[10] **Bankruptcy**
Effect

While retroactive application of abandonment, to restore debtor's interest in property nunc pro tunc, is the general rule, it is not a categorical imperative to be blindly followed to a result that is unjust. 11 U.S.C.A. § 554.

Cases that cite this headnote

[11] **Bankruptcy**
Effect

Reason for the general rule that abandoned property shall revest in debtor nunc pro tunc is to protect against the running of statutes of limitation and to compensate trustee for any cost he may have incurred in maintaining the property during his custody of it. 11 U.S.C.A. § 554.

Cases that cite this headnote

[12] **Bankruptcy**
Effect

Abandonment of estate asset is not to be taken lightly, as it removes the asset from the estate and returns it to the debtor. 11 U.S.C.A. § 554.

Cases that cite this headnote

[13] **Bankruptcy**
Proceedings

Before trustee abandons property of the estate, trustee must first give notice to creditors of the property to be abandoned. 11 U.S.C.A. § 554.

Cases that cite this headnote

[14] Bankruptcy
Abandonment

Intent to abandon an estate asset must be clear and unequivocal. 11 U.S.C.A. § 554.

Cases that cite this headnote

[15] Bankruptcy
Abandonment

There is no informal abandonment of property of the estate. 11 U.S.C.A. § 554.

Cases that cite this headnote

[16] Bankruptcy
Reversion of surplus to debtor

Designation of debtor's Chapter 7 case as "no asset" case provided debtor with no interest in unclaimed rents that trustee had collected from deed of trust property; trustee's designation of case as "no asset" case was based on assumption that creditors had lien interests in properties and in all rents collected therefrom.

Cases that cite this headnote

***417** Appeal from the United States Bankruptcy Court for the Eastern District of California, Honorable Fredrick E. Clement, Bankruptcy Judge, Presiding

Attorneys and Law Firms

Sharlene Fay Roberts-Caudle argued for appellant.

Before: SPRAKER, LAFFERTY, and BRAND, Bankruptcy Judges.

OPINION

SPRAKER, Bankruptcy Judge:

INTRODUCTION

Chapter 7 [1] debtor Augustine Pena, III, appeals from an order denying his application to recover $ 51,777.03 in unclaimed funds held in the bankruptcy court's registry. The unclaimed funds were rents his chapter 7 trustee collected from Pena's rental properties before the trustee abandoned those properties. The trustee initially tried to pay the rents to the creditors holding security interests in the underlying rental properties, but the secured creditors never cashed the trustee's checks. The trustee thereafter voided the checks and deposited the funds in the court's registry in accordance with § 347(a).

Pena claims that, because his former secured creditors are no longer entitled to the unclaimed funds, the monies should be paid to him instead. Pena argues that the trustee abandoned the rents when she abandoned the underlying rental properties. He reasons that, as a result, the estate has no interest in the funds the trustee deposited into the court's registry. We disagree. The chapter 7 trustee has administered these rents, and they remain property of the estate. As a result, ownership of the funds has never reverted to the debtor. None of Pena's other arguments on appeal have any merit. Accordingly, we AFFIRM the bankruptcy court's order denying Pena's application for unclaimed funds.

FACTS

Pena commenced his bankruptcy case by filing a voluntary chapter 11 petition in April 2012. At the time he filed his bankruptcy, ***418** Pena owned 30 parcels of real property, 29 of which were rental properties. In June 2012, the bankruptcy court sua sponte converted the case from chapter 11 to chapter 7 because of Pena's unauthorized use of cash collateral. Trudi G. Manfredo was appointed to serve as the chapter 7 trustee. Pena appealed the conversion order first to the United States District Court for the Eastern District of California and then to the Ninth Circuit Court of Appeals. He lost both appeals.

[1] After conversion, Manfredo sought to abandon the rental properties. The bankruptcy court ruled, however, that during the pendency of the debtor's appeals, it lacked jurisdiction to order relief from stay or abandonment with respect to any of Pena's real property. Instead, the bankruptcy court entered an order under § 721 authorizing Manfredo to manage

Pena's rental properties, including their maintenance and the collection of rents. Pursuant to that order, Manfredo managed the rental properties until Pena lost both appeals. Manfredo collected the rents from the rental properties, deposited them into the estate's account, and disbursed them in accordance with her duties as chapter 7 trustee. After the Ninth Circuit affirmed conversion of the case to chapter 7, Manfredo abandoned the rental properties and shortly thereafter ceased collection of rents. [2]

The unclaimed funds at issue represent rents Manfredo collected from rental properties throughout California. Two of the properties were located in Compton, California. The other rental properties at issue were in Visalia, Corcoran, and Tulare, California. Each property was encumbered by a deed of trust, and the rents from the properties were treated as cash collateral of the respective secured creditors while Manfredo administered the properties. Manfredo abandoned the Tulare property in July 2014, and abandoned the other properties in August 2014. During the second half of 2015, several months before the bankruptcy case was closed, Manfredo sought to pay the secured creditors a combined total of $ 51,777.03 comprised of rents collected from the properties. [3]

Manfredo's cash disbursement records reflect that she tried unsuccessfully to pay these amounts to the secured creditors several times. After those attempts failed, in February 2016, Manfredo paid the $ 51,777.03 in rent proceeds into the court registry. Manfredo's actions concerning the unclaimed funds were disclosed in her Final Account and Distribution Report ("Final Account").

Although Manfredo administered the rents on behalf of the secured creditors, the case was administered as a no asset case, and the Final Account proposed no distribution to Pena's unsecured creditors. Manfredo served the notice of the Final Account on all parties in interest, including Pena. The notice advised that if no objections were filed, a final decree would be entered and the case closed without further order. Neither Pena, nor anyone else, ***419** objected to the Final Account. The bankruptcy court entered a final decree and closed Pena's bankruptcy case on December 27, 2016.

Well over a year after the case was closed, on March 1, 2018, Pena filed an application seeking to recover the unclaimed funds without reopening the bankruptcy case. [4] According to Pena, none of the secured creditors could establish a present entitlement to the unclaimed funds because the subject properties had been foreclosed upon or Pena was current on his mortgage payments. Pena stated that he conveyed the Compton properties to a third party in September 2014. He also advised that the secured creditors of the Visalia and Corcoran properties foreclosed on these properties in 2016. Nothing in the record demonstrates what happened to the Tulare property.

Pena further argued that, as a result of Manfredo's abandonment of the rental properties in 2014, the rental properties – and the rents Manfredo collected – should be treated "as if no bankruptcy case had been filed," in which case he would have been entitled to collect and use all rents absent any event of default under his security agreements with his secured creditors. Therefore, Pena concluded that he, and not his unsecured creditors, was entitled to the unclaimed funds.

Pena served the application on the secured creditors, but received no objections. [5] Still, the bankruptcy court disagreed with Pena. According to the court, Manfredo's disbursement of the rents into the court's registry as unclaimed funds when the secured creditors failed to cash their disbursement checks was consistent with her statutory obligations under § 347. [6] Furthermore, the bankruptcy court held that, pursuant to 28 U.S.C. § 2042, the secured creditors had five years to claim the funds. The court noted that this time period was not close to running. If the five-year time period elapsed without the secured creditors successfully claiming the funds, the bankruptcy court opined that the funds should escheat to the United States. 28 U.S.C. § 2042.

More importantly, the bankruptcy court ruled that, as between Pena and his bankruptcy estate, the bankruptcy estate was entitled to the rents. The bankruptcy court rejected Pena's assertion that the unclaimed ***420** rents collected from the properties had been abandoned along with the properties in 2014, noting that rents were separate property of the estate under § 541(a)(6). The court explained that, under the distribution scheme imposed by § 726(a), it was the estate's unsecured creditors, not Pena, that were entitled to unclaimed rents if the secured creditors no longer had any entitlement to those funds. The court noted that Pena had disclosed $ 411,000 in unsecured debt that remained unpaid.

On March 29, 2018, the bankruptcy court entered an order denying Pena's application. Pena timely appealed.

JURISDICTION

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

ISSUE

Did the bankruptcy court err when it denied Pena's application to recover the unclaimed funds?

STANDARD OF REVIEW

[2] The issues raised by this appeal require us to construe the Bankruptcy Code and the federal statutes governing unclaimed funds. Issues of statutory construction are legal questions, which we review de novo. *Greenpoint Mortg. Funding, Inc. v. Herrera (In re Herrera)*, 422 B.R. 698, 709 (9th Cir. BAP 2010), *aff'd sub nom. and adopted*, *Home Funds Direct v. Monroy (In re Monroy)*, 650 F.3d 1300 (9th Cir. 2011).

DISCUSSION

I. The Trustee Properly Administered The Rents As Property of the Estate.

[3] Generally speaking, a chapter 7 trustee administers property of the estate by liquidating the assets to cash and then distributing them to the estate's creditors. *See* §§ 704(a)(1), 726; *see also* *Harris v. Viegelahn*, ––– U.S. ––––, 135 S. Ct. 1829, 1835, 191 L.Ed.2d 783 (2015); 2 Collier Bankruptcy Practice Guide ¶ 26.03 (2018) ("Collier"); Handbook For Chapter 7 Trustees (U.S. Dep't Of Justice) (Oct. 1, 2012) at pp. 4-1, 4-33, ("Trustee Handbook").[7] Here, the trustee did not liquidate the rental properties but instead managed them for a time under court authorization pursuant to § 721. As part of her management of the rental properties, Manfredo transmitted the collected rents to Pena's secured creditors. After she abandoned the rental properties, Manfredo transmitted the remaining collected rents in the same manner. Pena never objected to any of Manfredo's transmittals to the secured creditors. In fact, he repeatedly has conceded in his appeal brief that the rents Manfredo collected and successfully distributed to the secured creditors were estate property. This is consistent with § 541(a)(6), which defines property of the estate to include: "[p]roceeds, product, offspring, **rents**, or profits of or from property of the estate, except such as are earnings from services performed by an individual debtor after the commencement of the case." (Emphasis added.)[8]

After the secured creditors failed to cash the unclaimed funds checks identified ***421** above, Manfredo took action consistent with § 347(a) and Rule 3011.[9] When a creditor fails to cash a chapter 7 trustee disbursement check within 90 days of the final distribution, the trustee must stop payment on the check and pay the funds into the court registry as unclaimed funds. § 347(a); Rule 3011; *see also* 2 Collier, at 26.18[4]; Trustee's Handbook, at p. 4-33. Thereafter, the "rightful owners" of the funds may claim them from the court registry. 28 U.S.C. § 2041.[10] The federal statutory scheme further provides:

> In every case in which the right to withdraw money deposited in court under section 2041 **has been adjudicated or is not in dispute** and such money has remained so deposited for at least five years unclaimed by the person entitled thereto, such court shall cause such money to be deposited in the Treasury in the name and to the credit of the United States. Any claimant entitled to any such money may, on petition to the court and upon notice to the United States attorney and full proof of the right thereto, obtain an order directing payment to him.

28 U.S.C. § 2042 (emphasis added).

Here, the secured creditors' rights to the rents Manfredo administered were undisputed at the time the bankruptcy court entered its final decree. Among other things, the final decree approved Manfredo's disbursement of the unclaimed funds into the court registry (pursuant to § 347 and Rule 3011) in the name of the secured creditors to whom Manfredo had determined the funds were owed. Under 28 U.S.C. §§ 2041 and 2042, the funds must remain in the court registry until their "rightful owner" with "full proof" of entitlement comes to claim them. If, after five years, the funds still remain unclaimed in the court registry, then they must be turned over to the United States Treasury. 28 U.S.C. § 2042.

In short, the bankruptcy court did not err in finding that the trustee properly administered the unclaimed rents.

II. The Secured Creditors' Entitlement To The Rents.

Pena does not seriously dispute that Manfredo properly administered the unclaimed rents. Citing 28 U.S.C. §§ 2041 and 2042, he contends that the unclaimed rents now belong to him because the secured creditors no longer are the rightful owners of the unclaimed rents. Pena argues that, after the bankruptcy estate abandoned the real properties, the Compton properties were conveyed to a third party, and the Visalia and Corcoran properties were foreclosed. He argues that the secured creditors cannot prove a present entitlement to the funds, and this is why they never cashed the payments and never objected to his application for the funds.

[4] **[5]** As a general proposition of law Pena is correct that, if the secured creditors sought to collect the unclaimed funds ***422** deposited into the registry, they must prove they have "a 'present entitlement to the unclaimed funds sought.' " *In re Scott*, 346 B.R. 557, 559 (Bankr. N.D. Ga. 2006)(quoting *In re Acker,* 275 B.R. 143, 145 (Bankr. D.D.C. 2002)). A "claimant does not have a 'present entitlement' to unclaimed funds if the original secured claim has been brought current or satisfied, either through payment or foreclosure." *In re Pena*, 456 B.R. 451, 454 (Bankr. E.D. Cal. 2011) (unrelated to debtor)(quoting *In re Scott*, 346 B.R. at 559). Here, however, the secured creditors are not seeking to recover the unclaimed rents. Rather, Pena asserts that he is entitled to the unclaimed rents. Pena reasons that, since the secured creditors can no longer establish a present entitlement to these funds, state law governs and requires that the monies must be distributed to him. We need not determine what rights the secured creditors may currently have to the unclaimed rents because they remain property of the bankruptcy estate over which Pena has no interest.

III. The Estate's Abandonment Of The Rental Properties Did Not Abandon Its Interest In The Collected Rents.

[6] **[7]** Pena acknowledges that the bankruptcy estate had an interest in the rents prior to abandonment of the rental properties. He contends, however, that Manfredo abandoned any interest in the rents when she abandoned the real property. Since the secured creditors can no longer prove a present entitlement to the proceeds, and the bankruptcy estate abandoned any interest it had in the unclaimed rents, Pena reasons that the funds belong to him.

[8] Abandonment is the "formal relinquishment of the property at issue from the bankruptcy estate." *Catalano v. C.I.R.*, 279 F.3d 682, 685 (9th Cir. 2002). Abandonment of an estate asset is governed by § 554, and can occur in one of three ways: (1) the bankruptcy trustee can obtain bankruptcy court authority to abandon the asset (*see* § 554(a)); (2) another party in interest can seek to compel the trustee to abandon the asset (*see* § 554(b)); or (3) abandonment may occur by operation of law – also known as a "technical abandonment" (*see* § 554(c)). No other party has sought abandonment of the rents under § 554(b). While Pena does refer to the abandonment of the unclaimed rents upon the closing of the case, he has not asserted any argument that the estate technically abandoned the unclaimed rents under § 554(c). Nor does the record provide any support for technical abandonment, as Manfredo administered the rents by paying the secured creditors she understood had rights in the cash collateral at the time she closed the bankruptcy case. This leaves abandonment under § 554(a) as the basis for Pena's interest in the unclaimed rents.

Pena contends that Manfredo's abandonment of the underlying rental properties must be given nunc pro tunc effect to the petition date. He argues that, if the rental properties are deemed to have been abandoned retroactively to the bankruptcy filing, this divests the bankruptcy estate of any interest in not only the rental properties themselves, but also the rents derived from those properties.

[9] **[10]** **[11]** As a general rule Pena is correct that "[u]pon abandonment, the debtor's interest in the property is restored *nunc pro tunc* as of the filing of the bankruptcy petition." [11] ***423** *Catalano*, 279 F.3d at 685. "The purposes of retroactive vesting include to protect against the running of the statute of limitations, and to compensate the trustee for any cost he may have incurred in maintaining the property during his custody of it." *Morlan v. Universal Guar. Life Ins. Co.,* 298 F.3d 609, 617 (7th Cir. 2002) (internal citations omitted); 4 Norton Bankr. L. & Prac. 3d § 74:1 (2019).

[12] **[13]** **[14]** **[15]** As often noted, abandonment of an asset is not to be taken lightly as it removes the asset from the estate and returns it to the debtor. *Pham v. United States Trustee (In re Pham)*, 2019 WL 77505, *4 (C.D. Cal.

Jan. 2, 2019)(citing *Catalano*, 279 F.3d at 686). Before a trustee abandons property of the estate, she must give notice of the property to be abandoned. § 554(a); *Quarre v. Saylor (In re Saylor),* 108 F.3d 219, 221 n.3 (9th Cir. 1997). Moreover, the "intent to abandon an asset must be clear and unequivocal." *Reisinger v. Seneca Specialty Ins. Co.*, No. CV 3:07-1221, 2011 WL 13220212, at *7 (M.D. Pa. Mar. 21, 2011), report and recommendation adopted, No. 3:07CV1221, 2011 WL 2433681 (M.D. Pa. June 14, 2011) (citing *Catalano*, 279 F.3d at 686). Accordingly, "there is no abandonment without notice to creditors." *Sierra Switchboard Co. v. Westinghouse Electric Corp.*, 789 F.2d 705, 709 (9th Cir. 1986). For these very reasons, "there is no informal abandonment of property of the estate." *In re Hat*, 363 B.R. at 138.

Manfredo moved to abandon the rental properties, identifying the properties to be abandoned by street address. The required notice of abandonment stated only that the estate "intends to and will abandon the following described real properties as burdensome and inconsequential value to the estate ...." The subsequent notices filed by Manfredo to effectuate the abandonments similarly were limited to abandonments of the rental properties. None of the notices ever mentioned the rents the estate had collected. Manfredo never sought, or gave notice of any intent, to abandon the remaining rents the estate had collected. Her actions speak loudly to a contrary intent as she was attempting to distribute the collected rents.

Pena does not distinguish between the unclaimed rents and the abandoned rental properties from which they were derived. He contends that abandonment of the ***424** rental properties resulted in abandonment of the rents. However, they are not the same. Section 541(a)(6) independently categorizes proceeds from property of the estate. As distinct property of the estate, a trustee must clearly state her intent to abandon such rents under § 554(a).

In an unpublished decision, the District Court for the Central District of California recently considered whether the abandonment of rental properties precluded the chapter 7 trustee from denying the debtors their discharge under § 727(a)(2) for improperly transferring post-petition rents. *In re Pham*, 2019 WL 77505, *3-5. In *Pham*, the debtors argued that the trustee could not prove they had transferred property of the estate because the trustee had abandoned the rental properties that generated the rents. The bankruptcy court rejected the debtors' argument, noting that the notice of abandonment referred only to the rental properties and not the rents. *Id.* at *2. Moreover, the bankruptcy court found it telling that the trustee had made demand on the debtors for the turnover of the missing rents, further evincing an intent not to abandon the rents. *Id.*

On appeal, the district court affirmed the denial of the discharge under § 727(a)(2) based on the debtor's transfer of property of the estate. *Id.* at *5. The court found that the rental proceeds were separate interests distinct from the real property, and agreed that the record failed to establish any intent to abandon the rental proceeds. Explaining its reasoning, the district court noted that "numerous courts have held that the abandonment of real property does not also abandon personal property that is related to, but separable from the real property, such as rental proceeds or insurance policies." *Pham,* 2019 WL 77505, *5 (citing *Pierson v. Paris (In re Humeston)*, 83 F.2d 187, 189 (2d Cir. 1936); [12] *see also* *In re Hat*, 363 B.R. at 141-42 (abandonment of farms did not result in abandonment of insurance policies covering crops grown on the farms).

Pena's situation mirrors that of the debtor in *Pham*. In both cases, the trustees sought to abandon real property while attempting to administer rents from those properties. In *Pham*, the trustee was seeking turnover of the rents from the debtor. Here, Manfredo actually had collected the rents and was attempting to distribute them based on the interests as they existed at the time she closed the case. In neither situation did the trustee mention the rents within the notices of abandonment. Manfredo, like the trustee in *Pham*, did not abandon the rents she was attempting to administer.

Pena focuses upon the secured creditors' present entitlement to the unclaimed rents, but the bankruptcy court did not rule on this issue. Rather, it found that Pena was not entitled to the funds. Because the unclaimed rents remain property of the bankruptcy estate, the bankruptcy court did not err in denying Pena's application to recover those funds.

IV. The Designation Of The Bankruptcy As A No Asset Case Is Irrelevant To The Determination Of The Property Of The Estate.

[16] Pena also makes much of Manfredo's designation of his case as a no asset chapter 7 bankruptcy. [13] The designation of ***425** the case as a no asset case was based on the trustee's understanding that the secured creditors held continuing security interests against the rental properties and all rents she collected that were generated by those encumbered properties. This assumption was manifested in the trustee's Final Account. No one, including Pena, objected to the trustee's proposed distribution to the secured creditors. If these lenders no longer have secured claims against the remaining rents, and those funds actually are now unencumbered, they nonetheless remain property of the estate available for distribution pursuant to the statutory scheme Congress enacted for chapter 7 cases, as set forth in § 726(a). *Viegelahn*, 135 S. Ct. at 1835; *see also* *Elliot v. Four Seasons Props. (In re Frontier Props., Inc.)*, 979 F.2d 1358, 1366-67 (9th Cir. 1992).

The designation of the bankruptcy as a no asset case is irrelevant to the question presented in this appeal and provides the debtor with no interest in the remaining rents. The fact that some additional action is required to properly administer these rents in light of Manfredo's prior Final Account does not alter the nature of the unclaimed funds as property of the estate. Rather, a party in interest such as an unsecured creditor or the United States Trustee should be afforded the opportunity to reopen the bankruptcy case, establish that the unclaimed rents are not encumbered, and modify the Final Account to permit distribution of the unclaimed rents to the unpaid creditors pursuant to § 726(a). That distribution scheme contemplates payment in full of all creditors, including interest, before the debtor can receive any distribution from the estate's assets. *Viegelahn*, 135 S. Ct. at 1835.

CONCLUSION

For the reasons set forth above, we AFFIRM the bankruptcy court's order denying Pena's application seeking to recover the unclaimed funds.

All Citations

600 B.R. 415, 2019 Daily Journal D.A.R. 4829

Footnotes

1 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.

2 Pena did not include in his excerpts of record copies of Manfredo's 2014 filings pursuant to which she formally abandoned the estate's interest in the subject parcels of real property. However, we can and do take judicial notice of these court filings and the other papers filed in Pena's bankruptcy case. *O'Rourke v. Seaboard Sur. Co. (In re E.R. Fegert, Inc.)*, 887 F.2d 955, 957–58 (9th Cir. 1989).

3 Pena did not present any evidence before the bankruptcy court, or argument on appeal, to trace the origins of the unclaimed funds. Accordingly, we consider all the unclaimed funds to have come from pre-abandonment rents, as the bankruptcy estate would have no interest in post-abandonment rents.

4 Whereas the application requested recovery of the entire $ 51,777.03 in unclaimed funds on deposit in the court's registry, Pena's legal brief in support of his application only sought $ 45,685.12 of the unclaimed funds. The difference between these two amounts – $ 6,091.91 – roughly equals the aggregate amount of rents collected from the Tulare property that later became unclaimed funds ($ 6,091.89). Pena did not submit with his application any evidence or law pertaining to Tulare property or the $ 6,091.89. Furthermore, the certificate of service accompanying his application reflects that Pena did not attempt to serve any parties who might have claimed an interest in the Tulare property or the rents derived from that property. Pena does not mention the Tulare property in his brief on appeal either, further suggesting that he seeks to recover the unclaimed rents on the other properties but not those related to the Tulare property.

5 Pena also served his application on Manfredo, who did not file a response either. However, the closing of the bankruptcy case discharged the trustee, and Pena did not seek to have the bankruptcy case reopened. Accordingly, Manfredo was no longer the trustee for the case when Pena filed his application.

6 § 347(a) provides:

> Ninety days after the final distribution under section 726, 1226, or 1326 of this title in a case under chapter 7, 12, or 13 of this title, as the case may be, the trustee shall stop payment on any check remaining unpaid, and any remaining property of the estate shall be paid into the court and disposed of under chapter 129 of title 28.

7 Available at https://www.justice.gov/ust/file/handbook_for_chapter_7_trustees.pdf/download (last viewed April 17, 2019).

8 Except for his abandonment nunc pro tunc argument discussed below, Pena also has conceded that the rental properties were property of the bankruptcy estate until they were abandoned.

9 Rule 3011 provides:

> The trustee shall file a list of all known names and addresses of the entities and the amounts which they are entitled to be paid from remaining property of the estate that is paid into court pursuant to § 347(a) of the Code.

10 28 U.S.C. § 2041 provides:

> All moneys paid into any court of the United States, or received by the officers thereof, in any case pending or adjudicated in such court, shall be forthwith deposited with the Treasurer of the United States or a designated depositary, in the name and to the credit of such court.
>
> This section shall not prevent the delivery of any such money to the rightful owners upon security, according to agreement of parties, under the direction of the court.

11 Though retroactive application of abandonment is the general rule, it "is not a categorical imperative, to be blindly followed to a result that is unjust." *Wallace v. Lawrence Warehouse Co.*, 338 F.2d 392, 394 n.1 (9th Cir. 1964). The bankruptcy court concluded that, as between Pena and his unsecured creditors, the creditors, who were owed more than $ 411,000, had a superior right to the unclaimed funds. We agree. Pena's reliance on *Van Curen v. Great Am. Ins. Co. (In re Hat)*, 363 B.R. 123 (Bankr. E.D. Cal. 2007), is not persuasive. There, the chapter 11 trustee abandoned several farms, and permitted the debtor to farm the properties even prior to abandonment. *Id.* at 129, 132. When the crops failed, the estate claimed the insurance proceeds as property of the estate. *Id.* at 133-34. The debtor argued that the estate had no interest in the insurance proceeds based upon the prior abandonment of the farms, which included the crops. *Id.* at 141-42. The court held that, while abandonment did not deprive the estate of its insurance policy, retroactive application of the abandonment negated the estate's insurable interest in the crops and thus deprived the estate of any interest in the insurance proceeds. *Id.* Considering the equities before applying abandonment retroactively, the *Hat* court found that the estate's loss of its interest in the proceeds was not unjust given its realization that the estate would not be able to farm the properties and its decision to allow Hat to resume farming the properties prior to abandonment. *Id.* at 142. But whereas the equities in *Hat* supported retroactive abandonment of the farms and crops to prevent the estate from receiving a windfall from the debtor's efforts, in this case the windfall would result if Pena was to recover the rents while his unsecured creditors receive nothing. In any event, as we hold infra, abandonment of the rental properties did not alter the separate status of the rents as property of the estate.

12 In *Humeston,* Judge Learned Hand considered the effect of abandonment of real property on the bankruptcy estate's interest in encumbered rents and wrote: "even if the trustee did abandon the equity, he did not include the rents; the two were not inseparably linked." *In re Humeston*, 83 F.2d at 189.

13 Pena attempts to argue on appeal that the unclaimed funds actually were surplus funds because some of the secured creditors to whom Manfredo mailed the checks affirmatively refused the rent payments in light of the pending foreclosure of the underlying rental properties. Pena's argument makes no sense and ignores the nature of the rents as property of the estate subject to the distribution requirements of § 726(a) if administered by the trustee.

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Appeal Filed by WALTERS v. STEVENS, LITTMAN, BIDDISON, 10th Cir., June 11, 2019

2019 WL 2353534
Only the Westlaw citation is currently available.
NOT FOR PUBLICATION
United States Bankruptcy Appellate Panel of the Tenth Circuit.

IN RE Eric Theodore WAGENKNECHT and Susan Elizabeth Colbert, Debtors.
Stevens, Littman, Biddison, Tharp & Weinberg, LLC, Defendant-Appellant,
v.
Jared Walters, Trustee, Plaintiff-Appellee.

BAP No. CO-18-093
|
Bankr. No. 16-10419
|
Adv. No. 18-01018
|
FILED June 4, 2019

Appeal from the United States Bankruptcy Court for the District of Colorado

Attorneys and Law Firms

Kenneth J. Buechler, Denver, CO, for Debtors.

David V. Wadsworth, Lacey Bryan, Littleton, CO, for Plaintiff-Appellee.

Craig Weinberg, Boulder, CO, for Defendant-Appellant.

Before SOMERS, MOSIER, and MARKER, [1] Bankruptcy Judges.

OPINION [*]

SOMERS, Bankruptcy Judge.

***1** The subject of this appeal is the prepetition payment of the debt owed by Eric Wagenknecht (the "Debtor") to the defendant law firm, Stevens, Littman, Biddison, Tharp & Weinberg, LLC (the "Law Firm"), by the Debtor's mother, who simultaneously with the transfer received a promissory note from the Debtor in the amount of the payment. Jared Walters, the Chapter 7 Trustee (the "Trustee"), filed a complaint against the Law Firm to avoid the transfer as a preferential transfer pursuant to 11 U.S.C. § 547(b). [2] The Law Firm moved for summary judgment, contending that the transfer was not of an interest of the Debtor in property. The Trustee filed a cross motion for summary judgment. The Bankruptcy Court found there were no material facts in controversy, held the transfer was preferential, denied the Law Firm's motion, and granted the Trustee's motion. The Law Firm appeals. This panel **AFFIRMS**.

I. Facts

Prior to the petition date, the Law Firm provided legal services to the Debtor. By the end of 2015, the Debtor owed the Law Firm at least $ 20,000. Sharon Wagenknecht is the mother of the Debtor. On January 11, 2016, the Debtor executed a promissory note (the "Note") in which he promised to pay his mother $ 21,672.65. On or about January 14, 2016, the Debtor's mother paid $ 21,672.65 to the Law Firm.

The Debtor and his spouse filed a Chapter 13 petition on January 29, 2016. In the Statement of Financial Affairs, in response to the question of whether during the 90 days before filing any creditor was paid more than $ 600, the Debtor stated that a payment of $ 20,000 for legal services was made in January 2016 "by Sharon Wagenknecht on behalf of Debtor." [3] The Debtor and his spouse voluntarily converted their case to Chapter 7 on April 28, 2017, and Jared Walters was appointed the Trustee. On January 18, 2018, the Trustee initiated an adversary proceeding against the Law Firm, seeking to avoid and recover the $ 21,672.65 that was paid to the Law Firm.

On April 24, 2018, the Law Firm filed its motion for summary judgment. The statement of uncontroverted facts recited the basic facts stated above—the existence of the debt, the Debtor's execution of the Note, and Ms. Wagenknecht's payment to the Law Firm. Those facts were supplemented by statements that relied upon an affidavit of Ms. Wagenknecht that stated in material part:

5. I agreed to loan Debtor $ 21,672.65 for the sole purpose of paying the Law Firm's bill.

6. On or about January 11, 2016, Debtor signed and delivered to me a promissory note in the amount of $ 21,672.65.

7. On or about January 14, 2016, I wrote a check in the amount of $ 21,672.65 directly to the Law Firm. The check was written on an account at Alpine Bank in my name alone. Debtor holds no interest in my account at Alpine Bank.

8. I transmitted the check directly to the Law Firm on or about January 14, 2016.

***2** 9. The amount of the check exactly matches the amount of the promissory note that Debtor signed and gave to me.

10. My loan to Debtor of $ 21,672.65 was not a "general loan" to him. I required, as a requirement and condition of the loan, that the entire $ 21,672.65 be used exclusively to pay the specific debt owed to the Law Firm and for no other purpose. Again, the loan was not a general line of credit that Debtor could have used however he wanted or desired. I would not have made this loan unless the funds were used exclusively to pay the Law Firm. At no time did Debtor have possession, dominion, or control over the loan proceeds nor could he direct how those proceeds were used, applied, or distributed. [4]

The Law Firm argued, as a matter of law, that there was not a transfer of an interest of the Debtor, and the estate was not diminished by the payment to the Law Firm.

The Trustee filed a combined response and cross motion for summary judgment. He controverted the factual statement that relied on paragraphs 5 and 10 of the affidavit and disputed the admissibility of the affidavit. In reliance on *Marshall*, [5] a Tenth Circuit case holding that the payment of a credit card balance through a loan from a new credit card lender was preferential, the Trustee argued that the Debtor had an interest in the transferred funds and the transfer was therefore an avoidable preference.

The Bankruptcy Court held in favor of the Trustee on both issues. It ruled that the affidavit was inadmissable under the parol evidence rule holding that the Note was a fully integrated agreement and if Ms. Wagenknecht intended to restrict the Debtor's use of the loan proceeds she should have insisted that the restriction be included in the Note. After concluding the terms of the loan were limited to the text of the Note, the Bankruptcy Court then held the Debtor had an interest in and controlled the funds transferred to the Law Firm such that the transfer was preferential under the reasoning of *Marshall.* The Bankruptcy Court also rejected the Law Firm's reliance on the earmarking defense, finding the doctrine is limited to a codebtor situation and therefore barred as a matter of law, even if the facts in the affidavit were considered.

II. Jurisdiction

With the consent of the parties, this Court has jurisdiction to hear timely-filed appeals from "final judgments, orders, and decrees" of bankruptcy courts within the Tenth Circuit. [6] The Law Firm timely filed a notice of appeal from the order entering judgment in favor of the Trustee. Neither party in this case elected for this appeal to be heard by the United States District Court pursuant to 28 U.S.C. § 158(c). Accordingly, this Court has jurisdiction over this appeal.

III. Issues and Scope of Review

There are two issues on appeal: (1) whether the Bankruptcy Court erred in excluding Ms. Wagonknecht's affidavit submitted by the Law Firm in conjunction with its motion for summary judgment; and (2) whether the Bankruptcy Court erred when granting summary judgment to the Trustee on his claim to avoid and recover as preferential the payment by Ms. Wagonknecht to the Law Firm.

***3** The scope of review of both issues is de novo. "*De novo* review requires an independent determination of the issues, giving no special weight to the bankruptcy court's decision." [7] As to the first issue, "[w]hether a contract is partially integrated ... such that resort to parol evidence by the [trial] court was proper is generally a question of law that we review de novo." [8] Likewise, as to issue two, a bankruptcy court's grant of summary judgment is reviewed "*de novo*, applying the same legal standard as was used by the bankruptcy court." [9]

> Summary judgment is appropriate only if "the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any," when viewed in the light most favorable to the non-moving party, "show that there is no genuine issue as to any material fact and the moving party is entitled to judgment as a matter of law." [10]

IV. Analysis

a. The parol evidence rule does not preclude the admission of the facts stated in Ms. Wagonknecht's affidavit.

Federal Rule of Civil Procedure 56 ("Civil Rule 56") governing summary judgment is made applicable to this adversary proceeding by Federal Rule of Bankruptcy Procedure 7056. Subsection (c)(1)(a) of Civil Rule 56 provides that a party asserting that a fact cannot be disputed must support the fact by citing to particular parts of material in the record, including affidavits made for purposes of the motion only. Subsection (c)(2) provides that a party may object that the affidavit "cannot be presented in a form that would be admissible in evidence."[11] In this case, the Law Firm's position was that facts about the circumstances of making the loan, which were supported by the affidavit, were undisputed. The Trustee objected on the basis that the affidavit was inadmissable under the parol evidence rule. The Bankruptcy Court agreed.

The parol evidence rule is a substantive rule of law requiring the application of Colorado law.[12] In Colorado, "the parol evidence rule does not bar admission of oral representations which are not inconsistent with the terms of the final written instrument and are not of the type that one would necessarily expect to be incorporated into the final agreement."[13] Consistent with the forgoing principle, the Restatement (Second) of the Contracts rejects

> the assumption sometimes made that because a writing has been worked out which is final on some matters, it is to be taken as including all the matters agreed upon. Even though there is an integrated [complete] agreement, consistent additional terms not reduced to writing may be shown, unless the court finds that the writing was assented to by both parties as a complete and exclusive statement of all the terms.[14]

***4** A written document cannot of itself prove its own completeness.[15]

In this case, the written agreement is the Note, which appears to be a negotiable instrument under article 3, section 104 of the Uniform Commercial Code. "[T]he courts, though professing to apply the same doctrine with reference to parol evidence when negotiable instruments are concerned as when other written contracts are in question, have, nevertheless, frequently been more ready, when the controversy involved no holder in due course, to admit parol evidence of collateral agreements."[16]

In the circumstances of this case, the statements in the affidavit are not inconsistent with the Note, which appears to be a form contract prepared by the Debtor and/or his mother. The first paragraph of the Note is a promise by the Debtor to pay his mother $ 21,672.65 with no interest. The Note then states that payment is due upon demand, the Note is secured by personal property,[17] the Debtor has the right to prepay, the Debtor promises to pay collection costs, default is any one of eight events, the provisions of the Note are severable, and various "boiler plate" terms are applicable. There is no integration clause. Although the Note obligates the Debtor to make payment for value received, it does not identify the value or reflect any obligation of his mother to extend value. The Note is silent about the matters included in the affidavit. Under the circumstance of this case where the loan advance was being made by a check payable to the Debtor's creditor (rather than to the Debtor), there was no need to commit the restrictions on the use of the loan proceeds to writing.

We therefore conclude the Bankruptcy Court erred when ruling that the affidavit was inadmissable under the parol evidence rule.[18] The Note was not a fully integrated agreement, and the affidavit was offered to provide additional, consistent terms which were not included in the Note.

b. Under *Marshall*, as a matter of law, the Debtor had an interest in the funds transferred to the Law Firm and the transfer may be avoided, even if the facts stated in the affidavit are considered.

***5** A "preference" is a term of art in the Bankruptcy Code, and preferential transfers are governed by § 547 of the Code. Under § 547(b):

> a transfer is avoidable if it: (1) is of an interest of the debtor in property; (2) is

> for the benefit of a creditor; (3) is made for or on account of an antecedent debt owed by the debtor before the transfer was made; (4) is made while the debtor is insolvent; (5) is made on or within ninety days before the date the bankruptcy petition was filed; and (6) allows the creditor to receive more than the creditor would otherwise be entitled to receive from the bankruptcy estate. [19]

The only element of the Trustee's preferential transfer claim that is at issue is whether the payment to the Law Firm was a "transfer of an interest of the debtor in property." [20]

The Tenth Circuit Court of Appeals construed this element in *Marshall*, a case factually similar to this case, where it held that a preferential transfer occurred when payment was made to the debtors' MNBA credit card account with borrowed funds advanced from their Capital One credit card account, even though the funds were paid directly to MNBA. [21] The Tenth Circuit started its analysis by observing that "interest of the debtor in property" is not defined by the Bankruptcy Code. Following the guidance of the United States Supreme Court in *Begier*, [22] the Tenth Circuit looked to the expansive definition of property of the estate in § 541 and determined that "the right to use an item or to control its use is a property interest." [23] The Tenth Circuit adopted two tests, the dominion/control test and the diminution of the estate test, to determine whether the transfer was of an interest of the debtor in property. Both tests were satisfied by the substitution of credit card balances. The dominion/control test was satisfied because the transaction was "essentially the same as if Debtors had drawn on their Capital One line of credit, deposited the proceeds into an account within their control, and then wrote a check to MBNA." [24] "The Debtors' exercise of their ability to control the disposition of the loan proceeds is the essence of this case." [25] The diminution of the estate test was satisfied because "[t]he Capital One loan proceeds were an asset of the estate for at least an instant before they were preferentially transferred to MBNA." [26] The fact that the net value of the estate did not change was not relevant. [27]

In this case, after holding that the terms of the loan were limited to the text of the Note, the Bankruptcy Court analyzed whether the Debtor had possession of the loan proceeds under the dominion/control and diminution of the estate tests as developed in *Marshall*. When the facts stated in the affidavit were disregarded, the Bankruptcy Court concluded that the Debtor clearly had an interest in the property transferred. Because this panel has concluded that the facts stated in the affidavit were erroneously excluded from consideration, we must revisit the "interest of the debtor in property" issue.

***6** The following facts are uncontroverted: By the end of 2015, the Debtor owed the Law Firm over $ 20,000; the Debtor signed the Note to his mother for $ 21,672.65; and three days later, the Debtor's mother paid $ 21,672.65 to the Law Firm. In his Statement of Financial Affairs, in response to the question of whether payments were made to creditors during the 90 days preceding filing, the Debtor stated that $ 20,000 was paid "by Sharon Wagenknecht on behalf of Debtor" to the Law Firm. [28] We regard the facts stated in the affidavit concerning the circumstances under which the loan was made and the intent of the Debtor and Ms. Wagenknecht disputed, [29] but find that such dispute does not preclude summary judgment for the Trustee. [30]

As discussed above, the Tenth Circuit in *Marshall* adopted two tests for determining whether a transfer was of an interest of the debtor in property for purposes of to § 547(b). The first is the dominion/control test; and the second is the diminution of the estate test. In this case, the Debtor's exercise of his ability to control the loan proceeds is evidenced by his execution of the Note in which he agreed to pay his mother for a loan, the proceeds of which were transferred directly to his creditor. [31] The Debtor could have refused to accept a loan from his mother if the proceeds were not distributed to him, but he did not do so. In his Statement of Financial Affairs, the Debtor states that his mother paid the Law Firm on his behalf. There is no material distinction between *Marshall*, where debtors directed Capitol One to pay MBNA, and this case, where the Debtor agreed to a loan from his mother with the proceeds being transmitted to the Law Firm.

The Law Firm attempts to distinguish this case from *Marshall* by reference to the statement in *Marshall* that "[t]he payments were a debtor's discretionary use of borrowed funds to pay another debt." [32] The emphasis is on the phrase "discretionary use." The argument is that if the facts in the affidavit are true, the Debtor's mother, not the

Debtor, determined the use of the borrowed funds. But this interpretation ignores the Debtor's role in the transaction. If the transferred funds had been a gift, the Debtor would have had no control. But a gift was not made. We do not find *Marshall*'s use of the phrase "discretionary use" material to the Tenth Circuit's control analysis. What matters is that borrowed funds were used to pay the Debtor's creditor.

***7** As to diminution of the estate, the *Marshall* opinion recognized that the net value of the estate did not change as a result of the transfer because there was in essence a substitution of unsecured creditors. But the Tenth Circuit concluded that "[a] transfer of loan proceeds (an asset) diminishes the bankrupt's estate."[33] There were no facts in *Marshall* to support this finding; it appears to be a rule of law based upon the purpose served by recovery of preferential transfers. As the Tenth Circuit stated, "the issue is whether any asset, regardless of how fleeting its presence in the bankrupt's estate during the relevant [lookback] period of time, should be ratably apportioned among qualified creditors or permitted to benefit only a preferred creditor."[34]

In this case, a creditor of the Debtor was paid with loan proceeds, and under the reasoning of *Marshall*, the estate was diminished. If it were uncontroverted that the Debtor's mother would not have made the loan for any purpose other than to pay the Law Firm, the result would not change. *Marshall* rejects measuring the diminution of the estate by considering whether the Debtor would have received the loan proceeds if they had not been paid directly to the creditor in favor of a rule that the transfer of loan proceeds diminishes the estate.

The foregoing applications of the dominion/control test and the diminution of the estate test are strained, but they are required by *Marshall*. That decision is based upon legal fictions, not reality. Those fictions allowed the Tenth Circuit to follow the "general rule[ ] [that,] under § 547(b), a debtor's transfer of borrowed funds constitutes a preferential transfer of the debtor's property, assuming that the other elements of that section are met."[35]

For the foregoing reasons, we affirm the Bankruptcy Court's holding the transfer of $ 21,672.65 to the Law Firm by Sharon Wagenknecht of behalf of the Debtor was a preferential transfer under *Marshall*.

V. Conclusion

For the foregoing reasons we reverse the Bankruptcy Court on the parol evidence rule issue. We also hold that erroneous ruling was harmless because the Trustee is nevertheless entitled to summary judgment on the preferential transfer issue. Judgment in favor of the Trustee granting his motion for summary judgment and denial of the Law Firm's motion for summary judgment are therefore **affirmed.**

All Citations

Slip Copy, 2019 WL 2353534

Footnotes

1 Joel T. Marker, U.S. Bankruptcy Judge, United States Bankruptcy Court for the District of Utah, sitting by designation.

* This unpublished opinion may be cited for its persuasive value, but is not precedential, except under the doctrines of law of the case, claim preclusion, and issue preclusion. 10th Cir. BAP L.R. 8026-6.

2 All future references to "Code," "Section," and "§" are to the Bankruptcy Code, Title 11 of the United States Code, unless otherwise indicated.

3 *Statement of Financial Affairs* at 3, *in* Appellant's App. at 66.

4 *Affidavit of Sharon Wagenknecht*, *in* Appellant's App. at 17.

5 *Parks v. FIA Card Servs., N.A. (In re Marshall)*, 550 F.3d 1251 (10th Cir. 2008).

6 28 U.S.C. § 158(a)(1), (b)(1), and (c)(1); Fed. R. Bankr. P. 8002.

7 *Expert S. Tulsa, LLC v. Cornerstone Creek Partners, LLC (In re Expert S. Tulsa, LLC)*, 534 B.R. 400, 408 (10th Cir. BAP 2015) (citing *Salve Regina Coll. v. Russell*, 499 U.S. 225, 238 (1991)).

8 *Soc'y of Lloyd's v. Bennett*, 182 F. App'x. 840, 845, 2006 WL 1524621, at *3 (10th Cir. June 2, 2006) (first citing *Flying J Inc. v. Comdata Network, Inc.*, 405 F.3d 821, 832 (10th Cir. 2005), and then citing *Betaco, Inc. v. Cessna Aircraft Co.*, 32 F.3d 1126, 1131 (7th Cir. 1994)).

9 *In re Expert S. Tulsa, LLC*, 534 B.R. at 408 (citing *Rushton v. Bank of Utah (In re C.W. Mining Co.)*, 477 B.R. 176, 180 (10th Cir. BAP 2012), *aff'd sub nom. Jubber v. Bank of Utah (In re C.W. Mining Co.)*, 749 F.3d 895 (10th Cir. 2014).

10 *Id.* (quoting *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 247 (1986)).

11 Fed. R. Civ. P. 56(c)(2).

12 *Monus v. Colo. Baseball 1993, Inc.*, No. 95-1099, 1996 WL 723338, at *12 (10th Cir. Dec. 17, 1996) (citing *Klein v. Grynberg*, 44 F.3d 1497, 1503 (10th Cir. 1995)); *Glover v. Innis*, 252 P.3d 1204, 1208 (Colo. App. 2011) ("The parol evidence rule is a principle of contract law, rather then a rule of evidence.").

13 *Boyer v. Karakehian*, 915 P.2d 1295, 1299 (Colo. 1996) (en banc). In other words, the parol evidence rule allows oral representations which are consistent with the terms of the final written contract and are of the type that would not typically be expected to be in the written agreement.

14 Restatement (Second) of Contracts § 210 cmt. a (Am. Law Inst. 1981).

15 *Id.* cmt. b.

16 11 Williston on Contracts § 33:37 (4th ed. 2019). *McCaffrey v. Mitchell*, 56 P.2d 926, 928 (Colo. 1936) (explaining the principle stated).

17 If the Note constituted a grant of a security interest, that interest was unperfected. Neither of the parties have addressed this portion of the Note, which the panel will not further consider.

18 Even though the affidavit is admissible, we may disregard the legal meaning of the following statement: "At no time did the Debtor have possession, dominion, or control over the loan proceeds." *Affidavit of Sharon Wagenknecht* at 1, *in* Appellant's App. at 17. *See* *CLC Creditors' Grantor Tr. v. Howard Sav. Bank (In re Commercial Loan Corp.)*, 396 B.R. 730, 740 (Bankr. N.D. Ill. 2008) (explaining any legal connotation of an expert's statement in an affidavit that entities acted as conduits would be disregarded).

19 *Bailey v. Big Sky Motors, Ltd. (In re Ogden)*, 314 F.3d 1190, 1196 (10th Cir. 2002).

20 11 U.S.C. § 547(b).

21 *Parks v. FIA Card Servs., N.A. (In re Marshall)*, 550 F.3d 1251 (10th Cir. 2008).

22 *Begier v. IRS*, 496 U.S. 53, 58-59 (1990).

23 *Marshall*, 550 F.3d at 1255.

24 *Id.* at 1256.

25 *Id.* at 1257.

26 *Id.* at 1258.

27 *Id.*

28 *Statement of Financial Affairs* at 3, *in* Appellant's App. at 66.

29 Generally, "[t]he intent or state of mind of the parties to a transfer is not material to the general question of whether that transfer is a preference." *Johnson v. Barnhill (In re Antweil)*, 931 F.2d 689, 692 (10th Cir. 1991) (citing 4 *Collier on Bankruptcy* ¶ 547.01 (15th ed. 1990)).

30 Although the affidavit appears to have been drafted to satisfy the conditions for application of the earmarking doctrine, we do not address whether that doctrine would provide a defense. The doctrine was asserted in the Law Firm's answer, and its summary judgment pleadings. The Bankruptcy Court found the doctrine inapplicable as a matter of law. It expressly adopted the dicta in *Manchester v. First Bank & Tr. Co. (In re Moses)*, 256 B.R. 641, 645 (10th Cir. BAP 2000) and the holding of *Kerst v. Wray State Bank (In re Kerst)*, 347 B.R. 418, 421-22 (Bankr. D. Colo. 2006) that the earmarking doctrine is limited to codebtor situations. Debtor and Ms. Wagenknecht were not codebtors of the Law Firm.
Application of the earmarking doctrine is not an issue on appeal. While arguing that the parol evidence rule does not exclude the affidavit, the Law Firm's briefs do not urge reversal of the Bankruptcy Court's rejection of the earmarking defense, and at oral argument counsel for the Law Firm stated the issue has been waived. Further, because this Court is bound by its prior published decisions, we are not free to reconsider the *Moses* decision, under which earmarking is not an available defense in this case. Tenth Circuit BAP Local Rule 8026-6. That is for the Tenth Circuit to address.

31 *See* *In re Moses*, 256 B.R, at 645 ("Upon execution of the Trust Note, the debtor had a legal and an equitable interest in the Trust Loan proceeds, and the Transfer to the Bank diminished the debtor's estate.").

32 *In re Marshall*, 550 F.3d at 1257.

33 *Id.* at 1258.

34 *Id.*

35 *Bailey v. Big Sky Motors, Ltd. (In re Ogden)*, 314 F.3d 1190, 1199 (10th Cir. 2002) (citing *In re Smith*, 966 F.2d 1527, 1537 (7th Cir. 1992)).

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