2017 WL 715059
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NOT FOR PUBLICATION
United States Bankruptcy
Appellate Panel of the First Circuit.

IN RE Richard C. FRAHER and
Shannon M. Fraher, Debtors.
Above–All Transportation, Inc., Plaintiff–Appellant,
v.
Shannon M. Fraher, Defendant–Appellee.

BAP NO. MB
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Bankruptcy Case No. 14–14241–MSH
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Adversary Proceeding No. 14–01201–MSH
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February 21, 2017

Appeal from the United States Bankruptcy Court for the District of Massachusetts, (Hon. Melvin S. Hoffman, U.S. Bankruptcy Judge)

Attorneys and Law Firms

Bill N. Jacob, Esq., on brief for Appellant.

Patrick M. Culhane, Esq., on brief for Appellee

Before Deasy, Tester, and Finkle United States Bankruptcy Appellate Panel Judges.

Opinion

Deasy, U.S. Bankruptcy Appellate Panel Judge.

***1** Above–All Transportation, Inc. ("Above–All") appeals from that part of the adversary proceeding judgment wherein the bankruptcy court ruled in favor of Shannon Fraher on the count it brought under 11 U.S.C. § 523(a)(2)(A).[1] For the reasons set forth below, the Panel **AFFIRMS.**

BACKGROUND

Shortly after Shannon and Richard Fraher filed their joint chapter 13 bankruptcy petition, Above–All filed an adversary proceeding against the Frahers seeking either a judgment denying their discharge under § 727(a)(4)(A) or (a)(5) or, alternatively, ruling any debt they owed Above–All was nondischargeable under § 523(a)(2)(A) or (a)(6).[2] In the complaint, Above–All alleged that although Ms. Fraher was the principal of SMA Transportation, Inc. ("SMA"), a livery service company, Mr. Fraher was the true owner and operator of the corporation. Above–All explained that in February 2014 and pursuant to an asset sale agreement, the Frahers sold to Above–All most of the assets of SMA including the corporate name, two vehicles, various websites, and telephone numbers, and customer lists. The sale agreement provided, *inter alia*, that SMA, Ms. Fraher, and Mr. Fraher would not compete in any manner with Above–All for a specified period of time after the sale.

Above–All asserted that thereafter, both during and after his employment at Above–All and despite the provisions of the sale agreement, Mr. Fraher continued to run SMA and provided services to the customers Above–All acquired from SMA. As a result, Above–All filed suit against SMA and Mr. Fraher in state court under a variety of theories. On April 28, 2014, and May 21, 2014, the state court entered orders enjoining SMA, Mr. Fraher, and Ms. Fraher from competing with Above–All. Above– All explained that despite the non-compete provision of the sale agreement and the injunctions, SMA continued to operate a livery service in Massachusetts through at least June 2014.

With respect to Count III, the one it brought under § 523(a)(2)(A), Above–All asserted that the Frahers "fraudulently induced [Above–All] to enter into the Sale Agreement, to make payment in the amount of Sixty Thousand and 00/100 ($60,000.00) Dollars thereunder, to employ Fraher and pay him a salary while diverting both SMA and Above[–]All business to their own benefit, constituting fraud and deceit." With respect to that count, the Frahers answered that they had fully disclosed SMA's assets prior to the sale and that they disputed Above–All had suffered damages. For an affirmative defense, Ms. Fraher asserted Above–All had failed to state a claim against her.

***2** The parties then filed a Joint Pre–Trial Statement.[3]

In its narrative statement of the controversy, Above–All wrote that the action under § 523 was based upon the Frahers' "fraudulent and intentional actions in breaching [the sale agreement] ...." In their narrative statement, the Frahers claimed they did not violate the sale agreement and that Above–All did not suffer damages. The parties provided the following paraphrased issues of fact were all that remained to be litigated:

Plaintiff:

(i) Whether the Debtors made a false oath in connectionwith their bankruptcy filing;

(ii) Whether the Debtors failed to keep books, records,and to observe the corporate formalities as they relate to SMA, including comingling money;

(iii) Whether the Debtors intentionally breached theprovisions of the sale agreement by diverting certain SMA accounts and new business to their own benefit;

(iv) Whether the Debtors operated a livery businessin violation of the sale agreement and non-compete covenant, and in direct violation of the state court injunction, and derived income from their intentional actions, and received money or other consideration from former clients or customers of SMA Transportation, Inc., Marshfield Coach, Hingham Coach, Brite Lights Limousine, Brite Lites Limousine, Pride Limousine or Special Delivery Limousine, which funds were not turned over to the Plaintiff; and (v) Whether the Plaintiff is a creditor of the Debtors.

Defendant:

(i) Whether the Plaintiff suffered irreparable harm as aresult of the sale agreement;

(ii) Whether both Defendants intended to harm the Plaintiff;

(iii) Whether both Defendants, particularly ShannonFraher, breached the sale agreement by engaging in a business in competition with the Plaintiff;

(iv) Whether Plaintiff has produced financial recordsto establish he lost money due to the actions of the Defendants;

(v) Whether Shannon Fraher violated the non-competecovenant;

(vi) Whether the Defendants understood the saleagreement and intended to breach the agreement.

The parties agreed the following issues of law, and no others, remained to be litigated:

Plaintiff:

(i) Whether the Debtors are entitled to a Discharge; and

(ii) Whether the SMA corporate veil should be pierced.**Defendant:**

(1) Whether both Defendants intentionally harmed thePlaintiff; and

(2) Whether the Plaintiff suffered substantial harm andloss of property due to the Plaintiff.

At the end of the Joint Pre–Trial Statement the parties acknowledged that the document "shall supersede the pleadings and govern the course of the trial of this cause." Above–All confirmed that there were no other matters that might affect the trial.

When the trial commenced,[4] Above–All opened by reciting the facts and claiming that because the Frahers diverted business after they signed the sale agreement, Above–All did not receive the benefit of its bargain. In their opening statement, the Frahers' primarily argued that Above–All was pursuing a vendetta and could not show it was damaged.

***3** Mr. Fraher testified how he and Ms. Fraher decided to start SMA and subsequently when and why they decided to sell it to Above–All. He offered that any livery service SMA provided after the sale would simply have been doing a favor for a friend. Ms. Fraher testified that despite being the sole officer, director, and shareholder of SMA and the sole signator on its bank accounts, she did not take an active role in the operation of SMA. She testified she had no idea about Mr. Fraher's activities after he stopped working for Above–All.

At the close of the trial, the parties did not ask to make closing arguments or file post-trial briefs. Instead, the bankruptcy court immediately announced its decision from the bench.

First, the court found for the Frahers on Counts I and II. Then it summarily ruled in favor of Ms. Fraher on Count III on the grounds that Above–All failed to establish that "she had anything to do with the debt that was created as a result of the allegations being made here ...."[5] In ruling against Mr. Fraher on Count III, the court first cited to the definition of actual fraud that Justice Thomas cited in his dissent in Husky Int'l Elec., Inc. v. Ritz, 136 S.Ct. 1581, 1593 (2016) (Thomas J., dissenting) (explaining actual fraud "[c]onsists of any deceit, artifice, trick, or design involving direct and active operation of the mind used to circumvent and cheat another."). It then cited to the evidence demonstrating that after the parties signed the sale agreement, Mr. Fraher operated SMA in violation of the non-compete provisions of the sale agreement. It ruled that Mr. Fraher's indebtedness was nondischargeable and that that the amount of the debt should be adjudicated in state court.

Two days later, the bankruptcy court entered a judgment in favor of Ms. Fraher on all counts, in favor of Mr. Fraher on Count I, II, and IV, and in favor of Above– All and against Mr. Fraher on Count III. The court also issued a supplemental order on the same date explaining Count IV was dismissed and granting Above–All relief from stay to proceed in the state court against Mr. Fraher.

The bankruptcy docket reflects that neither party filed a post-judgment motion. Above–All timely appealed the judgment and Mr. Fraher did not cross-appeal. In its statement of issues, Above–All listed only one: Whether the bankruptcy court erred in ruling in favor of Ms. Fraher on Count III of the complaint.

JURISDICTION

A bankruptcy appellate panel is " 'duty-bound' " to determine its jurisdiction before proceeding to the merits, even if not raised by the litigants. Boylan v. George E. Bumpus, Jr. Constr. Co. (In re George E. Bumpus, Jr. Constr. Co.), 226 B.R. 724, 725–26 (B.A.P. 1st Cir. 1998) (quoting Fleet Data Processing Corp v. Branch (In re Bank of New Eng. Corp.), 218 B.R. 643, 645 (B.A.P. 1st Cir. 1998)). A panel may hear appeals from final judgments, orders, and decrees of the bankruptcy court. See 28 U.S.C. § 158(a)(1). Where, as here, the appeal is one from a judgment disposing of all counts of a complaint, the judgment is final. See, e.g., Stalnaker v. Gratton (In re Rosen Auto Leasing, Inc.), 346 B.R. 798, 800 (B.A.P. 8th Cir. 2006). As such, the Panel has jurisdiction over this appeal.

STANDARD OF REVIEW

The panel applies a de novo review to conclusions of law. See, e.g., deBenedictis v. Brady–Zell (In re Brady–Zell), 500 B.R. 295, 301 (B.A.P. 1st Cir. 2013). "A bankruptcy court's determination of whether a requisite element of a nondischargeability claim under § 523(a)(2) is present is a factual determination which we review for clear error." See id. (citing Douglas v. Kosinski (In re Kosinski), 424 B.R. 599, 607 (B.A.P. 1st Cir. 2010)).

ARGUMENTS OF THE PARTIES

***4** In its brief, Above–All assigns error to the bankruptcy court's ruling against Ms. Fraher based on a variety of arguments. First, it mentions fraud and that to prevail on this prong, a plaintiff must demonstrate the debtor actually intended to defraud. Next, it contends that the court should have imputed Mr. Fraher's fraudulent intent to Ms. Fraher, citing for support, Tsurukawa v. Nikon Precision, Inc. (In re Tsurukawa), 287 B.R. 515 (B.A.P. 9th Cir. 2002). It then explains that a plaintiff can establish intent to deceive by proving reckless indifference to or a reckless disregard of the truth. In support it cited Ins. Co. of North America v. Cohn (In re Cohn), 54 F.3d 1108, 1119 (3rd Cir. 1995) and Equitable Bank v. Miller (In re Miller), 39 F.3d 301, 305 (11th Cir. 1994).[6] It further cited to cases reviewing the elements of false representation. See, e.g., Palmacci v Umpierrez, 121 F.3d 781 (1st Cir. 1997). Above–All concludes that the totality of circumstances as represented by the Frahers' testimony reflects that Ms. Fraher had no intent to perform her obligations under the sale agreement, the Frahers operated a livery service in violation of state court injunctions, and, as such, the Panel should reverse the grant of judgment for Ms. Fraher on Count III.

In her brief, Ms. Fraher argues Above–All failed to establish that she played any role in creating the debt other than signing the sale agreement. As a result, she contends, there was no evidence to establish that she made a false representation. With respect to the agency argument, Ms. Fraher asserts

Above–All failed to establish that Mr. Fraher was her agent or that she had actual knowledge or a reckless indifference regarding Mr. Fraher's actions after they signed the sale agreement.

In its reply brief, Above–All addressed the theory of imputing fraud and also discussed how intent to deceive can be established by demonstrating a reckless disregard for the truth.

At oral argument, Above–All offered that the bankruptcy court erred because Mr. Fraher's acts should have been imputed to Ms. Fraher—an issue it believes it raised in the Joint Pre–Trial Statement. It also discussed actual fraud and offered that Ms. Fraher was willfully ignorant of Mr. Fraher's fraud and she benefitted either personally or through SMA from that fraud.

DISCUSSION

Before we address the applicable statute, we must first review certain bedrock principles that guide us in assaying bankruptcy appeals in this circuit. Absent extraordinary circumstances, it is apodictic that legal theories not squarely addressed and litigated below cannot be raised for the first time on appeal. J.R. Insulation Sales & Serv., Inc. v. P.R. Elec. Power Auth., 482 B.R. 47, 54–5 (D.P.R. 2012) (explaining issues raised before trial court without developed argumentation waived); Iverson v. City of Boston, 452 F.3d 94, 102 (1st Cir. 2006) (collecting cases and explaining the "echolalic regularity" with which the First Circuit applies the waiver rule); Campos–Orrego v. Rivera, 175 F.3d 89, 95 (1st Cir. 1999) (explaining issue neither raised in pleadings nor argued before *nisi prius* court was waived). If a litigant has somehow changed its strategy during the course of litigation, it must seek reconsideration or run the risk of waiving the argument on appeal. See, e.g., MCI Telecommun. Corp. v. Matrix Commun. Corp., 135 F.3d 27, 33 (1st Cir. 1998).

Failure to list an issue in the statement of issues and/or to brief the issue with reasoned arguments may also result in waiver. See, e.g., City Sanitation, LLC v. Allied Waste Serv. of Mass., LLC (In re Amer. Cartage, Inc.), 656 F.3d 82, 91 (1st Cir. 2011) (explaining issue waived unless explicitly listed or "the substance of the issue reasonably can be inferred" from the issues listed); United States v. Zannino, 895 F.2d 1, 17 (1st Cir. 1990) (explaining issues raised via cursory reference in appellate brief are deemed waived).

***5** The First Circuit has explained that an appellate court may exercise its discretion and grant relief from waiver based upon the following nonexhaustive list of factors:

> (1) whether the failure to raise the issue has deprived the appellate court of useful factfinding, or whether the facts have been sufficiently developed and the issue was of a purely legal nature; (2) whether the omitted argument raises an issue of constitutional magnitude; (3) whether the argument was highly persuasive and failure to reach it would threaten a miscarriage of justice; (4) whether considering the issue would cause prejudice or inequity to the adverse party; (5) whether the failure to raise the issue was inadvertent and provided no tactical advantage; and (6) whether the issue implicates "matters of great public moment."

Nat'l Ass'n of Soc. Workers v. Harwood, 69 F.3d 622, 627–28 (1st Cir. 1995). See also Montalvo v. Gonzalez– Amparo, 587 F.3d 43, 48–49 (1st Cir. 2009); Banco Bilbao Vizcaya Argentaria v. Wiscovitch–Rentas (In re Net– Velázquez), 625 F.3d 34, 41 (1st Cir. 2010).

With these principles in mind, we turn to the substance of this appeal. Pursuant to § 523(a)(2)(A), a discharge may not include a debt for "money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by—(A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition; ...." The three prongs of this subsection are distinct. Privitera v. Curran (In re Curran), 554 B.R. 272, 284 (B.A.P. 1st Cir. 2016). The necessary elements of either of the first two prongs, false pretense or false representation, require a plaintiff must satisfy six necessary elements. Id. at 285.[7] To establish the third prong, a debt is excepted from discharge for actual fraud, a plaintiff must show that a debtor committed an act that "counts as 'fraud' and is done with wrongful intent ...." Husky Intern. Elec., Inc. v. Ritz, 136 S.Ct. at 1586 (ruling fraudulent conveyance scheme can constitute actual fraud notwithstanding lack of false representation). It can be "effected without a false representation." Id. The Supreme Court explained that "[a]lthough 'fraud' connotes deception or trickery generally, the term is difficult to define more precisely."

Id.[8] To prevail under any of the three prongs, a plaintiff is subject to a preponderance of the evidence standard. See Grogan v. Garner, 498 U.S. 279, 287 (1991).

***6** To support Count III, Above–All offered in its complaint that by fraudulently inducing it to enter into the agreement, to make the payment described therein, to employ Fraher while diverting both SMA and Above[–]All business to their own benefit, the Frahers engaged in fraud and deceit. It did not specify which of the three statutory prongs it was relying upon with respect to Ms. Fraher and did not raise imputed fraud. In the Joint Pre–Trial Statement, Above–All claimed the only legal issue remaining to be litigated was whether "the SMA corporate veil should be pierced."[9] It did not list imputed or actual fraud in the Joint Pre–Trial Statement. At trial, Above–All did not specify which of three prongs it considered applicable and did not raise the issue of imputed fraud. The bankruptcy court did not refer to the statute when ruling in favor of Ms. Fraher and Above–All did not pursue post-trial clarification from the court.

Pursuant to Bankruptcy Rule 8009(a)(1)(A), Above–All filed its statement of issues in which it simply stated that the bankruptcy court had erred in failing to conclude Ms. Fraher's debt nondischargeable under § 523(a)(2)(A). As before, it did not cite to the prong of the statute on which it relied and it did not raise the issue of imputed fraud.

In its opening brief, Above–All claims that at trial it produced sufficient evidence to meet its burden as to Ms. Fraher. For the first time, it mentioned imputing the fraud of Mr. Fraher but instead of developing the argument, it moved on to address the first element of the six-factor

Footnotes

test in conjunction with an action brought under one of the first two prongs of the statute—a representation made in reckless disregard of the truth. It did not address the additional elements of those two prongs. It then proceeded on to an argument that appears to touch upon actual fraud. In its reply brief, Above–All again mentioned the first element of the first two prongs to argue for imputing Mr. Fraher's fraud, and to suggest Ms. Fraher could be liable for actual fraud. In neither of these briefs did Above–All present developed argumentation with respect to actual or imputed fraud.[10]

When questioned at oral argument, Above–All offered that it had addressed the theory of imputed fraud in the Joint Pre–Trial Statement.

After this conspectus, it is evident that Above–All never provided in its complaint, in the Joint Pre–Trial Statement, in its opening statement, at trial, in its statement of issues, or in its appellate briefs developed arguments that pertain to the theories which it now urges this Panel apply—imputed and actual fraud.[11] Under the First Circuit standards applicable to waiver, we are constrained to conclude that Above–All has waived the theories of imputed and actual fraud. As this appeal does not present issues of constitutional magnitude or matters of great public moment, we will not exercise our discretion and grant relief from waiver.

CONCLUSION

For the reasons set forth herein, the Panel **AFFIRMS** the judgment as to Ms. Fraher on Count III.

All Citations

Slip Copy, 2017 WL 715059

1 Unless expressly stated otherwise, all references to "Bankruptcy Code" or to specific statutory sections shall be to the Bankruptcy Reform Act of 1978, as amended, 11 U.S.C. §§ 101, et seq. All references to "Rule or Rules" are to the Federal Rules of Civil Procedure. References to "Bankruptcy Rule" are to the Federal Rules of Bankruptcy Procedure.

2 Above–All confirmed at trial that it was not pursuing the count it brought under § 523(a)(6).

3 Although Above–All did not include the Joint Pre–Trial Statement in the record, we may review the document. See Fed. R. Bankr. P. 8009(e)(2)(C). The parties filed the Joint Pre–Trial Statement pursuant to the Pre–Trial Order. In that order, the bankruptcy court explained that if a party wanted to file a trial memorandum, it could file one with the Joint Pre–Trial

Order. The court further explained that it would not permit other briefs or memoranda at trial unless it so ordered and that it might, but need not, set a deadline for post-trial pleadings.

4 Although Above–All designated the entire transcript, it only provided the Panel with a partial transcript in its appendix. The Panel, however, may review the entire transcript. See Fed. R. Bankr. P. 8009(e)(2)(C).

5 The court made no mention of the outstanding issue of piercing the corporate veil.

6 These cases address recklessness as it pertains to the element of intent to deceive in § 523(a)(2)(B).

7 In order to establish a debt is nondischargeable under § 523(a)(2)(A) due to a false representation, the plaintiff must show that: (1) the debtor made a knowingly false representation or one made in reckless disregard of the truth; (2) the debtor intended to deceive; (3) the debtor intended to induce the creditor to rely upon the false statement; (4) the creditor actually relied upon the misrepresentation; (5) the creditor's reliance was justifiable; and (6) the reliance upon the false statement caused damage. In re Curran, 554 B.R. at 284 (citing McCrory v. Spigel (In re Spigel), 260 F.3d 27, 32 (1st Cir. 2001).

8 Prior to Husky, any case brought under § 523(a)(2)(A) was subject to a five-part test. While the cases are few since Husky, it appears that cases under actual fraud would no longer be subject to the five-part test. See, e.g., BBI Architectural Serv. v. Janney (In re Janney), 557 B.R. 476, 480–81 (Bankr. M.D.La. 2016); In re Chicago Patrolmen's Fed. Credit Union v. Fenner (In re Fenner), 558 B.R. 877, 884–85 (Bankr. N.D. Ill. 2016) (explaining for actual fraud creditor must show debtor intended fraudulent act which resulted in debt). The intent may be established through direct evidence or inference from the facts and circumstances. Id. at 885.

9 Of the two issues of law it listed, this is the only one which pertained to Count III.

10 For example, in neither its opening brief nor in its reply brief does Above–All cite to cases such as Husky Int'l Elec., Inc. v. Ritz, 136 S.Ct. 1581 (2016) or Sauer, Inc. v. Lawson (In re Lawson), 791 F.3d 214 (1st Cir. 2015).

11 Even if we were to read the record with respect to actual fraud more generously, there is no basis upon which we could conclude that the bankruptcy court's findings were clearly erroneous.

End of Document

563 B.R. 431
United States Bankruptcy
Appellate Panel of the First Circuit.

In re Eric Zutrau, Debtor.
Leilani Zutrau, Plaintiff–Appellee,
v.
Eric Zutrau, Defendant–Appellant.

BAP NO. MB
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029
|
Bankruptcy Case No. 11–11815–FJB
|
Adversary Proceeding No. 11–01183–FJB
|
February 16, 2017

Synopsis

Background: Chapter 7 debtor's sister brought adversary proceeding to except debt from discharge on "false representation" and "willful and malicious injury" theories. The United States Bankruptcy Court for the District of Massachusetts, Frank J. Bailey, J., 546 B.R. 239, entered judgment in favor of sister, and later granted sister's motion to alter or amend judgment to increase amount of debt that was nondischargeable, and debtor appealed.

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

[1] bankruptcy court did not clearly err in finding thatChapter 7 debtor's promise to pay his sister back from proceeds realized upon sale of real property that he was developing was false when made, and that debtor, who secretly encumbered the property without sister's knowledge, had made this promise with fraudulent intent;

[2] bankruptcy court did not clearly err in findingthat sister, the individual making these advances, had justifiably relied on debtor's fraudulent promises of repayment; and

[3] bankruptcy court properly amended its judgmentto include refinanced debt among that excepted from discharge.

Affirmed.

West Headnotes (24)

[1] **Bankruptcy**
Finality

Bankruptcy court's determination of dischargeability of debt is "final order," that is reviewable as of right, once the damage amount is determined. 11 U.S.C.A. § 523(a); 28 U.S.C.A. § 158(a)(1).

Cases that cite this headnote

[2] **Bankruptcy**
Conclusions of law; d e novo review

Bankruptcy
Clear error

Bankruptcy Appellate Panel reviews bankruptcy court's findings of fact for clear error and its conclusions of law de novo. Fed. R. Bankr. P. 8013.

Cases that cite this headnote

[3] **Bankruptcy**
Particular cases and issues

Determinations regarding elements of dischargeability exception are findings of fact, that are reviewed for clear error. 11 U.S.C.A. § 523(a); Fed. R. Bankr. P. 8013.

Cases that cite this headnote

[4] **Bankruptcy**
Clear error

In order for bankruptcy appellate court to find that factual finding is clearly erroneous, that finding must strike appellate court as more than probably wrong; rather, it must prompt a strong, unyielding belief, based on the whole of the record, that bankruptcy judge made a mistake. Fed. R. Bankr. P. 8013.

Cases that cite this headnote

[5] **Bankruptcy**
Clear error

Where there are two permissible views of evidence, the factfinder's choice between them cannot be clearly erroneous.

Cases that cite this headnote

[6] **Bankruptcy**
Particular cases and issues

Case for deferring to bankruptcy judge's factfinding is particularly strong when intent is at issue, since intent finding depends heavily on witness credibility, and bankruptcy judge is uniquely qualified to make that call. Fed. R. Bankr. P. 8013.

Cases that cite this headnote

[7] **Bankruptcy**
Debts and Liabilities Discharged

Dischargeability exceptions are narrowly construed in favor of debtor in effort to further "fresh start" policy of the Bankruptcy Code, and creditor seeking to except debt from discharge must show that its claim comes squarely within a dischargeability exception. 11 U.S.C.A. § 523(a).

Cases that cite this headnote

[8] **Bankruptcy** Fraud

In order to establish that debt is nondischargeable upon "false representation" theory, creditor must establish each of the following elements: (1) that debtor made a representation which was knowingly false or made in reckless disregard of the truth; (2) that debtor intended to deceive; (3) that debtor intended to induce creditor to rely on the false representation; (4) that creditor actually relied upon the false representation; (5) that creditor's reliance was justifiable; and (6) that this reliance caused damage. 11 U.S.C.A. § 523(a)(2)(A).

Cases that cite this headnote

[9] **Bankruptcy**
Particular cases

Standard of proof in proceeding to except debt from discharge on "false representation" theory is proof by preponderance of the evidence. 11 U.S.C.A. § 523(a)(2)(A).

Cases that cite this headnote

[10] **Bankruptcy**
Promise or intention of future action; failure to pay or perform

"False representation," of kind required by fraud-based dischargeability exception, can include debtor's promise to act if, at the time debtor made that promise, he had no intention of performing. 11 U.S.C.A. § 523(a)(2)(A).

Cases that cite this headnote

[11] **Bankruptcy**
Intent or knowledge

Fraudulent intent, of kind required to except debt from discharge on "false representation" theory, includes intent to deceive, manipulate, or defraud. 11 U.S.C.A. § 523(a)(2)(A).

Cases that cite this headnote

[12] **Bankruptcy**
Intent or knowledge

While knowledge and intent elements of fraud-based dischargeability exception are distinct elements, in many cases, the same factors show both the debtor's knowledge or recklessness as to falsity of his representation and his intent to deceive. 11 U.S.C.A. § 523(a)(2)(A).

Cases that cite this headnote

[13] **Bankruptcy**
Debts for Goods, Services, or Credit Obtained by Fraud

Intent to deceive, of kind required in order to except debt from discharge on "false representation" theory, may be demonstrated by showing that debtor made a false representation recklessly, careless of whether it is true or false. 11 U.S.C.A. § 523(a)(2)(A).

Cases that cite this headnote

[14] Bankruptcy
Intent

That debtor acted with intent to deceive, of kind required in order to except debt from discharge on "false representation" theory, may be inferred from totality of the circumstances. 11 U.S.C.A. § 523(a)(2)(A).

Cases that cite this headnote

[15] Bankruptcy
Debts for Goods, Services, or Credit Obtained by Fraud

Subsequent conduct may reflect back to promisor's state of mind when promise was made and may be considered in ascertaining whether he or she acted with fraudulent intent, of kind required by fraud-based dischargeability exception. 11 U.S.C.A. § 523(a)(2)(A).

Cases that cite this headnote

[16] Bankruptcy
Reasonable or Justifiable Reliance

Creditor's reliance on debtor's false representation is "justifiable," as required by dischargeability exception, if the falsity of the representation would not have been readily apparent to person to whom it was made. 11 U.S.C.A. § 523(a)(2)(A).

Cases that cite this headnote

[17] Bankruptcy
Reasonable or Justifiable Reliance

When it determines whether creditor was justified in relying on debtor's false representation, as required in order to except debt from discharge on "false representation" theory, court must take into account the circumstances of that reliance, with understanding that individual is not obliged to investigate statements made to him, even though he cannot close his eyes to an obvious falsehood. 11 U.S.C.A. § 523(a)(2)(A).

Cases that cite this headnote

[18] Bankruptcy
Debts for Goods, Services, or Credit Obtained by Fraud

Bankruptcy court did not clearly err in finding that Chapter 7 debtor's promise to pay his sister back from proceeds realized upon sale of real property that he was developing was false when made, and that debtor, who secretly encumbered the property without sister's knowledge, had made this promise with fraudulent intent, solely for purpose of inducing sister to loan him more funds; debtor's pattern of deceptive conduct, in surreptitiously encumbering property which was to serve as source for repayment of his debt to sister and in failing to execute or record mortgages that he had promised would secure sister's advances, supported bankruptcy court's findings as to existence of requisite fraudulent intent in proceeding to except debt from discharge on "false representation" theory. 11 U.S.C.A. § 523(a)(2)(A).

Cases that cite this headnote

[19] Bankruptcy
Particular cases

In proceeding to except debt from discharge as one for money obtained by Chapter 7 debtor's false promises of repayment, bankruptcy court did not clearly err in finding that debtor's sister, the individual making these advances, had justifiably relied on her brother's promise that she would be fully repaid out of proceeds generated upon sale of real property which sister was helping debtor to develop, but which debtor, unbeknownst to sister, was secretly encumbering to obtain loans from third-party lenders. 11 U.S.C.A. § 523(a)(2)(A).

Cases that cite this headnote

[20] Bankruptcy
Particular cases
Bankruptcy
Hearing and Determination; D efault

While sister made her initial $128,000 advance to Chapter 7 debtor prior to debtor's fraudulent promises of full repayment out of proceeds from sale or real property that he was developing, such that sister could not have relied on these fraudulent promises in making initial $128,000 advance, evidence that sister had forborne in not insisting on prompt repayment of this $128,000 advance, and had agreed to refinance her initial loan and to make additional advances in justifiable reliance on debtor's fraudulent promises of full repayment, supported bankruptcy court's decision to alter or amend its judgment to include this $128,000 debt among obligations that were excepted from discharge on "false representation" theory. 11 U.S.C.A. § 523(a)(2)(A).

Cases that cite this headnote

[21] **Bankruptcy**

Judgment or Order

Motion to alter or amend judgment must demonstrate the reason why court should reconsider its prior decision, and must set forth facts or law of strongly convincing nature to induce the court to reverse its earlier decision. Fed. R. Civ. P. 59(e).

Cases that cite this headnote

[22] **Bankruptcy**

Judgment or Order

Party moving to alter or amend judgment must either clearly establish a manifest error of law, or must present newly discovered evidence. Fed. R. Civ. P. 59(e).

Cases that cite this headnote

[23] **Bankruptcy**

Judgment or Order

Party cannot use motion to alter or amend judgment in order to cure his own procedural failures or to introduce new evidence or advance arguments that could and should have been presented originally to the court. Fed. R. Civ. P. 59(e).

Cases that cite this headnote

[24] **Bankruptcy**

Award on determination of nondischargeability

In proceeding to except debt from discharge as one for money obtained by Chapter 7 debtor's false promises to repay loans that he obtained from his sister for development of investment property, bankruptcy court did not clearly err in crediting sister, and in allocating $84,000 prepetition payment by debtor to sister, not as partial repayment of loans that sister sought to except from discharge, but as debtor's share of expenses associated with other property that he and sister owned as co-tenants. 11 U.S.C.A. § 523(a)(2)(A).

Cases that cite this headnote

***434 Appeal from the United States Bankruptcy Court for the District of Massachusetts (Hon. Frank J. Bailey, U.S. Bankruptcy Judge)**

Attorneys and Law Firms

Eric Zutrau, Pro Se, on brief for Defendant–Appellant.

Dmitry Lev, Esq., for Plaintiff–Appellee.

Before Deasy, Tester, and Finkle, United States Bankruptcy Appellate Panel Judges.

Opinion

Tester, U.S. Bankruptcy Appellate Panel Judge.

Eric Zutrau (the "Debtor") appeals pro se[1] from the bankruptcy court's amended judgment determining that certain debts he owed to his sister, Leilani Zutrau (the "Appellee"), were nondischargeable pursuant to § 523(a)(2)(A) and (a)(6).[2] For the reasons set forth below, we **AFFIRM.**

BACKGROUND

I. Adversary Proceeding

Three months after the Debtor filed his chapter 7 petition, the Appellee filed a timely complaint seeking a determination that his debts to her in the total amount of $427,522.90 were nondischargeable under § 523(a)(2)(A) as debts arising from false representations, and under § 523(a)(6) as debts for willful and malicious injury. After the Debtor answered the complaint, the Appellee filed an amended complaint to allege additional facts to support her § 523(a)(2)(A) and (a)(6) counts and to object to the Debtor's discharge under § 727(a)(2)–(4).

On August 16, 2011, despite the existence of the amended complaint which included a count objecting to the Debtor's discharge, the bankruptcy court entered an order discharging the Debtor.[3]

Thereafter, the bankruptcy court held a hearing on the Debtor's motion to dismiss the complaint, the Appellee's motion for leave to amend further the complaint (to add additional facts to support her objections to discharge under § 727(a)(2)–(4)), and the Debtor's opposition to the motion for leave to amend (in which he argued that the proposed amendment was futile as the court had already entered his discharge). Subsequently, the court dismissed ***435** the Appellee's objections to discharge under § 727(a)(2)–(4), but allowed the Appellee to assert a revocation of discharge count under § 727(d). The court also denied the Debtor's request to dismiss the § 523(a)(2) (A) and (a)(6) counts.

In January 2014, the Debtor filed a motion for summary judgment as to the remaining counts under § 523(a)(2) (A), § 523(a)(6), and § 727(d), all of which the Appellee opposed. After a hearing, the bankruptcy court granted summary judgment in favor of the Debtor as to the count under § 727(d) for revocation of discharge and denied summary judgment as to the nondischargeability counts under § 523(a)(2)(A) and (a)(6). Although the Appellee moved for reconsideration and sought leave to file a third amended complaint, the bankruptcy court denied the motions after holding a hearing. As a result, only the nondischargeability counts under § 523(a)(2)(A) and (a)(6) remained for adjudication in the adversary proceeding.

In September 2014, the bankruptcy court held a five-day trial, at which both the Appellee and the Debtor testified. After the trial, the parties submitted proposed findings of facts and conclusions of law. On March 16, 2015, the bankruptcy court heard the parties' closing arguments, and took the matter under advisement.

II. The Bankruptcy Court's Decision

On February 24, 2016, the bankruptcy court entered a judgment ("Judgment") in favor of the Appellee ruling that $193,000 of the debt the Debtor owed the Appellee, plus applicable interest thereon, was excepted from discharge, and the balance of the debt was dischargeable. In its accompanying memorandum of decision, the bankruptcy court specified that $193,000, plus all applicable interest, was excepted from discharge under § 523(a)(2)(A), and of that amount, $80,000, plus all applicable interest, was also excepted from discharge under § 523(a)(6). See Zutrau v. Zutrau (In re Zutrau), 546 B.R. 239, 241 (Bankr. D. Mass. 2016).[4] In its decision, the bankruptcy court made thorough and detailed factual findings and legal conclusions based on the record, and the testimonial and documentary evidence presented at the trial.

A. Bankruptcy Court's Findings of Fact The Debtor was a self-employed contractor. The Appellee was employed as an executive at a financial services firm until June 2007; thereafter, she was self-employed performing "accounting work."

1. The Properties

(a) The Oak Bluffs Property

In 2002, the Debtor and the Appellee agreed to combine their resources and abilities to build a single family house on land the Debtor owned in Oak Bluffs, Massachusetts (the "Oak Bluffs Property"). The Debtor subsequently conveyed 50% of his interest in the Oak Bluffs Property to the Appellee, and they became tenants in common. In exchange for this conveyance, the Appellee agreed to contribute funds toward the construction project. The parties agreed that after the Appellee had contributed sufficient funds as consideration for her 50% interest, they would evenly split the expenses of the construction project. The parties obtained a $200,000 construction loan, and building began with the Debtor supervising the ***436** construction of the house. The house was completed in 2010.

(b) The Brookline Property

In 2006, the Debtor identified a property in Brookline, Massachusetts (the "Brookline Property") that he believed would be a profitable condominium conversion venture, and he approached the Appellee for funding. In March 2006, the Appellee loaned the Debtor $123,000 for him to use as a down payment to purchase the Brookline Property. The Appellee borrowed the funds from her line of credit with Chase Bank which was secured by her personal residence in New York ("Chase LOC").

On March 24, 2006, the Debtor executed a promissory note in which he agreed to repay the Appellee $123,000, with interest at a yearly rate of 7%, on or before September 24, 2006. The note contained a security clause providing that the principal and interest owed under the note would be secured by the Debtor's interest in the Oak Bluffs Property.

Using the $123,000 from the Appellee as a down payment, the Debtor purchased the Brookline Property in April 2006 for $825,000. The Debtor financed the balance of the purchase price by borrowing $618,750 from Taylor, Bean & Whitaker Mortgage Corp. and $122,901 from National City Bank, secured by first and second mortgages, respectively, on the Brookline Property.

2. The Citibank Line of Credit

In late March 2006, with the Debtor's consent, the Appellee obtained a $400,000 line of credit from Citibank ("Citibank LOC") secured by the Oak Bluffs Property. The Appellee was the sole obligor on the underlying promissory note. The parties had initially intended to apply for this line of credit together, but the Debtor's poor credit score dissuaded them from adding the Debtor's name to the application.

In April 2006, with the Debtor's consent, the Appellee used $123,000 drawn from the Citibank LOC to satisfy in full the Chase LOC, in effect, transferring the Chase LOC to the Citibank LOC. Thereafter, the Appellee drew additional funds from the Citibank LOC to fund the still ongoing Oak Bluffs Property construction and to pay for a portion of the Debtor's personal expenses. The parties agreed to share equally the cost of the interest payments on the Citibank LOC.

3. Note A

By September 2006, the Appellee had contributed sufficient funds toward the Oak Bluffs Property to more than satisfy her 50% interest in the property. At this time, the Debtor acknowledged that in addition to owing the Appellee the $123,000 he borrowed to purchase the Brookline Property, he owed the Appellee $77,000 for his share of the expenses for the Oak Bluffs Property.

In September 2006, rather than repaying the $123,000, plus interest, due under the promissory note as he had agreed, the Debtor asked the Appellee to loan him an additional $100,000 to continue the conversion of the Brookline Property into condominiums. He also asked the Appellee to "cover" his portion of the interest payments owed on the Citibank LOC for the duration of the loan. The Debtor promised to repay the full amount he owed the Appellee, from the sale proceeds of the Brookline Property condominiums, immediately after he satisfied the bank mortgages. In an e-mail dated September 11, 2006, the Debtor stated, "When I s[ell] the [Brookline Property], which I aim to do this fall, you will be right behind the bank, before anyone private I owe." In another e-mail dated September 16, 2006, the Debtor stated he intended to "repay ... ***437** upon sale [of the Brookline Property] ... even if I don't get to condo it." The two e-mails are referred to collectively as the "September 2006 E-mails."

On September 22, 2006, the Appellee loaned the Debtor the additional $100,000 using funds she borrowed from the Citibank LOC. The Appellee also agreed to temporarily "cover" $13,000 of the Debtor's portion of the upcoming interest payments on the Citibank LOC. The bankruptcy court found that, when making this loan, the Appellee relied on the Debtor's representation that after he satisfied his bank debts he would pay her in full using the sale proceeds of the Brookline Property condominiums.

On September 22, 2006, the Debtor executed a promissory note ("Note A") in which he agreed to repay the Appellee a total of $241,000 on or before April 22, 2007. The amount was comprised of the original $123,000 loan for the purchase of the Brookline Property; the new $100,000 loan; $13,000 for the Debtor's share of interest payments on the Citibank LOC; and $5,000 the Debtor owed the Appellee from a separate transaction. Note A contained a security clause which provided that "until the principal and interest owed under this promissory note are paid in full, this note will be secured by the mortgage covering [the Oak Bluffs Property]." Note A did not contain a separate provision for the payment of interest, but it did contemplate the accrual of interest, providing that the Debtor would make a lump-sum payment for the entire balance of "accrued principal & interest," and that payments would be applied "first to interest and then to principal." Note A also contained a "Collection of Costs" provision which provided: "If [the Appellee] prevails in a lawsuit to collect on this note, [the Debtor] will pay [the Appellee]'s costs and lawyer's fees in an amount the court finds to be reasonable."

On September 22, 2006, pursuant to the terms of Note A, the Debtor recorded a mortgage he had executed in favor of the Appellee on the Oak Bluffs Property in the amount of $241,000.

4. Note B

In December 2006, the Debtor approached the Appellee about borrowing an additional $30,000 to continue developing the Brookline Property. On December 18, 2006, the Debtor executed a promissory note ("Note B") in which he agreed to repay the Appellee $30,000, plus interest at a yearly rate of 7.75%, on or before February 18, 2007. Note B contained a security clause which provided that "until the principal and interest owed under this promissory note are paid in full, this note will be secured by a mortgage covering the [Brookline Property]." The Debtor orally promised the Appellee that he would execute and record a separate mortgage on the Brookline Property to secure the debt embodied by Note B. The bankruptcy court found that the Appellee, who lived in New York and traveled extensively, trusted the Debtor, who lived in Massachusetts, to both execute and record the mortgage securing Note B.

The Appellee loaned the Debtor the $30,000 identified in Note B in December 2006. The bankruptcy court found that, in making this loan, the Appellee relied on the Debtor's representation that he intended to execute and record a mortgage securing this debt, and the representations contained within Note B. Additionally, the bankruptcy court found that the Appellee continued to rely on the Debtor's promise in his September 2006 Emails that he would pay the Appellee in full from the sale proceeds of the Brookline Property condominiums after he had paid off his existing bank debts.

***438** The Debtor did not execute or record a mortgage on the Brookline Property securing Note B.

5. Note C

In January 2007, the Debtor asked the Appellee to loan him an additional $30,000 for the development of the Brookline Property. On January 9, 2007, the Debtor executed a promissory note ("Note C") in which he promised to repay the Appellee $30,000, plus interest at a yearly rate of 7.75%, on or before February 18, 2007. Note C contained a security clause (identical to that of Note B) stating that Note C would be secured by a mortgage covering the Brookline Property, and a Collection of Costs provision (identical to that of Note A) providing for attorney's fees and costs. Pursuant to Note C, the Debtor executed a mortgage on the Brookline Property to secure the debt embodied by Note C. The Debtor orally promised but failed to record this mortgage.

The Appellee loaned the Debtor the $30,000 identified in Note C in January 2007. The bankruptcy court found that, in making this loan, the Appellee not only relied on the Debtor's representation that he intended to record the mortgage, but also the representations contained within Note C. Additionally, the bankruptcy court found the Appellee continued to rely on the Debtor's promise in the September 2006 E-mails that he would pay her in full from the sale proceeds of Brookline Property condominiums after he paid off his existing bank debts.

6. Refinancing of Second Mortgage on the Brookline Property

On February 14, 2007, the Debtor refinanced the National City Bank second mortgage and executed and recorded new mortgage in favor of National City Bank in the amount of $250,000. The Debtor did not tell the Appellee about the new mortgage.

7. Repayment of Note B

In February and March 2007, the Debtor repaid the Appellee a total of $30,000 which represented the principal he owed on Note B (the "$30,000 Repayment").

8. Note D

In April 2007, the Debtor again approached the Appellee for an additional $30,000 to finance the Brookline Property project. At this time, Note C was overdue. The Debtor, however, assured the Appellee "that he would protect [her] interests and that he was actively trying to finish the project and sell the [Brookline Property] as soon as he could and that it was going to happen quickly and, therefore, [the Appellee] shouldn't worry, that he would repay [her] everything." The bankruptcy court found the Appellee took assurance in the fact that the Debtor had paid off Note B, and in her belief that the Debtor had done as he had promised and recorded a mortgage on the Oak Bluffs Property with respect to Note A and recorded a mortgage on the Brookline Property with respect to Notes B and C. In reality, however, the Debtor had only recorded the Oak Bluffs Property mortgage securing Note A.

On April 23, 2007, the Debtor executed a promissory note ("Note D") in which he promised to repay $30,000, plus interest at a yearly rate of 7.75%, on or before June 14, 2007. Note D contained a security clause (identical to the security clauses in Notes B and C) stating that Note D would be secured by a mortgage on the Brookline Property. The Debtor orally promised the Appellee that he would execute and record a mortgage on the Brookline Property to secure the debt embodied by Note D. Note D also contained a Collection of Costs provision (identical to that of the prior notes) providing for attorney's fees and costs.

***439** In April 2007, the Appellee loaned the Debtor the $30,000 identified in Note D from her personal funds. The bankruptcy court found that, in making this loan, the Appellee relied on the Debtor's representation that he intended to execute and record a mortgage securing this debt, and the representations contained within Note D. Additionally, the bankruptcy court found the Appellee continued to rely on the Debtor's promise in the September 2006 E-mails that he would pay her in full from the sale proceeds of the Brookline Property condominiums after he paid off his existing bank debts.

The Debtor did not execute or record a mortgage on the Brookline Property securing Note D.

9. Note E

In June 2007, the Debtor approached the Appellee yet again for an additional $20,000 to finish the Brookline Property project. On June 15, 2007, the Debtor executed a promissory note ("Note E") in which he promised to repay the Appellee $20,000 plus interest at a yearly rate of 7.75%. Note E contained the same security clause as the prior notes stating that the debt embodied by Note E would be secured by a mortgage on the Brookline Property, and the same Collection of Costs provision as the prior notes providing for attorney's fees and costs. Once again, the Debtor promised to execute and record a mortgage on the Brookline Property to secure Note E.

The Appellee loaned the Debtor the $20,000 identified in Note E in June 2007. The bankruptcy court found that, in making this loan, the Appellee once again relied on the Debtor's representation that he intended to execute and record a mortgage securing this debt and the representations contained within Note E. The court also found the Appellee continued to rely on the Debtor's promise in the September 2006 E-mails that he would pay the Appellee in full from the sale proceeds of the Brookline Property condominiums after he paid off his existing bank debts.

The Debtor did not execute or record a mortgage on the Brookline Property securing Note E.

10. Oak Bluffs Property Expenses

On June 16, 2007, the Debtor acknowledged that the amount he owed the Appellee for his share of the Oak Bluffs Property expenses was approximately $83,000.

11. Additional Loans Between July and November 2007

In June 2007, the Appellee lost her job. Around this time, the Debtor approached the Appellee for additional funds. The

Appellee was reluctant to give the Debtor any more money and she reiterated she wanted to be repaid. The Debtor responded that if the Appellee "didn't keep loaning him money to finish the project that [her] repayment was at risk." The Debtor insisted that he needed more money to finish the project so that he could sell the Brookline Property and pay the Appellee back.

From July through November 2007, the Appellee loaned the Debtor additional funds in over twenty separate installments totaling $150,296 (the "$150,296 Loan"), using money she borrowed from the Chase LOC. The Appellee considered these installments to be an "extraordinary loan," as they required her to borrow against her home. At this point, however, she felt that her only chance of being repaid was to continue helping the Debtor finish the Brookline Property. The Appellee claimed that, as an incentive for extending these additional funds, the Debtor promised to pay her an extra $15,000 (the "15,000 Bonus Payment") when he sold the Brookline Property condominiums. The bankruptcy court found the Debtor did make this ***440** promise and he does not challenge that finding on appeal.

In October 2007, as the Appellee grew increasingly frustrated with the situation, she asked the Debtor if he had recorded mortgages securing Notes B through E as he had promised. The Debtor admitted that he had not recorded the mortgages. After this revelation, the Appellee insisted, by an e-mail dated October 28, 2007 (the "October 2007 E-mail"), that the Debtor record mortgages securing all of the unsecured debt the Debtor owed her. She acknowledged, however, that they might have to wait until after the Debtor completed a refinancing of the Brookline Property that he was currently contemplating.

12. Refinancing and Sale of the Brookline Property Condominiums

On November 26, 2007, the Debtor again refinanced the Brookline Property, obtaining a loan of $333,000 and granting a mortgage in the same amount to Mortgage Electronic Registration Systems, Inc., as nominee for Union Capital Business Trust ("MERS"). The Debtor did not inform the Appellee of this mortgage. On November 30, 2007, the Debtor sold the first of three condominium units at the Brookline Property for $550,000. He did not inform the Appellee of the sale. In December 2007, using the proceeds of the new loan and sale, the Debtor obtained discharges of the $618,750 first mortgage and the $250,000 second mortgage.

On April 30, 2008, the Debtor sold the second condominium unit for $369,000, and, on June 16, 2008, the Debtor sold the third and last condominium unit for $365,000. The Debtor applied approximately $333,000 of the sale proceeds to pay off MERS. A discharge of this mortgage was recorded on August 25, 2008.

13. The $250,000 Repayment

On or about May 5, 2008, the Debtor repaid the Appellee $250,000 (the "$250,000 Repayment"). The Appellee applied the $250,000 Repayment as follows: (1) $150,296 to satisfy the $150,296 Loan; (2) $15,000 to satisfy the $15,000 Bonus Payment; and (3) $84,704 to satisfy the Debtor's share of the Oak Bluffs Property expenses.

Although the Debtor did not dispute Appellee's application of funds to satisfy the $150,296 Loan, he did challenge her application of funds to satisfy the $15,000 Bonus Payment and the $84,704 he owed for his share of the Oak Bluffs property expenses. The bankruptcy court found, however, that the parties agreed that the Appellee would satisfy what the Debtor owed her for his share of Oak Bluffs Property expenses from the $250,000 Repayment.[5] The Debtor challenges this finding on appeal.

***441** After the Appellee's application of the $250,000 Repayment, the Debtor continued to owe the Appellee at least $321,000 plus all applicable interest, as follows: (1) $241,000 for the principal of Note A; (2) $30,000 for the principal of Note C; (3) $30,000 for the principal of Note D; (4) $20,000 for the principal of Note E; and (5) all applicable interest under the terms of those notes. Although the Debtor had approximately $151,000 remaining from the sale proceeds of the Brookline Property, he did not submit any of that money to the Appellee to pay down his remaining debts to her, instead using the money to pay off other unsecured creditors.

14. State Court Litigation

In the summer of 2008, the Appellee informed the Debtor that she wanted to be repaid in full. The already strained relationship broke down completely, and the parties eventually proceeded to litigation in Massachusetts state court in 2009. During discovery, the Appellee learned for the first time about the multiple refinancings of the Brookline Property. The state court litigation was eventually stayed by the Debtor's bankruptcy filing.

B. Bankruptcy Court's Analysis

1. The § 523(a)(2)(A) Count

As to the § 523(a)(2)(A) count, the court found the Debtor knowingly made a false representation in September 2006 when he promised to pay the Appellee back in full from the sale of the Brookline Property, after repaying the banks, and he "intended to deceive [the Appellee] when he made this fraudulent representation in order to induce her to loan him more money." In re Zutrau, 546 B.R. at 252. The court also found the totality of the circumstances demonstrated the Debtor never intended to honor his promise, as evidenced by his subsequent actions in twice refinancing the Brookline Property without the Appellee's knowledge, his failure to record mortgages to protect the Appellee's position, and his failure to repay her in full from the sale proceeds of the Brookline Property condominiums. Id. at 252–53. With respect to Note A, the court found the Appellee justifiably relied on the Debtor's promise when lending him an additional $100,000 and agreeing to cover $13,000 of his share of payments. Id. at 253. The court found, however, there was no reliance with respect to the $123,000 down payment which was incorporated into Note A as the Appellee lent those funds prior to the Debtor's promise, or with respect to the $5,000 she loaned him in a "separate transaction" as the Appellee presented no evidence as to the circumstances of that loan. Id. With respect to Notes B through E, the court found the Appellee justifiably relied on the Debtor's false representation when she lent the Debtor those funds. Id. The court also found the Appellee incurred damages as a result of her reliance on the Debtor's false representation, and rejected the Debtor's arguments that the Appellee incorrectly applied the $250,000 Repayment and that he had repaid Notes C, D, and E. Id. at 253–54.

The bankruptcy court also found the Debtor made knowingly false representations when he promised to execute and record mortgages on the Brookline Property securing Notes B, C, D, and E (but not as to Note A as the Debtor executed and recorded a mortgage for Note A). In re Zutrau, 546 B.R. at 254. The court found the Debtor intended to deceive the Appellee in order to induce her to loan him funds, and the totality of the circumstances demonstrated his fraudulent intent. Id. The court found the Appellee actually and justifiable relied on these false representations, and she incurred damages as a result. Id. at 254–55.

***442** Based on the foregoing, the bankruptcy court ruled that $193,000 was excepted from discharge pursuant to § 523(a)(2)(A), representing:

> $113,000 of the principal under Note A ($100,000 new loan, plus $13,000 for the Debtor's share of interest on the Citibank LOC);
>
> $30,000 of the principal of Note C;
>
> $30,000 of the principal of Note D;
>
> $20,000 of the principal of Note E; and
>
> All applicable interest under the terms of the respective notes.

Id. at 255.

This total did not include $128,000 of the $241,000 principal of Note A (for the Debtor's prior debts of $123,000 and $5,000, which were incorporated into the note). Id. Nor did it include the amounts owed under Note B, or the funds the Appellee loaned to the Debtor between July and November 2007, as the Debtor had repaid those amounts. Id. The total also did not include the alleged balance for the Debtor's share of the Oak Bluffs Property expenses, other than the $13,000 included in Note A, as the Appellee did not provide sufficient evidence that she incurred the expenses in reliance on the Debtor's false representation. Id.

2. The § 523(a)(6) Count

As to the § 523(a)(6) count, the bankruptcy court found that Notes B through E contained security clauses which provided that the debts would be secured by mortgages on the Brookline Property. Id. at 256. The bankruptcy court found, notwithstanding the Debtor's failure to execute and record mortgages for Notes B, D, and E, these security pledges created a property interest (i.e. unperfected mortgage) for the Appellee "in the Brookline Property securing the amounts owed under Notes B through E, albeit one that was junior in priority to recorded mortgages ....” Id. Therefore, the bankruptcy court found the Appellee “held an interest in any proceeds from the sale of the Brookline Property condominium units.” Id. Because the Debtor did not pay off Notes C, D, and E, the Appellee held an interest in the $151,000 sale proceeds (remaining after paying off senior encumbrances). Id.

The court found that when the Debtor “used the sale proceeds in which [the Appellee] held an interest to pay off unsecured debts to other lenders,” he caused injury to the Appellee. Id. It found the Debtor “caused this injury deliberately as he intentionally diverted these funds for his own benefit with full knowledge of his obligation to turn them over to his sister.” Id. Thus, the Debtor “was well aware of both the injury he was causing and the wrongfulness of his actions.” Id. As a result, the court found the Appellee established all the elements of § 523(a) (6) with respect to $80,000 of the debt, plus all applicable interest thereon. Id. at 256–57.

Thus, the bankruptcy court held that, of the $193,000 excepted from discharge under § 523(a)(2)(A), $80,000, plus all applicable interest thereon, was excepted from discharge on a separate basis under § 523(a)(6) due to the Appellee's unperfected interest in the sale proceeds for the Brookline Property securing the amounts due under Notes C, D, and E (but not Note A, as the Debtor executed a mortgage with respect to Note A, or Note B, as he repaid that note). Id. at 256–57.

III. Motion to Amend

On March 9, 2016, the Appellee filed a motion to alter or amend the Judgment pursuant to Rule 59(e) (“Motion to Amend”), to except additional portions of the debt from discharge as follows: (1) $128,000 of the principal of Note A which the bankruptcy court deemed was not excepted ***443** from discharge because it was not originally loaned in reliance on the Debtor's false promise; (2) any interest owed under the terms of Note A; and (3) her legal fees and costs. The Debtor opposed the motion.

After a hearing on May 12, 2016, the bankruptcy court entered an order and memorandum granting the Motion to Amend. The bankruptcy court found the Appellee relied on the Debtor's representation that he would pay her back in full from the sale proceeds of the Brookline Property condominiums after paying off his bank debts when she agreed to incorporate earlier debts totaling $128,000 into Note A, and the incorporation of such earlier debts into Note A constituted a refinancing or a renewal of credit made in reliance on the Debtor's promise. Based on these additional findings, the bankruptcy court held that the Appellee had satisfied all elements of § 523(a)(2)(A) with respect to the remaining $128,000 of the $241,000 principal of Note A. The bankruptcy court also found that all interest, legal fees, and costs to which the Appellee was entitled under the notes were excepted from discharge.

As a result, the bankruptcy court entered an amended judgment (“Amended Judgment”) ruling that the debt owed to the Appellee in the amount of $321,000, plus all applicable interest thereon, and all applicable legal fees and costs provided under the terms of the notes, were excepted from the Debtor's discharge. This total consisted of:

$241,000 of the principal of Note A;

$30,000 of the principal of Note C;

$30,000 of the principal of Note D; and $20,000

of the principal of Note E.

The balance of any debt the Debtor owed the Appellee was not excepted from discharge.

IV. Notice of Appeal

Thereafter, the Debtor's counsel filed a motion seeking to withdraw as his counsel and to extend the time to file a notice of appeal. The bankruptcy court granted the motion, and on June 6, 2016, the Debtor filed a notice of appeal with respect to the Judgment and the Amended Judgment.[6]

JURISDICTION

[1] We have jurisdiction to hear appeals from final judgments, orders, and decrees of the bankruptcy court. See 28 U.S.C. § 158(a)(1). A bankruptcy court's determination regarding the dischargeability of a debtor's obligations is a final, reviewable order once the damage amount is determined. See Falcone v. Ragonese (In re Ragonese), 505 B.R. 605, 612 (1st Cir. BAP 2014) (citing

Douglas v. Kosinski (In re Kosinski), 424 B.R. 599, 606–607 (1st Cir. BAP 2010); Cambio v. Mattera (In re Cambio), 353 B.R. 30, 31 n.1 (1st Cir. BAP 2004). Thus, we have jurisdiction to hear this appeal.

STANDARD OF REVIEW

[2] [3] [4] [5] [6] We review a bankruptcy court's findings of fact for clear error and its conclusions of law de novo. See Castellanos Grp. Law Firm, L.L.C. v. F.D.I.C. (In re MJS Las Croabas Props., Inc.), 545 B.R. 401, 417 (1st Cir. BAP 2016) (citation omitted). Determinations regarding elements of an action under § 523(a)(2) are findings of fact reviewed for clear error. In re Kosinski, 424 B.R. at 607 (citations omitted). "[T]o find clear error, a finding must hit us as more than probably wrong—it must prompt 'a strong, unyielding ***444** belief, based on the whole of the record,' that the judge made a mistake." Toye v. O'Donnell (In re O'Donnell), 728 F.3d 41, 45 (1st Cir. 2013) (citation omitted) (internal quotations omitted). "Where there are two permissible views of the evidence, the factfinder's choice between them cannot be clearly erroneous." Anderson v. City of Bessemer City, 470 U.S. 564, 574, 105 S.Ct. 1504, 84 L.Ed.2d 518 (1985). "The case for deferring to the bankruptcy judge's factfinding McCrory v. Spigel (In re Spigel), 260 F.3d 27, 32 (1st Cir. 2001)). is 'particularly strong' when intent is at issue—since an intent finding depends heavily on the debtor's credibility, and the bankruptcy judge is uniquely qualified to make that call." In re O'Donnell, 728 F.3d at 45.

DISCUSSION

I. Nondischargeability Under § 523(a)(2)(A)
Section 523(a)(2)(A) provides:

> A discharge under section 727 ... of this title does not discharge an individual debtor from any debt—
>
> ...
>
> (2) for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by—
>
> (A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition ....

11 U.S.C. § 523(a)(2)(A).

[7] Because exceptions to discharge are narrowly construed in favor of the debtor in an effort to further the " 'fresh start' " policy underlying the Bankruptcy Code, the creditor asserting an exception to discharge must show that its claim comes " 'squarely' " within an exception enumerated in § 523(a). Sharfarz v. Goguen (In re Goguen), 691 F.3d 62, 68 (1st Cir. 2012) (quoting

[8] [9] In order to establish that a debt is nondischargeable under § 523(a)(2)(A) due to a false representation, a creditor must establish each of the following elements by a preponderance of the evidence:

> 1) the debtor made a knowingly false representation or one made in reckless disregard of the truth, 2) the debtor intended to deceive, 3) the debtor intended to induce the creditor to rely upon the false statement, 4) the creditor actually relied upon the false statement, 5) the creditor's reliance was justifiable, and 6) the reliance upon the false statement caused damage.

Id. at 66 (quoting In re Spigel, 260 F.3d at 32).

If the creditor fails to establish any one of the six elements, then the court must reject its claim. Knappik v. Dewhurst (In re Dewhurst), 528 B.R. 211, 224 (Bankr. D. Mass. 2015) (citing Palmacci, 121 F.3d at 787–88). at 615.

[10] The first element, making a knowingly false representation, refers to the conduct of the debtor and can include a debtor's promise to act, if, at the time the debtor made the promise, he had no intention of performing. Sega Auto Sales, Inc. v. Flores (In re Flores), 535 B.R. 468, 482 (Bankr. D. Mass. 2015) (citing Palmacci, 121 F.3d at 786). As the First Circuit has stated:

> A representation of the maker's own intention to do ... a particular thing is fraudulent if he does not have that intention at the time he makes the representation. ... [A] promise made without the intent to perform it is held to be a sufficient basis for an action of deceit. On the other hand,

> if, at the time he makes a promise, the maker honestly intends to keep it but later changes his ***445** mind or fails or refuses to carry his expressed intention into effect, there has been no misrepresentation. This is true even if there is no excuse for the subsequent breach. A debtor's statement of future intention is not necessarily a misrepresentation if intervening events cause the debtor's future actions to deviate from previously expressed intentions.
>
> The test may be stated as follows. If, at the time he made his promise, the debtor did not *intend to perform*, then he has made a false representation (false as to his intent) and the debt that arose as a result thereof is not dischargeable

523(a)(2)(A) requires only justifiable reliance—a lower standard than reasonable reliance. Field v. Mans, 516 U.S. 59, 74, 116 S.Ct. 437, 133 L.Ed.2d 351 (1995). Reliance is justifiable if the falsity of the representation would not have been readily apparent to the person to whom it was made. Id. at 70–72, 116 S.Ct. 437. For purposes of determining whether reliance was justified, "the circumstances of the reliance claim must be taken into account," and "the individual is not obliged to investigate statements made to him (although he cannot shut his eyes to an obvious falsehood)." Lentz v. Spadoni (In re Spadoni), 316 F.3d 56, 59 (1st Cir. 2003) (citation omitted).

[11] [12] [13] [14] [15] The second element refersprincipal of Note C; $30,000 of the principal of Note D; to a debtor's mental state and requires "a different type and $20,000 of the principal of Note E. We conclude that of intent—the debtor's intent to deceive, manipulate, the bankruptcy court's findings and conclusions are amply or defraud." In re Flores, 535 B.R. at 482 (citation supported ***446** by the record, and, therefore, are not clearly erroneous.

> (if the other elements of § 523(a)(2)(A) are met). If he did so intend at the time he made his promise, but subsequently decided that he could not or would not so perform, then his initial representation was not false when made.

Palmacci, 121 F.3d at 786–87 (footnotes omitted) (citations omitted) (internal quotations omitted). omitted). "Although the inquiries are distinct, in many cases the same factors show both the debtor's knowledge or recklessness as to the falsity of his representation and his intent to deceive." Id. (citation omitted). "Intent to deceive may be demonstrated by showing that [the debtor made] a false representation 'recklessly, careless of whether it is true or false.' " R.C. Olsen Cadillac, Inc. v. Haras (In re Haras), 526 B.R. 435, 440 (Bankr. D. Mass. 2015) (quoting Palmacci, 121 F.3d at 787). As a debtor will rarely, if ever, admit to acting with an intent to deceive, "the court may infer fraudulent intent from the totality of the circumstances." Id. (citation omitted); see also Palmacci, 121 F.3d at 789. In addition, "[s]ubsequent conduct may reflect back to the promisor's state of mind and thus may be considered in ascertaining whether there was fraudulent intent at the time the promise was made[.]" Aoki v. Atto Corp. (In re Aoki), 323 B.R. 803, 815 (1st Cir. BAP 2005) (quoting Williamson v. Busconi, 87 F.3d 602, 603 (1st Cir. 1996)).

[16] [17] The last four elements embody the requirement that the creditor's claim must arise directly from the debtor's fraud. In re Spigel, 260 F.3d at 32 (footnote omitted). As to the creditor's reliance, the U.S. Supreme Court has held that §

II. Analysis

[18] The bankruptcy court identified each of the elements for nondischargeability under § 523(a)(2)(A) and found they were satisfied with respect to debt owed to the Appellee in the amount of $321,000, which consisted of $241,000 of the principal of Note A; $30,000 of the It is undisputed that the Debtor sent the September 2006 E-mails, wherein he stated that after he repaid his bank debts he would pay the Appellee back in full from the sale proceeds of the Brookline Property condominiums. The bankruptcy court found that the Debtor's representation was a specific promise to give the Appellee priority treatment (after the banks), which the Debtor never intended to honor, and that he intended to deceive her when making this promise in order to induce her to loan him more money. The totality of the evidence supports these findings. Subsequent to his promise, the Debtor incurred additional debt from other lenders and granted mortgages on the Brookline Property without the Appellee's knowledge, thereby undermining her personal recovery. The evidence also showed that the Debtor made numerous other false representations in the course of his dealings with the Appellee that demonstrated his willingness to "throw his word around" without any intent of honoring it as he "extracted more and more money from his sister." In addition, when presented with an opportunity to substantially repay his sister with the sale proceeds from the Brookline Property condominiums, he instead opted to pay her only a portion of his obligation and used the excess proceeds to satisfy other debts. Although the Debtor's breach of his promise, by itself, would be insufficient to infer fraudulent intent, his breach combined with his other actions to undermine the Appellee's recovery from the Brookline Property, demonstrated a pattern of deception. Thus, the record supports the bankruptcy court's determination that the Debtor made a knowingly false representation with the intent to deceive the Appellee, and he intended to induce her to rely on the false promise and loan him more money.

[19] The evidence also supports the bankruptcy court's findings that the Appellee justifiably relied on his false representation when loaning the Debtor additional monies evidenced by Notes A through E and when she agreed to a refinancing or renewal of credit with respect to prior debts that were incorporated into Note A. The Appellee credibly testified that she would not have loaned the Debtor additional sums of money if he had not promised to give her priority treatment after he paid off the banks. Moreover, as the court pointed out, the Brookline Property eventually sold for a substantial profit and had the Debtor followed through on his promise to repay the Appellee in full after the banks, she would have recovered much of what she loaned the Debtor.

In addition, the evidence showed that the Appellee did not know that the Debtor had twice refinanced the Brookline Property, thus incurring more secured debt and undermining the Appellee's recovery. Thus, the bankruptcy court did not err in finding that the Appellee justifiably relied on the Debtor's false representation. Finally, the evidence supports the bankruptcy court's finding that the Appellee incurred damages as a result of her reliance on the Debtor's false representation in the amount of the outstanding debts.

It was also undisputed that the Debtor executed Notes B through E, in which he promised to execute and record mortgages on the Brookline Property securing the notes, and that the Debtor did not record any mortgages securing Notes B through E. The bankruptcy court found that the Debtor knowingly made false representations when he promised to record the mortgages, and that he intended to deceive the Appellee in order to induce her to loan him more funds. These findings are supported by the record. Although the Debtor ***447** argued that he genuinely intended to pay the Appellee back in full, his actions demonstrated otherwise. He repeatedly promised to execute and record mortgages that would have protected the Appellee's interests and, repeatedly, he made no attempt to fulfill his obligations. Moreover, he granted subsequent mortgages on the Brookline Property without the Appellee's knowledge, thereby subordinating any interest she expected to have in the Brookline Property. Finally, after he sold the three Brookline Property condominiums, he failed to convey to the Appellee the full amount of the proceeds remaining after he paid the senior lienholders.

The Debtor argued that the Appellee released him from his obligations to execute and/or record the mortgages in question, based on the October 2007 E-mail. The bankruptcy court rejected that argument, noting that by October 2007, the Debtor had "long since shirked his obligation to execute and record the mortgages," and even if the court were to construe the e-mail as a release of the obligation to record the mortgages, it did not alter the court's finding that the Debtor's representations were false at the time he made them. The record also supports the bankruptcy court's finding that the Appellee justifiably relied on these false representations for all funds she loaned the Debtor beginning with Note B and ending in October 2007 when she discovered that the Debtor had not recorded the mortgages.

Thus, the bankruptcy court's findings and conclusions under § 523(a)(2)(A) are supported by the record.

III. The Debtor's Arguments On Appeal

The Debtor does not make any specific arguments regarding the elements for nondischargeability under § 523(a)(2)(A). Rather, he argues the following: (1) the bankruptcy court erred in ruling that any of the principal due under Note A was excepted from discharge under § 523(a)(2)(A) because he recorded a mortgage in connection with Note A; (2) the bankruptcy court erred in making new findings and amending its prior Judgment so that the remaining $128,000 of the principal due under Note A, which the bankruptcy court previously ruled was dischargeable, was now excepted from discharge under § 523(a)(2)(A); (3) the bankruptcy court erred in excepting anything from discharge under § 523(a)(2) (A) because if the Appellee had properly allocated the $250,000 Repayment to the principal balances due on Notes C, D, and E, he would not owe anything to the Appellee and there would be no basis for her claim; and (4) the Debtor challenges the bankruptcy court's findings regarding his failure to execute and record mortgages on the Brookline Property securing Notes C, D, and E.[7]

A. The Note A Issue

The Debtor argues that the elements of § 523(a)(2)(A) were not met with respect to any of the amounts due under Note A because he executed and recorded a mortgage with respect to Note A. In support, he points to the following language in the bankruptcy court's decision:

> I further find that [the Appellee] actually and justifiably relied on these false ***448** representations for all funds, excluding those related to the Oak Bluffs Property expenses, that she lent to [the Debtor] for the period beginning with Note B in December 2006 and ending in October 2007 when she learned the [Debtor] had not recorded the mortgages. This period does not include Note A as [the Debtor] did, in fact, execute and record a mortgage for Note A.

546 B.R. at 254 (emphasis added).

According to the Debtor, executing and recording the mortgage with respect to Note A was "the measure of overcoming § 523(a)(2)(A)" and the bankruptcy court's statement above shows that the elements of § 523(a)(2)(A) were not met with respect to Note A.

The Debtor misconstrues the bankruptcy court's findings and conclusions with respect to Note A. As noted above, the bankruptcy court found that the Debtor made two different false representations. The first was a false representation in September 2006 when he promised to repay the Appellee in full from proceeds of the Brookline Property condominium sales after he repaid his bank debts. The second knowingly false representation was the Debtor's promise to execute and record mortgages on the Brookline Property securing Notes B, D, and E. The court found that the Appellee justifiably relied on the second false representation for all funds she loaned the Debtor beginning with the loan evidenced by Note B. It is within this context that the bankruptcy court remarked that the period affected by the second false representation did not include the amounts loaned under Note A because the Debtor executed and recorded a mortgage with respect to Note A. In other words, the Debtor's promise to execute and record mortgages securing the notes was not false with respect to Note A as he followed through on the promise in that instance. The Debtor's execution of a mortgage with respect to Note A does not, however, absolve him of his false promise that he would repay the Appellee in full from the sale proceeds of the Brookline Property condominiums after he satisfied his bank debt. Thus, the Debtor's argument must fail.

B. The Amended Judgment Issue

[20] The Debtor also challenges the bankruptcy court's decision to amend its Judgment to include the remaining $128,000 of the principal due under Note A. He argues that, because the bankruptcy court made previous findings that the Appellee did not rely on his promise with respect to the $123,000 down payment which was incorporated into Note A, concluding that the $123,000 was dischargeable,[8] it should not have made additional findings or altered its conclusion.

[21] **[22]** **[23]** In making this argument, the Debtor does not address the law that applies to a motion to alter or amend an order of the bankruptcy court. The Appellee moved to alter or amend the judgment pursuant to Rule 59(e), which is applicable in bankruptcy pursuant to Bankruptcy Rule 9023. Rule 59(e) authorizes the filing of a written motion to alter or amend a judgment after its entry. "The motion must demonstrate the 'reason why the court should reconsider its prior decision' and 'must set forth facts or law of a strongly convincing nature' to induce the court to reverse its earlier decision." ***449** Perez Mujica v. FirstBank P.R. (In re Perez Mujica), 470 B.R. 251, 254 (Bankr. D.P.R. 2012) (citation omitted), aff'd, 492 B.R. 355 (D.P.R. 2013). The movant "must 'either clearly establish a manifest error of law or must present newly discovered evidence.' " Marie v. Allied Home Mortg. Corp., 402 F.3d 1, 7 n.2 (1st Cir. 2005) (quoting Pomerleau v. W. Springfield Pub. Sch., 362 F.3d 143, 146 n.2 (1st Cir. 2004)). "The party cannot use a [Rule] 59(e) motion to cure its own procedural failures or to introduce new evidence or advance arguments that could and should have been presented originally to the court." In re Perez Mujica, 470 B.R. at 254 (citation omitted).

In the Motion to Amend, the Appellee asserted the bankruptcy court erred in finding she did not rely on the Debtor's false representation that he would repay her in full from the sale proceeds of the Brookline Property condominiums with respect to the remaining $128,000 of the principal of Note A, which represented prior debts of $123,000 and $5,000, because the Appellee loaned those funds prior to the September 2006 promise. According to the Appellee, Note A replaced the obligations and terms of repayment for those earlier debts totaling $128,000, extinguishing the prior obligations and promises that the Debtor made under those earlier agreements. Thus, she alleged (1) the Debtor agreed anew to repay the $128,000 as part of the principal of Note A, with new terms, and a new due date; (2) the Debtor's execution of Note A constituted either a refinancing of the earlier debts or a renewal of credit in the amount of $128,000; and (3) the evidence showed she justifiably relied on the Debtor's promise of priority repayment when she engaged in this refinancing or renewal of credit. Therefore, she alleged, the remaining $128,000 due under Note A also fell within the § 523(a)(2)(A) exception to discharge.

As noted above, § 523(a)(2)(A) provides that debts "for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by" a false representation is excepted from discharge. 11 U.S.C. § 523(a)(2)(A). The bankruptcy court determined that, at the hearing and in his written opposition to the Motion to Amend, the Debtor was unable to contest the evidence demonstrating that the incorporation of the $128,000 in prior loans into Note A constituted either a refinancing or a renewal of credit. The bankruptcy court then made additional findings that the Appellee relied on the Debtor's representation that he would pay her back in full, from the sale proceeds of the Brookline Property condominiums, after he paid off the banks when she agreed to such refinancing or credit renewal by incorporating this debt into Note A. As such, the court determined that the Appellee satisfied all of the elements of § 523(a)(2)(A) with respect to the entire principal due under Note A.

The bankruptcy court's additional findings are supported by the record and we conclude that the bankruptcy court did not err in entering the Amended Judgment.

C. The Allocation Issue

[24] The Debtor argues that if the Appellee had properly allocated the $250,000 Repayment to the principal balances due on Notes C, D, and E, he would not owe anything to the Appellee on those notes and there would be no basis for her claim. He contends that the $250,000 Repayment was more than sufficient to satisfy the amounts due under Note C ($30,000), Note D ($30,000), Note E ($20,000), and the $150,296 he borrowed from July 2007 to November 2007. Specifically, he challenges the Appellee's allocation of $84,704 of the $250,000 Repayment to the Debtor's share ***450** of the Oak Bluffs Property expenses. He refers to this as "the $84,000 question."

With respect to the so-called $84,000 question, the Debtor asserts the bankruptcy court did not properly weigh the evidence regarding the Appellee's allocation of the $250,000 Repayment. According to the Debtor, the evidence established that there was no written contract which allowed the Appellee to allocate $84,704 of the $250,000 Repayment to the Debtor's share of the Oak Bluffs Property expenses. Rather, he argues, the evidence established that the Oak Bluffs Property was a completely separate endeavor and the parties had agreed that any income generated or expenses incurred with respect to the Oak Bluffs Property would be handled independently from the Brookline Property project. Thus, he claims, the Appellee should not have allocated $84,704 from the $250,000 Repayment for expenses relating to the Oak Bluffs Property and should have allocated those funds for Notes C through E, all of which related to the Brookline Property project. He also contends that, in discrediting his testimony, the bankruptcy court placed undue weight on the April 1, 2008 e-mail (wherein, shortly before making the $250,000 payment, the Debtor told the Appellee, "My debt to you will be paid in full pretty soon, starting with the May [$250,000] payment, that should put me in positive equity in [the Oak Bluffs Property] and then we should discuss the solution that will get you paid off in the best way."). Instead, he claimed, the court should have considered the totality of the evidence.

As noted above, the Appellee testified that the parties agreed to apply $84,704 of the $250,000 Repayment to the Debtor's share of the Oak Bluffs Property expenses. Although the Debtor testified to the contrary, the bankruptcy court found the Debtor was not credible on this point as his own e-mails (including the April 1, 2008 e-mail) indicated his desire to use these funds to pay down the secured debt linked to the Oak Bluffs Property. The court credited the Appellee's testimony on this point and found that the parties agreed that $84,704 of the $250,000 would be applied to the Debtor's share of the Oak Bluffs Property expenses. Although the Debtor would have us conclude that the bankruptcy court erred in relying on the April 1, 2008 e-mail in discrediting his testimony, the bankruptcy court's view of the evidence is plausible and, therefore, cannot be clearly erroneous. See Anderson, 470 U.S. at 573–74, 105 S.Ct. 1504. Moreover, we must give great deference to the bankruptcy court's factual findings when they are based on the credibility and demeanor of witnesses. See Mission Prod. Holdings, Inc. v. Old Cold, LLC (In re Old Cold, LLC), 558 B.R. 500, 517 (1st Cir. BAP 2016) (citation omitted).

Footnotes

In light of the foregoing, we reject this argument.

D. The Failure to Execute Mortgages Issue Finally, the Debtor challenges the bankruptcy court's findings regarding his failure to execute and record mortgages on the Brookline Property securing Notes C, D, and E. He argues the bankruptcy court failed to properly consider the October 2007 E-mail (wherein the Appellee stated that they might have to wait to record a lien securing all of the unsecured debt the Debtor owed her until after the Debtor completed a refinancing of the Brookline Property). He claims this is evidence of a written modification of the mortgage clauses in Notes C, D, and E. Again, although the Debtor would have us conclude that the bankruptcy court erred by not viewing this email as evidence of a written modification of the mortgage clauses in the ***451** notes, the bankruptcy court's view of the evidence is plausible and, therefore, cannot be clearly erroneous. See Anderson, 470 U.S. at 574, 105 S.Ct. 1504. Moreover, the bankruptcy court clearly considered this argument and rejected it, holding that even if the court construed the e-mail as a written modification of the obligation to record the mortgages, it does not alter the fact that the Debtor's promises to record the mortgages were false at the time they were made. Thus, this argument must also fail.

CONCLUSION

For the reasons set forth above, we **AFFIRM** the Amended Judgment.

All Citations

563 B.R. 431

1 The Debtor was represented by counsel throughout the proceedings in the bankruptcy court.

2 Unless expressly stated otherwise, all references to "Bankruptcy Code" or to specific statutory sections shall be to the Bankruptcy Reform Act of 1978, as amended, 11 U.S.C. §§ 101, et seq. All references to "Bankruptcy Rule" shall be to the Federal Rules of Bankruptcy Procedure. All references to "Rule" shall be to the Federal Rules of Civil Procedure.

3 In a later order on the Appellee's motion for leave to file another amended complaint, the bankruptcy court explained why it entered the discharge, stating: "No objection to discharge having been filed by the deadline for doing so, the Court entered a discharge in favor of [the Debtor] on August 16, 2011." See A.P. Doc. No. 47 at 2.

4 As the Debtor does not dispute most of the bankruptcy court findings, much of what follows is a review of those findings.

5 The bankruptcy court stated as follows:

> [The Appellee] applied $84,704 of the $250,000 to [the Debtor's] share of the Oak Bluffs Property expenses. [The Appellee] testified that the parties agreed to apply the $84,704 toward the Oak Bluffs Property expenses. [The Debtor] testified to the contrary. I do not find [the Debtor] credible on this point as his own e-mails indicate his desire to use these funds to pay down the secured debt linked to the Oak Bluffs Property. In an e-mail dated April 1, 2008, shortly before making the $250,000 payment, Eric told [the Appellee], "My debt to you will be paid in full, pretty soon, starting with the May [$250,000] payment, that should put me in positive equity in [the Oak Bluffs Property] and then we should discuss the solution that will get you paid off in the best way." I credit [the Appellee's] testimony on this point. Accordingly, I find that the parties agreed that $84,704 of the $250,000 would be applied to [the Debtor's] share of the Oak Bluffs Property expenses.

In re Zutrau, 546 B.R. at 249–50 (footnote omitted).

6 The Appellee did not cross-appeal the bankruptcy court's dismissal of the § 727(a) counts or the judgment it entered in the Debtor's favor on the § 727(d) count.

7 Although the bankruptcy court also ruled that a portion of the debt owed to the Appellee was excepted from discharge on a separate basis under § 523(a)(6), the Debtor does not raise any argument relating to that ruling and, therefore, has waived it. See Perez v. Deutsche Bank Nat'l Trust Co. (In re Perez), 556 B.R. 527, 532 (1st Cir. BAP 2016) (citing Furness v. Wright Med. Tech., Inc. (In re Mercurio), 402 F.3d 62, 64 n.1 (1st Cir. 2005) (explaining failure to adequately brief or argue issue results in waiver)).

8 The amount at issue was actually $128,000, which consisted of prior loans in the amount of $123,000 for the down payment on the Brookline Property and another $5,000 that the Appellee loaned the Debtor in a "separate transaction." In his brief, the Debtor addresses only the $123,000 down payment.

End of Document

2017 WL 549020
Only the Westlaw citation is currently available.
This case was not selected for publication in West's Federal Reporter.
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.

In re: Ampal-American Israel Corporation, Debtor.
Merhav Ampal Group, Ltd., f/k/a Merhav-Ampal Energy, Ltd., Plaintiff-Appellee,
v.
Merhav (M.N.F.) Limited, Yosef A. Maiman, Defendants-Appellants.

No.
16
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979
-bk
|
February 9, 2017

Appeal from a judgment of the United States District Court for the Southern District of New York (Jed S. Rakoff, *Judge*; Stuart M. Bernstein, *Bankruptcy Judge*).

***1** UPON DUE CONSIDERATION, IT IS HEREBY ORDERED, ADJUDGED, AND DECREED that the judgment entered on February 29, 2016, is AFFIRMED.

Attorneys and Law Firms

APPEARING FOR APPELLANTS: DANIEL A. FLIMAN (David M. Friedman, Andrew R. Kurland, on the brief), Kasowitz, Benson, Torres & Friedman LLP, New York, New York.

APPEARING FOR APPELLEE: JOHN P. CAMPO, Akerman LLP, New York, New York.

PRESENT: BARRINGTON D. PARKER, REENA RAGGI, CHRISTOPHER F. DRONEY, Circuit Judges.

SUMMARY ORDER

Defendants Merhav (M.N.F.) Limited and Yosef

Maiman (collectively "Merhav") appeal from the district court's affirmance of the bankruptcy court's grant of summary judgment in favor of plaintiff Merhav Ampal Group, Ltd., ("MAG") arguing that the bankruptcy court lacked subject matter jurisdiction over the adversary proceeding.[1] Specifically, defendants argue that there was no basis for "related to" jurisdiction pursuant to 28 U.S.C. § 1334(b) because there was no preponderance showing that a recovery by MAG, which is in the process of winding up, could conceivably affect the debtor's estate in the purportedly related Chapter 7 proceeding of MAG's parent, Ampal-American Israel Corporation ("Ampal"). On plenary review of a decision of a district court functioning as an intermediate appellate court in a bankruptcy case, we assess legal conclusions, including a determination of subject-matter jurisdiction, *de novo*, while we consider factual findings only for clear error. *See In re Lehman Bros. Holdings Inc.*, 761 F.3d 303, 308 (2d Cir. 2014); *Bechtel v. Competitive Techs., Inc.*, 448 F.3d 469, 471 (2d Cir. 2006). In so doing, we assume the parties' familiarity with the facts and procedural history of this case, which we reference only as necessary to explain our decision to affirm substantially for the reasons articulated by both the district and bankruptcy courts. *See In re Ampal–Am. Israel Corp.*, No. 15–CV–7949 (JSR), 2016 WL 859352 (S.D.N.Y. Feb. 28, 2016); *In re Ampal–Am. Israel Corp.*, No. 12–13689 (SMB), 2015 WL 5176395 (Bankr. S.D.N.Y. Sept. 2, 2015).

Title 28 U.S.C. § 1334(b), by way of 28 U.S.C. § 157(c), confers jurisdiction upon bankruptcy courts over "civil proceedings ... related to cases under title 11." 28 U.S.C. §

1334(b); *see* *id.* § 157(c). The Supreme Court has characterized this provision as "a grant of some breadth." *Celotex Corp. v. Edwards*, 514 U.S. 300, 308, 115 S.Ct. 1493, 131 L.Ed.2d 403 (1995); *but see* *id.* at 310, 115 S.Ct. 1493 (noting that "jurisdiction of bankruptcy courts may extend more broadly" in "reorganization under Chapter 11" than in "liquidation under Chapter 7"). This

court has held that litigation falls within a bankruptcy court's "related to" jurisdiction if it "has a significant connection with a pending bankruptcy proceeding [such that] its outcome might have any conceivable effect on the bankrupt estate." *In re Cuyahoga Equip. Corp.*, 980 F.2d 110, 114–15 (2d Cir. 1992) (internal quotation marks omitted); *accord* *In re Robert Plan Corp.*, 777 F.3d 594, 597 (2d Cir. 2015).

Applying this standard here, we conclude that the bankruptcy court possessed "related to" jurisdiction over this litigation because there is a "conceivable possibility that the Trustee will pay some or all of the net proceeds of any recovery to Ampal in partial satisfaction of its $62 million claim against MAG," which would "directly affect the distributions in this [bankruptcy] case." *In re Ampal–Am. Israel Corp.*, 2015 WL 5176395, at *9. In an unrebutted sworn declaration, MAG's Managing Director, Shlomi Kelsi, averred that if MAG prevailed in this adversary proceeding, approximately $10 million would remain to make a payment on the capital notes to Ampal and the other subsidiaries after MAG satisfied its tax and third-party liabilities. Indeed, even if the remainder of the proceeds were distributed *pari passu* among MAG's affiliated creditors, Ampal would still stand to receive 16% of the distribution, *i.e.*, $1.6 million. The possibility for Ampal to receive a distribution of at least $1.6 million constitutes a "conceivable effect" on the debtor's estate supporting "related to" jurisdiction.

***2** None of the cases cited by defendants present analogous circumstances, specifically, an unrebutted sworn declaration that at least part of the recovery in the adversary proceeding would be administered as part of a wind-up to benefit the debtor's estate. Indeed, despite the bankruptcy court's persuasive distinguishment of *In re Parade Place, LLC*, 508 B.R. 863 (Bankr. S.D.N.Y. 2014), defendants again invoke that case on appeal. In that case, however, it was clear that the action between two non-debtors "could not have any conceivable effect on the bankruptcy estates." *Id.* at 872. Because this adversary proceeding could at least conceivably benefit the bankrupt estate, it is sufficiently "related to" the bankruptcy case to confer jurisdiction. *See* *In re Quigley Co., Inc.*, 676 F.3d 45, 53 (2d Cir. 2012); *Parmalat Capital Fin. Ltd. v. Bank of Am. Corp.*, 639 F.3d 572, 579 (2d Cir. 2011) (ruling conceivable effect test satisfied because "[i]f [plaintiffs are] successful in their claims against [defendant], the funds they recover will benefit ... bankruptcy estates"); *see also* *In re Kolinsky*, 100 B.R. 695, 702 (Bankr. S.D.N.Y. 1989) ("If a resolution of an action between nondebtors would affect the amount of property available for distribution to the creditors of a bankruptcy estate or the allocation of property among such creditors, or if the outcome could alter the debtor's rights or liabilities, such civil proceeding will be regarded as related to the bankruptcy case.").

We have considered defendants' remaining arguments and conclude that they are without merit. For the reasons stated, the district court's February 29, 2016 judgment is

AFFIRMED.

All Citations

--- Fed.Appx. ----, 2017 WL 549020 (Mem)

Footnotes

1 Defendants do not here challenge the substantive bases for the grant of summary judgment. Thus, we deem any such challenges abandoned and do not address them further. *See* *Higazy v. Templeton*, 505 F.3d 161, 168 n.7 (2d Cir. 2007).

2017 WL 775780
Only the Westlaw citation is currently available.
United States Bankruptcy Court, D. Delaware.

In re Money Center of **America**, Inc., et al., Debtors.
Casino Caribbean, LLC, Macau Casino, LLC, Macau Southcenter, LLC, and Yakima Cardroom, LLC, Plaintiffs,
v.
Money Centers of **America**, Inc.
Check Holdings, LLC, Defendants.
Michael St. Patrick Baxter, Solely in his capacity as Chapter 11 Trustee of **Money Centers** of **America**, Inc., et al. Plaintiff,
v.
Thunderbird Entertainment **Center**, Inc., a wholly owned entity of the sovereign Absentee Shawnee Tribe of Oklahoma, Defendant.

Case No. 14–10603(CSS) Jointly Administered
|
Adv. Proc. Case No.: 14–50437 (CSS),
Adv. Proc. Case No.: 16–50410 (CSS)
|
Signed February 28, 2017

Synopsis

Background: Chapter 11 trustee brought adversary proceeding to recover allegedly preferential transfers made to tribal entity the operated casino for benefit of Indian tribe. In separate proceeding, another tribal entity brought adversary proceeding for determination that sums owed to it under its financial services agreement with debtor were not included in property of the estate, and trustee counterclaimed for recovery of prepetition preferential transfers. Tribal entities moved to dismiss trustee's complaint or counterclaims based on their alleged tribal sovereign immunity.

Holdings: The Bankruptcy Court, Sontchi, J., held that:

[1] entities which operated casinos for benefit of Indiantribes had sufficiently close relationship to tribes to share in tribes' sovereign immunity;

[2] Congress did not unequivocally express its intent toabrogate sovereign immunity of Indian tribes, such that Indian tribes, or closely-affiliated entities that operated casinos on tribes' behalf, could not be object of preference avoidance proceedings absent a waiver of their tribal sovereign immunity;

[3] waiver issue could not be determined on motion todismiss;

[4] bankruptcy statute that barred creditor that wasrecipient of avoidable transfer from recovering on its claim until transfer was repaid was not operative as to tribal entity; and

[5] tribes and tribal entities were not "governmentalunits," under statute providing that "governmental unit" that had filed a proof of claim was deemed to have waived its sovereign immunity with respect to a claim against that governmental unit which was property of the estate, and which arose out of the same transaction or occurrence.

Motion granted in part and denied in part.

West Headnotes (19)

[1] Bankruptcy

Bankruptcy court has jurisdiction to determine whether it has subject matter jurisdiction over adversary proceeding filed in the case before it.

Cases that cite this headnote

[2] Bankruptcy

Generally, when court's subject matter jurisdiction is challenged on motion to dismiss, plaintiff bears burden of persuading the court that subject matter jurisdiction exists. Fed. R. Civ. P. 12(b)(1). Cases that cite this headnote

[3] Bankruptcy

While plaintiff generally bears burden of persuading court that subject matter jurisdiction exists whenever court's jurisdiction is challenged on motion to dismiss, sovereign] immunity, as something which can be expressly waived or forfeited through non-assertion,does not implicate federal subject matter jurisdiction in the ordinary sense, and the party asserting sovereign immunity thus bears the burden of providing its applicability. Fed. R. Civ. P. 12(b)(1).

Cases that cite this headnote

[4] Bankruptcy

On motion to dismiss that was in nature of facial challenge to bankruptcy court's ability to decide Chapter 11 trustee's preference claims based on transferees' alleged tribal sovereign immunity, bankruptcy court had to consider trustee's pleading, and attached exhibits, in light most favorable to trustee, and would also consider documents which transferees provided in attempt to establish their connection to their respective Indian tribes, which was something that transferees bore burden of proving. 11 U.S.C.A. § 547(b); Fed. R. Civ. P. 12(b)(1).

Cases that cite this headnote

[5] Indians

Tribal sovereign immunity may extend to subdivisions of Indian tribe, including those engaged in economic activities, provided that the relationship between the tribe and the entity is sufficiently close to properly permit the entity to share in the tribe's immunity.

Cases that cite this headnote

[6] Indians

Factors that court may consider in deciding whether connection between entity and Indian tribe is sufficiently close to permit entity to share in tribe's sovereign immunity include, but are not limited to, the following: (1) manner in which entity was created; (2) its purpose; (3) its structure, ownership and management, including amount of control that tribe has over the entity; (4) whether the tribe intended for entity to have tribal sovereign immunity; (5) financial relationship between tribe and the entity; and (6) whether the purposes of tribal sovereign immunity are served by granting immunity to the entity.

Cases that cite this headnote

[7] Indians

Entity which owned and operated casino for benefit of Indian tribe, as governmental subdivision of tribe that was charged with providing maximum possible economic benefit to tribe and with at all times exercising its powers in best interest of tribe, and that was specifically designated, in tribal resolution, as being entitled to all privileges and immunities of the tribe, had sufficiently close relationship to tribe to share in tribe's sovereign immunity.

Cases that cite this headnote

[8] Indians

Corporation which was established by Indian tribe to run tribal casino, all of whose shares were owned by tribe with no prospect of being alienated to individual or legal entity other than tribe, and which was designated in bylaws as having same tax status and immunities as tribe, had sufficiently close relationship to tribe to share in tribe's sovereign immunity.

Cases that cite this headnote

[9] Bankruptcy

By enacting provision of the Bankruptcy Code that abrogated sovereign immunity of “governmental units” in causes of action under specifically enumerated sections of the Bankruptcy Code, and by defining “governmental unit” as “the United States, State, Commonwealth, District, Territory, municipality ... or other foreign or domestic government,” Congress did not unequivocally express its intent to abrogate sovereign immunity of Indian tribes, such that Indian tribes, or closely-affiliated entities that operated casinos on tribes' behalf, could not be object of preference avoidance proceedings brought by Chapter 11 trustee absent a waiver of their tribal sovereign immunity. 11 U.S.C.A. §§ 106(a), 547(b).

Cases that cite this headnote

[10] Indians

Abrogation by Congress of Indian tribe's sovereign immunity cannot be implied, but must be unequivocally expressed in explicit legislation.

Cases that cite this headnote

[11] Indians

When Indian tribe files suit, it waives its sovereign immunity as to counterclaims that sound in recoupment.

Cases that cite this headnote

[12] Bankruptcy

Right of set-off is to be distinguished from right of recoupment; while both rights permit a creditor that owes a debt to debtor to reduce the amount of its debt by the amount of a debt owed by the debtor to that creditor, right to recoupment must arise out of the same transaction.

Cases that cite this headnote

[13] Bankruptcy

Claims do not arise out of the “same transaction,” as required for exercise of right of recoupment, merely because there is logical relationship between them, or because the same two parties are involved, or because a similar subject matter gave rise to both claim; both claims must arise out of single, integrated transaction, such that it would be inequitable for debtor to enjoy the benefits of that transaction without also meeting its obligations.

Cases that cite this headnote

[14] Bankruptcy

In bankruptcy context, while recoupment has often been applied when claims arise out of a single contract, an express contractual right is not necessary to effect a recoupment, nor does the fact that contract exists between debtor and creditor automatically enable creditor to effect a recoupment.

Cases that cite this headnote

[15] Bankruptcy

To determine whether claims arise out of the “same transaction,” as required for exercise of right of recoupment, court must examine the equities; recoupment is applicable only to claims that are so closely intertwined that allowing debtor to escape its obligation would be inequitable notwithstanding the Bankruptcy Code's tenet that all unsecured creditors share equally in the estate.

Cases that cite this headnote

[16] Bankruptcy

Whether entity that owned and operated casino for Indian tribe, by filing proof of claim in Chapter 11 case for sums that debtor allegedly owed to entity under financial services agreement between them, and by commencing adversary proceeding for determination that these sums were not included in bankruptcy estate, had thereby waived its sovereign immunity as to preference claims asserted by Chapter 11 trustee to recover prepetition payments that debtor had made pursuant to this same financial services agreement, could not be determined on motion by entity to dismiss preference claims on sovereign immunity grounds, absent further development of record regarding nature of financial services agreement and whether it contemplated one singular, yet ongoing, transaction, of kind sufficient to give rise to right of recoupment.

Cases that cite this headnote

[17] Bankruptcy

Even if Chapter 11 trustee's preference claims arose out of same underlying transaction as proof of claim filed by tribal entity named as preference defendant, any right of recoupment that trustee had could not be for amount in excess of tribal entity's proof of claim; trustee was barred, by tribal entity's sovereign immunity, from pursuing preference claim for amount in excess of entity's proof of claim.

Cases that cite this headnote

[18] Bankruptcy

Bankruptcy statute that barred creditor that was recipient of avoidable transfer from recovering on its claim until transfer was repaid was not operative as to tribal entity, from which trustee was generally barred from recovering by tribal entity's sovereign immunity. 11 U.S.C.A. § 502(d).

Cases that cite this headnote

[19] Bankruptcy

Bankruptcy statute providing that "governmental unit" that had filed a proof of claim was deemed to have waived its sovereign immunity with respect to a claim against that governmental unit which was property of the estate, and which arose out of the same transaction or occurrence, did not apply to Indian tribes or their closely affiliated entities, which were not "governmental units." 11 U.S.C.A. §§ 101(27), 106(b).

Cases that cite this headnote

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OPINION[1]

Sontchi, J.

INTRODUCTION

***1** Before the Court are two motions to dismiss preferential actions brought by the Chapter 11 Trustee of the above-captioned estates. The two movants are casinos that were formerly in a contractual relationship with the Debtors.[2] The two moving casinos are both associated with and are run by their respective Indian tribes. The motions are based the tribes' sovereign immunity from lawsuits. Therein, the Court is asked whether the casinos have a sufficient relationship with their respective Indian tribes to enjoy the tribes' sovereign immunity, whether Section 106(a) of the Bankruptcy Code abrogates their sovereign immunity, if any, and whether one of the casinos waived its sovereign immunity, if any, by filings a complaint and/or proof of claim against one of the Debtors' estates.

As set forth *infra*, the Court finds that (i) this is a facial attack on the Court's subject matter jurisdiction allowing the Court to review various documents attached to the pleadings; (ii) both QCA and Thunderbird are sufficiently related to their respective Indian tribes to enjoy the tribes' sovereign immunity; and (iii) neither Section 106(a) nor Section 101(27) abrogates QCA's and Thunderbird's sovereign immunity.

Thus, the Court lacks subject matter jurisdiction over the claims against QCA and Thunderbird, provided, however, the Court further finds that QCA *may* have waived its sovereign immunity *solely* to the extent of recoupment, but *only* to the extent of QCA's claims against the estates (i.e. the Trustee will not be able to recover any amounts in excess of QCA's claims from QCA).

JURISDICTION

The matter before the Court is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(A), (B), (E) and (F), and the Court has jurisdiction pursuant to 28 U.S.C. § 1334 and 28 U.S.C. § 157(a).

[1] A bankruptcy court has jurisdiction to determine whether it has subject matter jurisdiction over an adversary proceeding filed in a case before the court.[3] The motion to dismiss for lack of subject matter jurisdiction is filed under Federal Rule of Civil Procedure 12, which apples to adversary proceedings pursuant to Federal Rule of Bankruptcy Procedure 7012. Accordingly, this Court may determine whether to dismiss Trustee's claims for lack of subject-matter jurisdiction.

FACTUAL BACKGROUND

A. Background of the Debtors' Bankruptcy Cases On March 21, 2014, Money Centers of America, Inc. ("Money Centers") filed a voluntary petition with the United States Bankruptcy Court for the District of Delaware under chapter 11 of title 11 of the United States Code (the "Bankruptcy Code"). On May 23, 2014, Money Center's wholly owned subsidiary, Check Holdings, LLC ("Check Holdings," and collectively with Money Centers, the "Debtors"), filed its voluntary petition under the Bankruptcy Code. Thereafter, the Court entered an order jointly administering the Debtors' cases.

***2** On April 23, 2014, the Court ordered that the Office of the United States Trustee appoint a Chapter 11 trustee for Money Center's estate. The Court further ordered that Money Center's interest as the sole member of Check Holdings, LLC, vests in the trustee and the trustee shall be in control of the membership interest and all powers thereto.[4] The Court later approved the appointment of Michael St. Patrick Baxter as chapter 11 trustee (the "Trustee") in the Debtors' cases.[5]

B. Parties in the Adversary Actions

i. Casino Caribbean, LLC v. Money Centers of America, Inc., Adv. Pro. No. 14–50437

The intervening plaintiff in Adversary Proceeding 14–50437 (the "QCA Adversary Action") is Quapaw Casino Authority ("QCA") an alleged governmental subdivision of the Quapaw Tribe of Oklahoma, a federally recognized Indian tribe and sovereign nation, which owns and operates the Quapaw Casino in Miami, Oklahoma. QCA is listed on Check Holdings' bankruptcy schedules as a creditor.[6] In addition, QCA filed a proof of claim in these cases.[7]

The defendant in the QCA Adversary Action is Check Holdings.

ii. *Baxter v. Thunderbird Entertainment Center, Inc.,* Adv. Pro. No. 16–50410

The plaintiff in Adversary Proceeding 16–50410 is the Trustee on behalf of Debtors in an action to avoid preferential transfers against the defendant Thunderbird Entertainment Center, Inc., a wholly owned entity of the Absentee Shawnee Tribe of Oklahoma, a federal recognized Indian Tribe and sovereign nation (hereinafter, "Thunderbird," and Adversary Proceeding 16–50410, the "Thunderbird Adversary Action").

C. Procedural Background of Adversary Actions

i. QCA Adversary Action

On July 7, 2014, four gaming enterprises and creditors of Check Holdings brought the above-captioned QCA Adversary Action seeking to recover funds they are owed on the basis that such funds are not property of the Check Holdings' bankruptcy estate. Thereafter, on January 28, 2016, as it had substantially identical claims to that of the plaintiffs, QCA was granted leave to intervene as an additional adversary plaintiff in the QCA Adversary Action. Shortly thereafter, QCA filed its intervenor complaint (the "QCA Complaint"). On March 2, 2016, the Trustee filed its answer and counterclaims seeking to recover alleged transfers made to QCA, pursuant to Sections 547, 548, and 550 of the Bankruptcy Code (the "QCA Counterclaims"). QCA filed a motion to dismiss (the "QCA Motion to Dismiss") the QCA Counterclaims on the basis of tribal sovereign immunity. The QCA Motion to Dismiss has been fully briefed and is the subject of this Opinion.

ii. Thunderbird Adversary Action

On March 21, 2016, the Trustee commenced the Thunderbird Adversary Action by filing a complaint against Thunderbird seeking recovery of transfers pursuant to sections 547, 548 and 550 of the Bankruptcy Code made in the 90–days prior to Money Center's petition date in an amount not less than $220,633.80, as well as claims disallowance pursuant to section 502 of the Bankruptcy Code. In response, Thunderbird filed a motion to dismiss (the "Thunderbird Motion to Dismiss") the complaint on the basis of tribal sovereign immunity. The Thunderbird Motion to Dismiss has been fully briefed and is also subject of this Opinion.

D. Factual Background Related to Adversary Actions

Both QCA and Thunderbird entered into various "Financial Services Agreements" (each an "Agreement" and together the "Agreements") with Check Holdings.[8] Through the Agreements, Check Holdings provided Automated Teller Machines ("ATM") and other cash advance transaction services to QCA and Thunderbird, both operating casinos. Patrons of both casinos would use their credit or debit cards at ATMs located in the casinos or would present checks to the casinos' cash vaults and would receive cash. The casinos would advance the cash by stocking the ATMs from their vaults or by directly providing cash to patrons for check advances, and Check Holdings would process the transactions through the patrons' financial institution (which included its fee). Check Holdings incurred an independent liability to the casinos to reimburse the casinos for the amount paid to the patron.

i. Factual History Related to QCA

***3** QCA alleges that beginning April 25, 2014, Check Holdings failed to reimburse funds that QCA had advanced through ATM stocks and direct advances to its patrons. Several days later, as alleged by QCA, QCA's management discovered that Money Centers had filed for bankruptcy several months earlier and that Money Centers and its owners had judgments taken against them by other tribal gaming enterprises.

QCA alleges that on May 14, 2014, QCA stopped allowing cash advances and on May 15, 2014, QCA notified Check

Holdings and the Trustee that it was terminating the Agreement. As noted above, about a week after this (alleged) termination, Check Holdings filed for bankruptcy.

QCA alleges that QCA advanced $502,018.00 under the Agreement from April 16, 2014 to May 14, 2014, for which Check Holdings failed to reimburse QCA. In addition to filing its proofs of claim, QCA commenced the abovecaptioned adversary for declaratory judgment seeking a declaration from the Court that the funds are not property of the Debtors' bankruptcy estates and that the automatic stay does not apply (or, in the alternative, for relief from the automatic stay).

In his answer and in addition to denying the claims set forth by QCA, the Trustee asserted the QCA Counterclaims to avoid and to recover preferential transfers made by Check Holdings to QCA in the 90 days preceding Check Holdings' bankruptcy. The Trustee asserts that Check Holdings made $1,114,020.76 in preferential transfers to QCA and seeks the return of those **monies** and disallowance of QCA's proof of claim.

QCA filed this motion to dismiss the QCA Counterclaims on the grounds that the claims are barred by tribal sovereign immunity. QCA further asserts that the QCA Counterclaims do not sound in recoupment and, therefore, do not fall within the exception to sovereign immunity for defenses and counterclaims for recoupment.

ii. Factual History Related to Thunderbird

The Trustee alleges that when a casino patron submitted their credit or debit cards to Thunderbird, Thunderbird would process those cards through equipment provided by **Money Centers**. If the transaction was approved by the patron's card issuer, Thunderbird would advance the cash to its patron. Thereafter, **Money Centers** would obtain an amount equal to the cash advance from the patron's card issuer. Upon receipt of the **monies** from the card issuers, **Money Centers** was required to forward the amount to Thunderbird, retaining its fee. The Trustee alleges that **Money Centers** remitted these amounts to Thunderbird and that in the 90–days prior to **Money Center's** bankruptcy, **Money Center** transferred payments aggregating an amount not less than $220,633.80 to Thunderbird. The Trustee, on behalf of **Money Centers**' estate, seeks avoidance and recovery of these transfers.

Thunderbird filed a motion to dismiss the complaint on the grounds that the claim is barred by tribal sovereign immunity.

STANDARD OF REVIEW

QCA and Thunderbird assert that their claims of sovereign immunity are a matter of subject matter jurisdiction and are properly challenged under Rule 12(b) (1) of the Federal Rules of Civil Procedure.

The Trustee responds that a claim for sovereign immunity is an affirmative defense and not an issue of subject matter jurisdiction. The Trustee asserts that the QCA's and Thunderbird's sovereign immunity defense is based on facts that are not alleged in the movants' pleadings and that the QAC and Thunderbird will need to prove these facts at trial.

***4** Rule 12(b)(1) of the Federal Rules of Civil Procedure allows a party to bring a motion to dismiss for lack of subject matter jurisdiction.[9] As a rule, the party invoking the federal court's jurisdiction bears the burden of establishing that the Court has the requisite jurisdiction.[10] A motion to dismiss under Rule 12(b)(1) challenges the power of the federal court to hear a claim or case.[11] “If a court lacks subject matter jurisdiction, it is generally barred from taking any action that goes to the merits of the case.”[12] A defendant may challenge the plaintiff's invocation of federal jurisdiction in one of two ways: (1) to challenge the sufficiency, but not the accuracy, of the facts alleged in the complaint; or (2) to challenge the accuracy of the complaint's factual allegations.[13] As discussed above, there is a dispute between the parties whether QCA's and Thunderbird's claim for sovereign immunity should be reviewed as a subject matter jurisdiction challenge or whether it should be asserted by QCA and Thunderbird as an affirmative defense.

[2] [3] Sovereign immunity can be reviewed (i) on the basis of subject matter jurisdiction or (ii) as an affirmative defense.[14] In *Christy v. Pennsylvania Turnpike Commission*, the Third Circuit held that sovereign immunity did not implicate subject matter jurisdiction.[15] In citing *Christy*, the Delaware District Court explained:

> The Third Circuit has recognized that an assertion of Eleventh Amendment immunity does not implicate subject matter jurisdiction in the ordinary sense. In that regard, Eleventh Amendment immunity is treated as an affirmative defense, and the party asserting immunity must prove its existence. With respect to factual questions that arise in that analysis, the party asserting Eleventh Amendment immunity bears the burden of production and persuasion.[16]

However, one year later, in *Blanciak v. Allegheny Ludlum Corp.,* the Third Circuit held:

> Although defendants brought their Eleventh Amendment objection by way of a motion for summary judgment under Fed.R.Civ.P. 56(b), the Eleventh Amendment is a jurisdictional bar which deprives federal courts of subject matter jurisdiction. Accordingly, the motion may properly be considered a motion to dismiss the complaint for lack of subject matter jurisdiction under Fed.R.Civ.P. 12(b)(1).[17]

Thus, "[t]ypically, when jurisdiction is challenged pursuant to Rule 12(b)(1), the plaintiff bears the burden of persuading the court that subject matter jurisdiction exists. However, because ... [sovereign] immunity can be expressly waived by a party, or forfeited through nonassertion, it does not implicate federal subject matter jurisdiction in the ordinary sense, and therefore, a party asserting ... [sovereign] immunity bears the burden of providing its applicability.[18]

***5** The District Court for the Eastern District of Pennsylvania in *Frederick L. v. Department of Public Welfare*, after reviewing both of the Third Circuit's holdings noted above,[19] discussed the two different varieties of Rule 12(b)(1) motions:

> With regard to the first type, a facial attack on the court's subject matter jurisdiction, the court is required to assume that plaintiff's allegations are true. When confronted with the second type, a factual attack, the court is "free to weigh the evidence and satisfy itself as to the existence of its power to hear the case" because there is "no presumptive truthfulness attache[d] to plaintiff's allegations." Factual evaluations under Rule 12(b)(1) are appropriate at any stage in the proceedings after the filing of an answer. Here, no answer has been filed. Thus, regardless of whether I treat Defendants' assertion of the Eleventh Amendment bar as a motion under Rule 12(b)(1) or Rule 12(b)(6), I am required to take Plaintiffs' facts as true.[20]

[4] Here, QCA and Thunderbird are making facial attacks on subject matter jurisdiction, as they have disputed the QCA Counterclaims and the Thunderbird Complaint based on the face of the allegations contained therein, rather than on any factual basis asserted by the Trustee.[21] Furthermore, it is QCA's and Thunderbird's burden to prove the entitlement to sovereign immunity. Therefore, on reviewing the question of sovereign immunity here, the Court must only consider the QCA Counterclaims, along with the exhibits, and the Thunderbird Complaint, under Rule 12 in the light most favorable to the Trustee.[22]

***6** However, both QCA and Thunderbird provided documents establishing their connection to their respective Indian tribes (which is their burden to prove). These documents were not rebutted by the Trustee. The documents, discussed in detail below, provide support for their respective claims of sovereign immunity. As both QCA and Thunderbird are attacking the Court's subject matter jurisdiction, for the reasons set forth below, it is appropriate for the Court to review these documents under Rule 12 in making the determination whether the Court has jurisdiction to hear these matters.

ANALYSIS

A. Tribal Sovereign Immunity

i. Parties' Arguments

Both QCA and Thunderbird assert that an Indian tribe is subject to suit only where Congress has authorized the suit or the tribe has waived its immunity. Furthermore, QCA and

Thunderbird assert that abrogation by Congress of sovereign immunity cannot be implied but must be unequivocally expressed in explicit legislation. They continue that sovereign immunity possessed by Indian tribes also extends to all tribal agencies and subdivisions of a tribe engaged in economic activities, such as running of casinos.

The Trustee responds that QCA and Thunderbird are asserting facts beyond the pleadings and they will have to prove sovereign immunity as an affirmative defense (rather than a matter of subject matter jurisdiction). The Trustee further argues that Congress has abrogated any applicable tribal sovereign immunity by enacting section 106 of the Bankruptcy Code.

QCA and Thunderbird reply that the Court may determine its power to hear a case and to do so it may look to evidence extraneous to the complaint to determine if jurisdiction is proper. QCA and Thunderbird continue that sovereign immunity is properly extended to QCA and Thunderbird in these matters.

ii. Considering Facts Outside of the Pleading to Rule Upon Jurisdictional Issues.

a. Discussion

In considering whether QCA and Thunderbird are entitled to sovereign immunity, the Court must consider whether the QCA has a sufficient relationship with Quapaw Tribe of Oklahoma and whether Thunderbird has a sufficient relationship to the Absentee Shawnee Tribe of Oklahoma for sovereign immunity to also attach to the casinos. In addition, the Court must decide whether it has enough evidence at this time to make this determination.

[5] [6] "Tribal sovereign immunity may extend to subdivisions of a tribe, including those engaged in economic activities, provided that the relationship between the tribe and the entity is sufficiently close to properly permit the entity to share in the tribe's immunity."[23] In *Breakthrough Management Group, Inc. v. Chukchansi Gold Casino and Resort*,[24] the Tenth Circuit Court of Appeals held that the Court should look to a variety of factors when examining the relationship between the economic entities, in this case the casinos, and the tribe. The factors including, but are not limited to:

> (1) their method of creation; (2) their purpose; (3) their structure, ownership, and management, including the amount of control the tribe has over the entities; (4) whether the tribe intended for the entities to have tribal sovereign immunity; (5) the financial relationship between the tribe and the entities; and (6) whether the purposes of tribal sovereign immunity are served by granting immunity to the entities.[25]

The Tenth Circuit explained that the policies underlying tribal sovereign immunity and its connection to tribal economic developed include "protection of the tribe's **monies**, as well as preservation of tribal cultural autonomy, preservation of tribal self-determination, and promotion of commercial dealings between Indians and non-Indians."[26]

***7** In the cases *sub judice*, the Trustee asserts that the *Breakthrough* 6–factor test is factual, therefore, the Court "must" deny the Motions to Dismiss so that the parties may proceed with discovery. In response, the QCA and Thunderbird assert that the Court may consider the documents that the QCA and Thunderbird attached to their respective pleadings and should make determinations based on those attachments.

The relationship between a casino and a tribe was discussed by the Ninth Circuit Court of Appeals in *Allen v. Gold Country Casino*:

> [The Indian Gaming Regulatory Act[27] (the "IGRA")] provides for the creation and operation of Indian casinos to promote tribal economic development, self-sufficiency, and strong tribal governments. One of the principal purposes of the IGRA is to insure that the Indian tribe is the primary beneficiary of the gaming operation. The compact that created the Gold Country Casino provides that the Casino will enable the Tribe to develop self-sufficiency, promote

> tribal economic development, and generate jobs and revenues to support the Tribe's government and governmental services and programs. With the Tribe owning and operating the Casino, there is no question that these economic and other advantages inure to the benefit of the Tribe. Immunity of the Casino directly protects the sovereign Tribe's treasury, which is one of the historic purposes of sovereign immunity in general. In light of the purposes for which the Tribe founded this Casino and the Tribe's ownership and control of its operations, there can be little doubt that the Casino functions as an arm of the Tribe. It accordingly enjoys the Tribe's immunity from suit.[28]

In *Allen*, a former tribal casino employee sued the casino for various employment violations. The Ninth Circuit held that whether tribal immunity extends to a tribal business entity depends not on "whether the activity may be characterized as a business, which is irrelevant under *Kiowa*, but whether the entity acts as an arm of the tribe so that its activities are properly deemed to be those of the tribe."[29] The Ninth Circuit noted that the tribe authorized the casino through a tribal ordinance and interstate gaming contract, that the economic advantages created by the casino "inure[d] to the benefit of the Tribe," and that "[i]mmunity of the casino directly protect[ed] the sovereign Tribe's treasury."[30] The Ninth Circuit concluded that the casino functioned as "an arm of the Tribe" and accordingly enjoyed tribal immunity.[31]

Both the QCA and Thunderbird attached documentation showing that the casinos were indeed owned and operating by the respective tribes for the economic benefit of the tribes.

b. QCA

[7] QCA attaches to its pleadings the Quapaw Tribe of Oklahoma's Resolution No. 082709–C (the "QCA Resolution"), which chartered a new governmental subdivision of the tribe to operate the QCA casino to "operate, manage, maintain and promote the Gaming Business ..." and to "carry out the purpose and intent of the IGRA ...."[32] Furthermore, the resolution continues that the purpose of the QCA is to "provide the maximum possible economic benefit" to the Quapaw Tribe of Oklahoma.[33] The QCA Resolution also states that the QCA "shall at all times exercise its powers in the best interest of the Tribe."[34] The QCA Resolution also continues that the "QCA shall not have the power to waive the Tribe's sovereign immunity from suit. ... [and the] QCA shall be entitled to all of the privileges and immunities of the Tribe, including without limitation, sovereign immunity from suit."[35] The Resolution also states that the QCA shall make monetary distribution to the tribe monthly.[36]

***8** As a result of the provisions of the Resolution, the Court finds the QCA has a sufficient relationship with the Quapaw Tribe of Oklahoma to enjoy the Tribe's sovereign immunity. Although the Trustee asserts that this is a factual issue, the Court finds that the Resolution can be used to challenge the Court's subject matter jurisdiction. Nothing was asserted by the Trustee in it counterclaim to rebut these documents as asserted by QCA. Furthermore, the Trustee avers in the QCA Counterclaims that "QCA is a governmental subdivision of the Quapaw Tribe of Oklahoma, which owns and operates the Quapaw Casino ...."[37] Thus, the Court finds that QCA enjoys the sovereign immunity of the Quapaw Tribe of Oklahoma.

c. Thunderbird

[8] Similarly, Thunderbird attached Executive Resolution No. E–AS–2010–106 which states that Thunderbird Entertainment **Center**, Inc. is wholly owned by the Absentee Shawnee Tribe of Oklahoma and recognizing Thunderbird as a tribal corporation and tribal entity.[38] Furthermore, Thunderbird attached its By-laws, which state that "[a]ll shares in the Corporations shall be owned by the Absentee Shawnee Tribe for the benefit of the Tribe and its recognized members. No individual or legal entity other than the Absentee Shawnee Tribe shall acquire any shares in the Corporation or by paid any dividends."[39] The Thunderbird By–Laws continue that "[a]ll Rights of the shareholder of the Corporation shall be exercised by the

Tribe's Executive Committee acting as the Shareholders' Representative, in accordance with the Tribe's Code of Laws."[40] Furthermore, the Thunderbird By–Laws state that the Thunderbird Entertainment **Center** "shall have the same tax status and *immunities* under federal law as the Absentee Shawnee Tribe."[41]

As such, based on the documents provided by Thunderbird, the Court finds that Thunderbird has a sufficient relationship with the Absentee Shawnee Tribe of Oklahoma to enjoy the tribe's sovereign immunity. Again, although this may be a factual inquiry, such inquiry may be completed by reviewing the documents attached to Thunderbird's pleadings that attack this Court's subject matters jurisdiction.[42]

d. Conclusion

***9** As set forth above, the Court considers the corporate documents attached to the pleadings and finds that both QCA and Thunderbird enjoy the sovereign immunity of their respective tribes. Thus, the next inquiry is whether such sovereign immunity has been abrogated by Congress in the Bankruptcy Code or has been waived by either of the movants.

iii. Congress Has Not Abrogated Sovereign Immunity Through the Bankruptcy Code.

[9] The Trustee asserts that the tribes' sovereign immunity, if any, has been abrogated by Congress in Section 106 of the Bankruptcy Code. The Trustee asserts that *even if* QCA and Thunderbird are arms of their respective tribes and enjoy sovereign immunity (which the Court finds that they do), the Trustee's claims are not barred. QCA and Thunderbird respond that Section 106 does not abrogate their sovereign immunity because Congress has not clearly and unequivocally expressed an intent to abrogate the sovereign immunity of Indian tribes in the Bankruptcy Code.

[10] Indian tribes have long been recognized as possessing common law immunity from suit traditionally enjoyed by sovereign powers.

> Unlike the immunity of states, which derives from the Eleventh Amendment, the immunity of tribes is a matter of common law, which has been recognized as integral to the sovereignty and self-governance of tribes. Indian tribes enjoy immunity from suits on contracts, whether those contracts involve governmental or commercial activities, and whether they were made on or off a reservation or settlement. This aspect of tribal sovereignty, like all others, is subject to the superior and plenary control of Congress. But without congressional authorization, the Indian Nations are exempt from suit. Abrogation by Congress of sovereign immunity cannot be implied, but must be "unequivocally expressed" in "explicit legislation."[43]

As a result, the Court must determine if Congress, in the Bankruptcy Code, abrogated the tribes' sovereign immunity. Section 106(a) states in relevant part:

> (a) Notwithstanding an assertion of sovereign immunity, sovereign immunity is abrogated as to a governmental unit to the extent set forth in this section with respect to ...
>
> (1) [Several enumerated sections of the Bankruptcy Code, including § 542 relating to turnover of estate assets, and § 544 relating to avoidance of liens.]
>
> (2) The court may hear and determine any issue arisingwith respect to the application of such sections to governmental units.[44]

Section 101(27) defines "governmental unit" as:

> (27) "governmental unit" means United States; State; Commonwealth; District; Territory; municipality; foreign state; department, agency, or instrumentality of the United States (but not a United States trustee while serving as a trustee in a case under this title), a State, a Commonwealth, a District, a Territory, a municipality, or a foreign state; or other foreign or domestic government.[45]

There is a split of authority regarding whether "governmental unit" includes Indian tribes. In *Krystal Energy Co. v. Navajo Nation*,[46] the Ninth Circuit held that

> The definition of "governmental unit" first lists a sub-set of all governmental bodies, but then adds a catch-all phrase, "or other foreign or domestic governments." 11 U.S.C. § 101(27). Thus, all foreign and domestic governments, including but not limited to those particularly enumerated in the first part of the definition, are considered "governmental units" for the purpose of the Bankruptcy Code, and, under § 106(a), are subject to suit.
>
> ***10** Indian tribes are certainly governments, whether considered foreign or domestic (and, logically, there is no other form of government outside the foreign/domestic dichotomy, unless one entertains the possibility of extra-terrestrial states).
>
> The Supreme Court has recognized that Indian tribes are " 'domestic dependent nations' that exercise inherent sovereign authority over their members and territories." So the category "Indian tribes" is simply a specific member of the group of domestic governments, the immunity of which Congress intended to abrogate.
>
> Had Congress simply stated, "sovereign immunity is abrogated as to all parties who otherwise could claim sovereign immunity," there can be no doubt that Indian tribes, as parties who could otherwise claim sovereign immunity, would no longer be able to do so. Similarly here, Congress explicitly abrogated the immunity of any "foreign or domestic government." Indian tribes are domestic governments. Therefore, Congress expressly abrogated the immunity of Indian tribes.[47]

Thus, the Ninth Circuit reasoned that: (i) the Supreme Court has referred to Indian tribes as "domestic dependent nations;" (ii) Congress enacted sections 106 and 101(27) with that reference in mind; (iii) Congress abrogated sovereign immunity as to states, foreign states, and other foreign or domestic governments; and, therefore (iv) Congress must have intended to include Indian tribes as "other foreign or domestic governments."

In ***In re*** *Whitaker*, the Eighth Circuit Bankruptcy Appellate Panel (hereinafter, the "*Whitaker* BAP") disagreed with *Krystal Energy*.[48] In *Whitaker*, trustees in separate Chapter 7 cases brought adversary proceedings to avoid liens or compel turnover against an Indian tribe and the tribal finance company.[49] The *Whitaker* BAP held that the 4–step process noted above in the *Krystal Energy* ruling is not an "explicit" abrogation of immunity. Furthermore, the *Whitaker* BAP found that *Krystal Energy* relied on cases that do not support the *Krystal Energy* holding.[50] The *Whitaker* BAP concluded that the precedent upon which the *Krystal Energy* court relied did not refer to Indian tribes as "governments" or "domestic governments," rather the Indian tribes were referred to as "domestic sovereigns."[51] The *Whitaker* BAP held that in enacting section 106, "Congress did not unequivocally express its intent by enacting legislation explicitly abrogating the sovereign immunity of tribes. ... The Tribes are, therefore, protected from suit here by their sovereign immunity."[52] The *Whitaker* BAP ultimately dismissed the actions because Congress did not unequivocally express its intent to abrogate sovereign immunity of Indian tribes in suits under the Bankruptcy Code and the tribal finance company was sufficiently close to the Indian tribe to assert sovereign immunity and could not be subject of avoidance actions brought by the trustees.[53]

11** Similarly, in ***In re *Greektown Holdings, LLC*, the District Court for the Eastern District of Michigan stated:

> This Court cannot say with "perfect confidence" that the phrase "other domestic government" unambiguously, clearly, unequivocally and unmistakably refers to Indian tribes. The Bankruptcy Court's conclusion does not give appropriate deference to the Supreme Court's recent admonition that "[t]he special brand of sovereignty the tribes retain—both the nature and its extent— rests in the hands of Congress." While Congress may not have to utter "magic words," Supreme Court precedent clearly dictates that it utter words that beyond equivocation or the slightest shred of doubt mean "Indian tribes." Congress did not do so in sections 106(a) and 101(27) of the Bankruptcy Code and thus the Tribe is entitled to sovereign immunity from suit in the underlying MUFTA proceeding.[54]

The *Greektown* court stated that it could not presume Congress intended to include Indian tribes in the abrogation set forth in section 106(a) "solely by force of deduction."[55] Although the Supreme Court has noted that Congress need not state its intent in a particular way (i.e. use "magic words") the abrogation of immunity needs to be clearly discernible from the statutory text; however, the *Greektown* court noted that there is not a single example in which the Supreme Court has found that Congress intended to abrogate a tribe's sovereign immunity without specifically using the words "Indians" or "Indian tribes."[56]

This Court concludes that Congress has not unequivocally abrogated the sovereign immunity of Indian tribes under sections 106(a) and 101(27) of the Bankruptcy Code. The Court is persuaded by the reasoning in *Whitaker* and *Greektown*. Both decisions discuss the case history, are well reasoned, and carefully construe the text of the Bankruptcy Code. The Court finds that, as neither the terms "Indians" nor "Indian tribes" were included in the language of section 101(27) of the Bankruptcy Code, Congress did not unequivocally express an intent to abrogate the sovereign immunity of Indian tribes in section 106(a) of the Bankruptcy Code.

iv. Conclusion

As a result, the Court finds that not only do QCA and Thunderbird enjoy their respective tribes' sovereign immunity but such sovereign immunity has not been abrogated by the Bankruptcy Code. Thus, the Trustee's claims are barred against Thunderbird. The Trustee's claims against QCA are also barred unless such sovereign immunity has been waived.

B. Waiver of Sovereign Immunity (QCA Only)

i. Parties' Arguments

***12** The Trustee argues that QCA waived any sovereign immunity it may have had concerning the Trustee's counterclaim when it filed a proof of claim against Check Holdings. QCA asserts that it did not waive its immunity as the Trustee's counterclaim for avoidance of a preference is wholly separate and distinct from QCA's affirmative claims for recovery of funds from Check Holdings under its theory that the funds held by Check Holdings are the legal and/or equitable property of QCA. QCA asserts that the only recognized exception to sovereign immunity is that a tribe, by filing a lawsuit, waives sovereign immunity for the equitable defenses sounding in recoupment. QCA asserts that this exception is narrow and does not apply to claims of a different form or nature nor exceeding in amount that sought by the sovereign as plaintiff. QCA continues that the series of transactions subject to its claims against Check Holdings are not even in the same timeframe and thus, are not recoupment claims.

The Trustee responds that (i) both QCA's claims and the QCA Counterclaims all arise under the Finance Services Agreement and are based on the same series of occurrences; (ii) the claim and counterclaims both involve the same issue: whether the Financial Services Agreement established a debtor-creditor relationship between Check Holdings and QCA and the nature of Check Holdings' obligations under the contract; (iii) the Trustee seeks to avoid preferential transfers to QCA under the Financial Services Agreement and courts have held that preference claims by a bankruptcy estate arise out of the same transaction or occurrence as claims filed by a governmental entity against the estate; (iv) Section 502(d) of the Bankruptcy Code bars any recovery on QCA's claim until any preferential transfers have been repaid to the estate; and (v) QCA waived it sovereign immunity by filing a proof of claim, and such waiver, although limited, is broader than that sounding in recoupment.

QCA replied that its waiver of sovereign immunity are limited to those sounding in recoupment, which is narrowly construed in the bankruptcy context.

ii. Discussion

As discussed above, the Court finds that QCA enjoys the tribe's sovereign immunity and Section 106(a) and 101(27) do not abrogate QCA's immunity. As a result, the next question becomes whether by filing a proof of claim or the Intervener Complaint, did QCA waive its sovereign immunity? In *Oklahoma Tax Commission v. Citizen Band Potawatomi Indian Tribe of Oklahoma*,[57] an Indian tribe sought an injunction against a proposed tax assessment and the taxing commission answered and asserted a compulsory counterclaim.[58] The Supreme Court held that the tribe possessed immunity from direct suit; thus, the Indian tribe possessed a similar immunity from cross-suits.[59] The taxing commission did not argue that it received congressional authorization to adjudicate a counterclaim against the Tribe; thus, the Supreme Court concluded that "the Tribe did not waive its sovereign immunity merely by filing an action for injunctive relief."[60]

[11] In *Berrey v. Asarco, Inc.*,[61] the plaintiff Indian tribe alleged the defendants caused environmental contamination on Indian lands as a result of the defendants' mining activities.[62] The defendants asserted counterclaims for contribution and indemnity, which the plaintiff Indian tribe asserted were barred by sovereign immunity.[63] The Tenth Circuit held that tribal sovereign immunity is deemed to be coextensive with the immunity of the United States.[64] The Tenth Circuit analogized that the Supreme Court has recognized that when the United States brings suit, it impliedly waives its immunity as to all claims asserted by the defendant in recoupment.[65] The Tenth Circuit continued:

> Claims in recoupment arise out of the same transaction or occurrence, seek the same kind of relief as the plaintiff, and do not seek an amount in excess of that sought by the plaintiff. The waiver of sovereign immunity is predicated on the rationale that recoupment is in the nature of a defense arising out of some feature of the transaction upon which the sovereign's action is grounded.... [W]e extended application of the recoupment doctrine to Indian tribes; thus, when a tribe files suit it waives its immunity as to counterclaims of the defendant that sound in recoupment.[66]

***13** The Tenth Circuit continued: "Waiver under the doctrine of recoupment, however, does not require prior waiver by the sovereign or an independent congressional abrogation of immunity. If the defendant's counterclaims are already permitted under an independent congressional abrogation of immunity, there would be no need for implied waiver under the recoupment doctrine."[67] Thus, regardless of whether Congress explicitly waived tribal sovereign immunity, a claim for recoupment is not barred.

[12] **[13]** In *Jicarilla Apache Tribe v. Andrus*,[68] the Tenth Circuit held:

> "when the sovereign sues it waives immunity as to claims of the defendant which assert matters in recoupment-arising out of the same transaction or occurrence which is the subject matter of the government's suit, and to the extent of defeating the government's claim but not to the extent of a judgment against the government which is affirmative in the sense of involving relief different in kind or nature to that sought by the government or in the sense of exceeding the amount of the government's claims; but the sovereign does not waive immunity as to claims which do not meet the 'same transaction or occurrence test' nor to claims of a different form or nature than that sought by it as plaintiff nor to claims exceeding in amount that sought by it as plaintiff."[69]

Furthermore, the Third Circuit has held that recoupment is to be narrowly construed:

> a mere logical relationship is not enough: the fact that the same two parties are involved, and that a similar subject matter gave rise to both claims, ... does not mean that the two arose from the "same transaction." Rather, both debts must arise out of a **single integrated transaction** so that it would be inequitable for the debtor to enjoy the benefits of that transaction without also meeting its obligations.[70]

The Third Circuit distinguishes the right from set-off from the right of recoupment, although both permit a creditor that owes a debt to the debtor to reduce the amount of its debt by the amount of a debt owed by the debtor to the creditor, as the right to recoupment must arise out of the same transaction.[71] For example, in ***In re*** *Anes*, the debtor's debt arose from a loan she obtained from her government-employer's retirement system whereas the governmental unit's obligation to pay the debtor's salary arose from the debtor's contract of employment and performance of her job.[72] The Third Circuit opined that there may be a right to set-off but not a right to recoupment because the obligation to repay the loan did not arise from same transaction as their employers' obligations to pay their salaries.[73] Thus, "[f]or the purposes of recoupment, a mere logical relationship is not enough: the 'fact that the same two parties are involved, and that a similar subject matter gave rise to both claims, ... does not mean that the two arose from the "same transaction." ' Rather, both debts must arise out of a single integrated transaction so that it would be inequitable for the debtor to enjoy the benefits of that transaction without also meeting its obligations. Use of this stricter standard for delineating the bounds of a transaction in the context of recoupment is in accord with the principle that this doctrine, as a non-statutory, equitable exception to the automatic stay, should be narrowly construed."[74]

a. The Court Does Not Have Enough Information To Assess The Transactions Under The Financial Services Agreement.

***14** QCA and the Debtors were parties to the Financial Services Agreement and the claims asserted against the Check Holdings' estate by QCA as well as the avoidance of the preferential transfers sought by the Trustee arise out of the Financial Services Agreement.

[14] The Third Circuit has held that:

> In the bankruptcy context, recoupment has often been applied where the relevant claims arise out of a **single contract** "that provide[s] for advance payments based on estimates of what ultimately would be owed, subject to later correction." However, an express contractual right is not necessary to effect a recoupment. Nor does the fact that a contract exists between the debtor and creditor automatically enable the creditor to effect a recoupment.[75]

In *University Medical **Center***, the court concluded that the Department of Health and Human Services ("HHS") was not entitled to equitable recoupment for overpayments in 1985 through 1987 against amounts due to the bankrupt medical **center** in 1988 under a Medicare provider agreement. The court recognized that the Medicare program operated on a net balance accounting system where HHS paid the medical **center** based on estimates of future expenditures and then, following an annual audit to determine actual costs, adjusted subsequent payments to account for prior over or underpayments.[76] The Third Circuit further stated that while recoupment has been applied where relevant claims arise from a single contract, the fact that a contract exists between the debtor and creditor does not automatically enable the creditor to effect a recoupment.[77] The Third Circuit concluded that the provider agreement, which it characterized as a "unique type of contract" that did not "provide for a defined transaction or even a series of transactions" and had not been assumed by the medical **center** postbankruptcy, merely established a "relationship between the parties."[78] This relationship was "not sufficient to support the conclusion that Medicare overpayments made to UMC in 1985 arise from the same transaction, for the purposes of equitable recoupment, as Medicare payments due UMC for services provided in 1988."[79] "Recovery of the 1985 overpayment therefore, is the final act of the transaction that began in 1985. UMC's 1988 post-petition services were the beginning of transactions that would stretch into the future, but they were not part of the 1985 transactions."[80]

[15] Similarly, as stated by the Tenth Circuit:

> A "same contract equals same transaction" rule would be overly simplistic. Instead, as our case law illustrates, the "same transaction" analysis involves an examination of the parties' equities. We held ... that recoupment permits a creditor to offset a claim that arises from the same transaction as the debtor's claim because application of the limitations on setoff in bankruptcy would be inequitable.... [W]e analogized recoupment to unjust enrichment: The situation before us is not one in which the creditor seeking relief consciously extended credit as did the bankrupt's ordinary creditors, but rather allowing [the debtor's] ... other creditors to share in this **money** in controversy would give them a windfall, a classic case of unjust enrichment. In light of recoupment's equitable foundation, the doctrine is only applicable to claims that are so closely intertwined that allowing the debtor to escape its

> obligation would be inequitable notwithstanding the Bankruptcy Code's tenet that all unsecured creditors share equally in the debtor's estate.[81]

***15** "The common thread in the decisions ruling recoupment rights are present is that the rights are derived from a single agreement. The contract often called for numerous, separate deliveries, services or payments over a period of time. In finding a single transaction, the courts looked to the agreement of the parties and found the conduct at issue within the scope of the agreement."[82]

[16] **[17]** In the case *sub judice*, the Court simply does not have enough information to evaluate QCA's claims against Check Holdings in comparison to those claims brought by the Trustee against QCA to determine if the transfers are part of the same transaction or each individual transactions. QCA's claims against Check Holdings concern reimbursements that were *not* made between April 16, 2014, and May 14, 2014; whereas, the Trustee's counterclaims against QCA seek reimbursements of payments *made* to QCA between February 24, 2014, and April 23, 2014. Obviously, there is some overlap of time. Furthermore, the nature of the contract between the Trustee and QCA may be one singular, yet ongoing, transaction; however, the Court does not have enough information to make this determination. At the very least, the Court would need to review the terms of the Financial Services Agreement to determine whether the terms of the contract dictate individual transactions or one cohesive transaction. However, the Court finds that, under no circumstances, could the amount sought by the Trustee under recoupment exceed the amount sought by QCA —**at most**, QCA's claim ($502,018) could be brought to $0 by the Trustee's claim of recoupment ($1,114,020.76), if any.[83]

Thus, the Court will deny the motion to dismiss the QCA Counterclaims solely for the purpose of determining whether the Trustee's counterclaims and QCA claims may be subject to recoupment. However, the Court determines that the Trustee may not avoid an amount in excess of QCA's claims against **Money Centers**. Thus, although the Court is not making a ruling on whether QCA's claims are subject to recoupment, there is a substantially narrowing of the gap between the parties.

b. Section 502(d) Does Not Apply to a Sovereign Tribe.

[18] The Trustee asserts that, pursuant to Section 502(d), QCA is barred from recovering on its claim until the preferential transfers have been repaid to the estate. As mentioned above, the QCA Counterclaims are barred by sovereign immunity except in the limited exception of recoupment. Thus, the Court finds that Section 502(d) is not operative as to the QCA.

c. QCA Did Not Waive Its Sovereign Immunity By Filing a Claim.

[19] QCA filed a proof of claim against Check Holdings in the amount of $502,018.[84] The Trustee asserts that by filing a proof of claim, QCA waived it sovereign immunity, at least as to the matters set forth in QCA's claim.

Section 106(b) of the Bankruptcy Code, which provides:

> A **governmental unit** that has filed a proof of claim in the case is deemed to have waived sovereign immunity with respect to a claim against such governmental unit that is property of the estate and that arose out of the same transaction or occurrence out of which the claim of such governmental unit arose.[85]

***16** Contrary to what was asserted by the Trustee, the Bankruptcy Code refers to a "governmental unit" that files a proof of claim, not a "sovereign." Thus, again, we must refer back to Section 101(27) which, as held above, does not include Indian tribes in its definition. Thus, Section 106(b) is not operative in the QCA Adversary Action.

iii. Conclusion

As discussed above, the waiver of sovereign immunity is limited to claims sounding in recoupment. The Court does not have sufficient information to determine whether the transaction contemplated in QCA's complaint against the Debtors result from the same transaction as the Trustee's preference claims against QCA. However, even if the Trustee's counterclaims sound in recoupment, the Trustee's claim would be limited to the amount asserted by QCA. In other words, the Trustee would be unable to collect affirmative relief (i.e. cash) from QCA. Other than this limited circumstance of recoupment, QCA has not waived its sovereign immunity by filing its adversary action against the Debtors nor by filing a proof of claim.

CONCLUSION

As set forth above, the Court finds that: (i) this is a facial attack on the Court's subject matter jurisdiction allowing the Court to review various documents attached to the pleadings; (ii) both QCA and Thunderbird are sufficiently related to their respective Indian tribes to enjoy the tribes' sovereign immunity; and (iii) neither Section 106(a) nor Section 101(27) abrogates QCA's and Thunderbird's sovereign immunity. Thus, Thunderbird's motion to dismiss will be granted.

Furthermore, as to QCA only, the Court finds that it does not have sufficient information to determine whether there was a limited waiver of QCA's sovereign immunity, to the extent of recoupment *only*, as to QCA's claims. Although, at most recoupment would be limited to the amount of QCA's claims against the **Money Center's** estate.

Thus, the Court will grant, in part, and deny, in part, QCA's motion to dismiss by finding that, indeed, QCA enjoys sovereign immunity but finding that this sovereign immunity *may* have been waived to the extent of recoupment, but *only* to the extent of QCA's claims against the estates (i.e. the Trustee will not be able to recover any amounts in excess of QCA's claims from QCA).

Respective orders will be entered.

All Citations

--- B.R. ----, 2017 WL 775780

Footnotes

1 "The court is not required to state findings or conclusions when ruling on a motion under Rule 12..." Fed. R. Bankr. P. 7052(a)(3). Accordingly, the Court herein makes no findings of fact and conclusions of law pursuant to Rule 7052 of the Federal Rules of Bankruptcy Procedure.

2 Capitalized terms not defined herein shall have the meaning ascribed to them *infra*.

3 *See The Fairchild Liquidating Trust v. State of New York (**In re** The Fairchild Corp.)*, 452 B.R. 525, 528 (Bankr.D.Del.2011) (citations omitted). *See also Chicot County Drainage Dist. v. Baxter State*, 308 U.S. 371, 60 S.Ct. 317, 84 L.Ed. 329 (1940) (explaining a federal court has authority to determine whether it has jurisdiction over a dispute)).

4 D.I. 85.

5 D.I. 89.

6 D.I. 178, Schedule F.

7 *See* Claims Register of MCA, Claim No. 23–1; Claims Register of Check Holdings, Claim No. 3–1.

8 The Thunderbird Adversary Action pleadings did not contain any factual detail; however, as this is the general basis of the Debtors' business prior to bankruptcy, it is set forth herein to show how the (alleged) transfers occurred between **Money Centers** and both QCA and Thunderbird.

9 Fed. R. Civ. P. 12(b)(1).

10 *See, e.g., Common Cause of Pa. v. Pennsylvania*, 558 F.3d 249, 257 (3d Cir. 2009).

11 *See, e.g.*, *Democracy Rising PA v. Celluci*, 603 F.Supp.2d 780, 788 (M.D. Pa. 2009).

12 *Shortt v. Richlands Mall Assocs., Inc.*, No. 90–2056, 922 F.2d 836, 1990 WL 207354, at *4 (4th Cir. Dec. 19, 1990).

13 *McCann v. Newman Irrevocable Trust*, 458 F.3d 281, 290 (3d Cir. 2006); *Broadhollow Funding, LLC v. Bank of **America**, N.A. (**In re** Am. Home Mortg. Holdings, Inc.)*, 390 B.R. 120, 128 (D. Del. 2008).

14 *Frederick L. v. Dep't of Pub. Welfare*, 157 F.Supp.2d 509, 515 (E.D. Pa. 2001).

15 *Christy v. Pennsylvania Tpk. Comm'n*, 54 F.3d 1140, 1144 (3d Cir. 1995) (*citing ITSI T.V. Prods., Inc. v. Agric. Associations*, 3 F.3d 1289, 1291 (9th Cir. 1993)) ("We agree with the Ninth Circuit that whatever its jurisdictional attributes, Eleventh Amendment immunity should be treated as an affirmative defense, and like any other such defense,

that which is promised by the Eleventh Amendment must be proved by the party that asserts it and would benefit from its acceptance. We also agree with the Ninth Circuit that considerations of fairness support this conclusion." (quotation marks and text modifications omitted)).

16 *Miller v. Delaware Tech. & Cmty. Coll.*, No. CIV.A. 12-216-SLR, 2013 WL 1832072, at *6 (D. Del. May 1, 2013), *report and recommendation adopted*, No. CV 12-216-SLR/CJB, 2013 WL 5314871 (D. Del. Sept. 16, 2013) (*citing Christy v. Pennsylvania Tpk. Comm'n*, 54 F.3d 1140, 1146 (3d Cir.1995) and *Febres v. Camden Bd. of Educ.*, 445 F.3d 227, 229 (3d Cir. 2006)). The Fourth Circuit noted:

> Unlike subject-matter jurisdiction, which cannot be waived, a State can always waive its immunity and consent to be sued in federal court, *Atascadero State Hosp. v. Scanlon*, 473 U.S. 234, 238, 105 S.Ct. 3142, 87 L.Ed.2d 171 (1985), and a court need not raise the issue on its own initiative, *Wis. Dep't of Corr.*, 524 U.S. [381] at 389, 118 S.Ct. 2047 [141 L.Ed.2d 364 (1998)]. Because a defendant otherwise protected by the Eleventh Amendment can waive its protection, it is, as a practical matter, structurally necessary to require the defendant to assert the immunity. We therefore conclude that sovereign immunity is akin to an affirmative defense, which the defendant bears the burden of demonstrating. In so concluding, we join every other court of appeals that has addressed the issue.

Hutto v. S. Carolina Ret. Sys., 773 F.3d 536, 543 (4th Cir. 2014) (citations omitted).

17 *Blanciak v. Allegheny Ludlum Corp.*, 77 F.3d 690, 694 n. 2 (3d Cir. 1996) (*citing Pennhurst State School & Hosp. v. Halderman*, 465 U.S. 89, 98–100, 104 S.Ct. 900, 906–07, 79 L.Ed.2d 67 (1984)). *See also Love v. New Jersey State Police*, No. CV141313FLWTJB, 2016 WL 3046257, at *6 (D.N.J. May 26, 2016) ("An assertion of Eleventh Amendment immunity is a challenge to a district court's subject matter jurisdiction."); *Zimmer v. New Jersey Div. of Child Prot. & Permanency*, No. CV152524FLWDEA, 2016 WL 234844, at *4 (D.N.J. Jan. 20, 2016) (same); *Orden v. Borough of Woodstown*, 181 F.Supp.3d 237, 243–45 (D.N.J. 2015) ("The plaintiff ordinarily has the burden of establishing jurisdiction. But because immunity under the Eleventh Amendment is treated as an affirmative defense, it does not implicate federal subject matter jurisdiction in the ordinary sense, and the party asserting Eleventh Amendment immunity (and standing to benefit from its acceptance) bears the burden of proving its applicability." (internal quotation marks and citations omitted)); *Rozzelle v. Univ. of N. Carolina at Charlotte*, No. 3:15-CV-00050-MOC, 2015 WL 6393004, at *4 (W.D.N.C. Oct. 2, 2015), *report and recommendation adopted*, No. 3:15-CV-00050-MOC, 2015 WL 6440839 (W.D.N.C. Oct. 21, 2015) ("It is appropriate to consider Defendants' claim of immunity as a challenge to the Court's subject matter jurisdiction."); *Aryafar v. S. Piedmont Cmty. Coll.*, No. 3:14-CV-702-RJC-DSC, 2015 WL 5737904, at *2 (W.D.N.C. Sept. 30, 2015) ("Ordinarily, a plaintiff bears the burden of proving subject matter jurisdiction when a Rule 12(b)(1) motion challenge is raised. However, a defendant bears the burden of demonstrating sovereign immunity under the Eleventh Amendment when seeking dismissal under Rule 12(b)(1)." (citations and footnote omitted)).

18 *Love v. New Jersey State Police*, No. CV141313FLWTJB, 2016 WL 3046257, at *6 (D.N.J. May 26, 2016) (citations and internal quotation marks omitted). *See also Zimmer v. New Jersey Div. of Child Prot. & Permanency*, No. CV152524FLWDEA, 2016 WL 234844, at *4 (D.N.J. Jan. 20, 2016).

19 The *Federick L.* Court stated:

> Defendants raise the issue of Eleventh Amendment immunity under Rule 12(b)(1) on subject matter jurisdiction grounds. In *Blanciak* ..., the Third Circuit recognized that the Eleventh Amendment is a jurisdictional bar which deprives federal courts of subject matter jurisdiction. The Third Circuit went on to say that such a motion may be filed pursuant to Rule 12(b)(1). One year before, however, our court of appeals stated that Eleventh Amendment immunity does not implicate federal subject matter jurisdiction in the ordinary sense because it can be expressly waived by a party, or forfeited through non-assertion. As such, the Third Circuit determined in *Christy* that Eleventh Amendment immunity should be analyzed as an affirmative defense to be established by the party raising it. Where Eleventh Amendment immunity was asserted in a motion to dismiss for lack of subject matter jurisdiction, this Court has evaluated the motion under the standard provided for by Rule 12(b)(6).

Frederick L., 157 F.Supp.2d at 515 (citations and quotations marks omitted).

20 *Id.* (citations and quotation marks omitted). The District Court also stated:

> I am mindful that the Third Circuit has "cautioned against treating a Rule 12(b)(1) motion as a Rule 12(b)(6) motion and reaching the merits of the claims" because "the standard for surviving a Rule 12(b)(1) motion is lower than that for a 12(b)(6) motion." *Gould Elecs. Inc. v. United States*, 220 F.3d 169, 178 (3d Cir.2000) (citation omitted). In considering whether Defendants' are protected from suit by the Eleventh Amendment, I will avoid evaluation of the merits of Plaintiffs' claims.

Id.

21 *Coles v. New Jersey Dep't of Human Servs.*, No. CIV.A. 13-3987 FLW, 2014 WL 2208142, at *3 (D.N.J. May 28, 2014). *See also Orden v. Borough of Woodstown*, 181 F.Supp.3d 237, 242–43 (D.N.J. 2015) (citations omitted) ("A facial

challenge contests the sufficiency of the complaint because of an alleged pleading deficiency, while a factual attack challenges the actual failure of the plaintiff's claims to comport with jurisdictional prerequisites.”).

22 *Love v. New Jersey State Police*, No. CV141313FLWTJB, 2016 WL 3046257, at *6 (D.N.J. May 26, 2016).

23 *Breakthrough Mgmt. Grp., Inc. v. Chukchansi Gold Casino & Resort*, 629 F.3d 1173, 1183 (10th Cir. 2010) (footnote and citation omitted).

24 *Id.*

25 *Id.* at 1181.

26 *Breakthrough Mgmt. Grp., Inc. v. Chukchansi Gold Casino & Resort*, 629 F.3d 1173, 1188 (10th Cir. 2010) (citations and internal quotation marks omitted).

27 25 U.S.C. § 2701, *et seq.*

28 *Allen v. Gold Country Casino*, 464 F.3d 1044, 1046–47 (9th Cir. 2006) (citations and internal quotation marks omitted).

29 *Id.* at 1046.

30 *Id.* at 1046–47.

31 *Id.* at 1047.

32 *Reply Brief of the Quapaw Casino Authority in Support of Its Motion to Dismiss Trustee's Counterclaim*, Adv. 14–50437, D.I. 69, Exh. A (Quapaw Tribe of Oklahoma Resolution No. 082709–C, dated Aug 27, 2009, at § 4(a)(1–2)).

33 *Id.* at § 4(A)(4).

34 *Id.* at § 5(C).

35 *Id.* at § 7(E) and 8(B).

36 *Id.* at § 13(C).

37 Adv. Pro. No. 14–50437, D.I. 64 (*Chapter 11 Trustee's Answer and Counterclaim*), at Counterclaim ¶ 8.

38 Thunderbird Motion to Dismiss, Adv. 16–50410, D.I. 5, Exh. A (Executive Resolution No. E–AS–2010–106 Absentee Shawnee Tribe of Oklahoma, Special executive Committee Meeting, dated Dec. 28, 2010).

39 Defendant's Reply Memorandum in Support of Motion to Dismiss, Adv. 16–50410, D.I. 7, Exh. B (By–Laws of Thunderbird Entertainment **Center**, Inc., Art. IV(B) (hereinafter, the “Thunderbird By–Laws”)).

40 *Id.* at Art. IV(D).

41 Thunderbird By–Laws, Art. III (B) (emphasis added). The Thunderbird By–Laws also state that the Thunderbird Board of Directors may grant limited waiver of its immunity from suit and consent to be sued in the court of the Absentee Shawnee Tribe or another court of competent jurisdiction, provided, however, that: ...

> c. any limited waiver of sovereign immunity may be granted only upon a resolution adopted by the Board of Directorsof Thunderbird Entertainment **Center**, Inc., for the specific purpose of granting a waiver, and upon approval of the Shareholders' Representatives at duly called meeting of the Shareholders' Representatives. Further, the language of the limited waiver must be explicit: and pertain to only Thunderbird Entertainment assets, and no real o monetary assets of the Absentee Shawnee Tribe. Finally, the waiver must be contained in a written contract or commercial document to which Thunderbird Entertainment **Center**, Inc., is a party;
>
> d. a limited waiver of sovereign immunity may be granted only when necessary to secure a substantial advantageor benefit to Thunderbird Entertainment **Center**, Inc., or a tribal entity; and
>
> e. a limited waiver of sovereign immunity must be specific and limited as to duration, guarantee, transaction, propertyor funders of the tribal entity subject to the waiver, court having jurisdiction and applicable law.

Id. at Art. X(D)(c–e).

42 The Thunderbird Complaint does **not** make any averments that Thunderbird is related to the Absentee Shawnee Tribe of Oklahoma, rather it limits its averments to Thunderbird's principal place of business address. *See* Adv. Pro. No. 16–50410, D.I. 1 (*Complaint to Avoid Transfers Pursuant to 11 U.S.C. §§ 547, 548, and 502 and to Recover Property Transferred Pursuant to 11 U.S.C. § 550*), at ¶ 9.

43 *Whitaker v. Dakota Finance Corp. (In re Whitaker)*, 474 B.R. 687, 690–91 (8th Cir. B.A.P. 2012) (citations, internal quotation marks and footnotes omitted).

44 11 U.S.C. § 106(a).

45 11 U.S.C. § 101(27).

46 357 F.3d 1055, 1057–58 (9th Cir. 2004), *as amended on denial of reh'g* (Apr. 6, 2004).

47 *Id.* at 1057–58 (citations omitted).

48 *Whitaker v. Dakota Finance Corp. (In re Whitaker)*, 474 B.R. 687 (8th Cir. B.A.P. 2012).

49 *Id.* at 689–90. 50 *Id.* at 693–95.

51 *Id.* at 695 (*citing Blatchford v. Native Vill. of Noatak & Circle Vill.*, 501 U.S. 775, 786, 111 S.Ct. 2578, 115 L.Ed.2d 686 (1991) (holding that abrogation of sovereign immunity must be made "unmistakably clear in the language of the statute." (citations omitted)).

52 *Id.* (citations and footnotes omitted).

53 *Id.* at 697.

54 *In re Greektown Holdings, LLC*, 532 B.R. 680, 700–01 (E.D. Mich. 2015) (*quoting Michigan v. Bay Mills Indian Cmty.*, ––– U.S. ––––, 134 S.Ct. 2024, 2037, 188 L.Ed.2d 1071 (2014)). *See also Meyers v. Oneida Tribe of Indians of Wisconsin*, 836 F.3d 818, 826 (7th Cir. 2016) ("We need not weigh in on the conflict between these courts on how to interpret the breadth the term 'other domestic governments' under the Bankruptcy Code, because we conclude that Congress simply has not unequivocally abrogated the sovereign immunity of Indian Tribes under the FACTA provision at issue in this case.").

55 *Id.* at 698.

56 *Id.* at 699.

57 498 U.S. 505, 111 S.Ct. 905, 909, 112 L.Ed.2d 1112 (1991).

58 *Id.* at 509.

59 *Id.*

60 *Id.* at 509–10.

61 439 F.3d 636 (10th Cir. 2006).

62 *Id.* at 640.

63 *Id.*

64 *Id.* at 643.

65 *Id.* (*citing Bull v. United States*, 295 U.S. 247, 260–63, 55 S.Ct. 695, 79 L.Ed. 1421 (1935)).

66 *Id.* (citations and internal quotation marks omitted).

67 *Id.* at 644.

68 687 F.2d 1324 (10th Cir. 1982).

69 *Id.* at 1344 (*quoting Frederick v. United States*, 386 F.2d 481, 488 (5th Cir. 1967) (other citations omitted).

70 *In re Univ. Med. Ctr.*, 973 F.2d 1065, 1081 (3d Cir. 1992) (emphasis added, citations and internal quotation marked omitted).

71 *In re Anes*, 195 F.3d 177, 182 (3d Cir. 1999).

72 *Id.* at 183.

73 *Id.*

74 *Id.* at 182.

75 *Univ. Med. Ctr. V. Sullivan (In re Univ. Med. Ctr.)*, 973 F.2d 1065, 1080 (3d Cir. 1992).

76 *Id.* at 1070.

77 *Id.* at 1080.

78 *Id.* at 1081.

79 *Id.*

80 *Id.* at 1082. *See also Reliance Ins. Co. (In Liquidation) v. Apple Computer, Inc.*, No. 1 REL 2001, 2011 WL 10894815, at *7 (Pa. Commw. Ct. June 23, 2011) (not precedential) ("[T]he parties in the present case formed a contractual relationship under the Policy but this relationship is not alone enough to make their every interaction related to the Policy an integrated transaction for purpose of recoupment.").

81 ***In re*** *Peterson Distrib., Inc.*, 82 F.3d 956, 960 (10th Cir. 1996) (collecting cases) (citations, quotation marks and modifications omitted).

82 *First Union Nat'l Bank of Fl. v. Abbey Fin Corp. (**In re** Abbey Fin. Corp.)*, 193 B.R. 89, 96 (Bankr. D. Mass. 1996).

83 *See Jicarilla Apache Tribe*, 687 F.2d at 1344.

84 *See*, *supra*, n. 5.

85 11 U.S.C. § 106(b) (emphasis added).

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2017 WL 543227
Only the Westlaw citation is currently available.
This case was not selected for publication
in West's Federal Reporter.
See Fed. Rule of Appellate Procedure 32.1 generally
governing citation of judicial decisions issued on or
after Jan. 1, 2007. See also
U.S.Ct. of App. 5th Cir. Rules 28.7 and 47.5.
United States Court of Appeals, Fifth Circuit.

In the Matter of: Stephen Chu Debtor
Stephen Chu, Appellant
v.
State of Texas, Appellee

No. 15-11001
|
Filed February 9, 2017

Synopsis

Background: Creditor brought adversary proceeding to deny debtor a Chapter 7 discharge. The United States Bankruptcy Court for the Northern District of Texas entered judgment in favor of creditor on its "false oath" and "unexplained asset loss" theories, and debtor appealed. The District Court affirmed. Debtor appealed.

Holdings: The Court of Appeals held that:

[1] creditor had standing to file complaint objecting todebtor's general Chapter 7 discharge, though debtor's debt to this particular creditor might be nondischargeable;

[2] bankruptcy court did not clearly err in finding thatnumerous omissions on Chapter 7 debtor's bankruptcy schedules and statement of financial affairs supported inference that debtor had acted with at least reckless indifference to the truth; and

[3] debtor's failure to provide any explanation for whathappened to $11,000 worth of household items, books and pictures worth $1,000, and a ring worth $500 that he recently possessed was sufficient to warrant denial of his discharge for failing to satisfactorily explain loss or deficiency of assets.

Affirmed.

West Headnotes (4)

[1] **Bankruptcy**

Determination of Dischargeability

Creditor had standing to file complaint objecting to debtor's general Chapter 7 discharge, though debtor's debt to this particular creditor might be nondischargeable, such that creditor would gain no benefit from denial of debtor's general bankruptcy discharge; at time creditor filed its complaint, there had been no determination of dischargeability or nondischargeability of debtor's obligation to creditor. 11 U.S.C.A. §§ 523(a), 727(a).

Cases that cite this headnote

[2] **Bankruptcy**

False oath or account

Bankruptcy court did not clearly err in finding that numerous omissions on Chapter 7 debtor's bankruptcy schedules and statement of financial affairs supported inference that debtor had acted with at least reckless indifference to the truth and warranted denial of debtor's discharge based on his knowing and fraudulent, material false oaths. 11 U.S.C.A. § 727(a)(4)(A).

Cases that cite this headnote

[3] **Bankruptcy**

Right of review and persons entitled; p arties; w aiver or estoppel

On appeal from order denying debtor a Chapter 7 discharge based on his failure to satisfactorily explain loss or deficiency of assets, debtor waived any argument that plaintiff had failed to meet its initial burden of showing that he possessed substantial, identifiable assets that were now unavailable for distribution to creditors, by defending plaintiff's claim solely on basis that his explanation was "satisfactory." 11 U.S.C.A. § 727(a)(5).

Cases that cite this headnote

[4] Bankruptcy

Failure to explain loss or deficiency

Chapter 7 debtor's failure to provide any explanation for what happened to $11,000 worth of household items, books and pictures worth $1,000, and a ring worth $500 that he recently possessed was sufficient to warrant denial of his discharge for failing to satisfactorily explain loss or deficiency of assets. 11 U.S.C.A. § 727(a)(5).

Cases that cite this headnote

Appeal from the United States District Court for the Northern District of Texas, USDC No. 3:14-CV-3584

Attorneys and Law Firms

William Chu, Esq., Dallas, TX, for Appellant

Herbert Charles Shelton, II, Assistant Attorney General, Office of the Attorney General for the State of Texas, Austin, TX, for Appellee

Before JOLLY, HIGGINBOTHAM, and GRAVES, Circuit Judges.

Opinion

PER CURIAM:[*]

***1** Stephen Chu is an orthodontist who filed a petition under Chapter 7 of the Bankruptcy Code after his dental practice took a downturn. He appeals from the district court's judgment affirming the bankruptcy court's denial of discharge under 11 U.S.C. § 727(a)(4)–(5) based on its conclusion that he "knowingly and fraudulently, in or in connection with the case—made a false oath or account" and that he "failed to explain satisfactorily ... any loss of assets or deficiency of assets to meet the debtor's liabilities." 11 U.S.C. § 727(a)(4)(A) and (a)(5). The determination was based in large part on Chu's failure to disclose several large monetary transactions in his Schedules and Statement of Financial Affairs ("SOFA"). We find no reversible error and AFFIRM.

I.

Chu's orthodontics practice primarily treated patients qualifying for Medicaid. Once thriving, his practice came to an abrupt halt in 2011 when the Texas Health and Human Services Commission ("HHSC") notified him of a payment hold because he allegedly engaged in Medicaid fraud from 2007 to 2011. The HHSC alleged, in particular, that Chu received over $11 million in Medicaid overpayments. Chu's practice went downhill for over a year following the Medicaid payment hold. In December 2012, Chu filed for Chapter 7 bankruptcy. He filed his Schedules and SOFA at the time of his original bankruptcy filing; over a year later, Chu filed an amended SOFA but did not amend his Schedules.

At around the same time as Chu's bankruptcy filing, the State of Texas commenced a *qui tam* action under seal against Chu, his professional association, and other entities. The *qui tam* action, pursued in state court, was partially unsealed in February 2013 to alert Chu and the bankruptcy court to its existence. After Bankruptcy Rule 2004 investigations during the summer of 2013, the State filed an adversary proceeding to contest Chu's request for discharge in the bankruptcy court. *See* FED. R. BANKR. P. 2004. The State claimed that Chu had violated Section 727(a)(2)–(5) of the Bankruptcy Code.

At the close of discovery, the State moved for summary judgment on all counts. The bankruptcy court denied summary judgment, and a trial was conducted on the merits. Chu amended his Schedules and SOFA shortly prior to trial. At the end of the presentations of the evidence and testimony, the matter was taken under advisement. The bankruptcy court found "numerous and significant omissions" in Chu's Schedules[1] and concluded that he either acted with "fraudulent intent" or "reckless indifference for the truth." *In re Chu*, No. 12–37962–HDH–7, at *5 (Bankr. N.D. Tex. Aug. 26, 2014).

***2** When the trial drew to a close, the bankruptcy court declined to find that Chu violated 11 U.S.C. § 727(a)(2) and (3), but nonetheless denied his discharge pursuant to

11 U.S.C. § 727(a)(4) and (5). Chu appealed to the district court. His appeal was untimely filed, and he moved in the bankruptcy court for an extension of time for which to file an appeal. The court granted Chu's motion without a hearing. The district court affirmed the judgment of the bankruptcy court and Chu's global denial of discharge. Chu has timely appealed to this court.

II.

This court reviews the factual findings of the bankruptcy court for clear error and its conclusions of law under a de novo standard of review. *In re Beaubouef,* 966 F.2d 174, 177 (5th Cir. 1992). A bankruptcy court's findings of fact are "clearly erroneous" if "on the entire evidence, the court is left with the definite and firm conviction that a mistake has been committed." *In re Duncan,* 562 F.3d 688, 694 (5th Cir. 2009) (quoting *In re Dennis,* 330 F.3d 696, 701 (5th Cir. 2003)).

III.

A.

[1] As an initial matter, Chu challenges the standing of the State of Texas to seek a global denial of discharge under § 727. In support of this argument, Chu contends that any debt owed to Texas fell within the 11 U.S.C. § 523(a)(7) exception to discharge, which states:

> A discharge under ... this title does not discharge an individual debtor from any debt ... to the extent such debt is for a fine, penalty, or forfeiture payable to and for the benefit of a governmental unit, and is not compensation for actual pecuniary loss....

11 U.S.C. § 523(a)(7). If the debt owed to Texas were completely non-dischargeable, Chu argues, the State would not stand to gain any benefit from obtaining a global denial of discharge and therefore ought not to have standing to bring an adversarial proceeding. Chu further argues that any claim against him by the State pursuant to the *qui tam* action is a "fine, penalty, or forfeiture payable to and for the benefit of a governmental unit," and is therefore automatically non-dischargeable.

Chu's argument here is based on speculation. It is unclear whether and to what extent the § 523(a)(7) exception applies to Chu's debt owed to the State of Texas. No final determination regarding the nature of Chu's liability to the State,[2] or its subsequent dischargeability, has been made. Thus, Texas stood to gain by seeking global denial of discharge by way of an adversarial proceeding, thereby satisfying the constitutional standing requirement.

B.

[2] In the light of our finding that the State possessed standing to object to Chu's discharge, we consider Chu's challenge to the merits of the bankruptcy court's decision. The bankruptcy court first found that Chu had "knowingly and fraudulently, in or in connection with the case ... made a false oath or account." *In re Chu*, No. 12– 37962–HDH–7, at *3 (quoting 11 U.S.C. § 727(a)(4)). In doing so, the court acknowledged that to show a "false oath," the creditor must show that the debtor "made a statement under oath," that "the statement was false," that "the debtor knew the statement was false," that "the debtor made the statement with fraudulent intent," and that "the statement related materially to the bankruptcy case." *Id.* at *4. Courts do not simply aggregate a debtor's mistakes to determine fraudulent intent; such intent, however, can be established by a showing of actual intent or "reckless indifference to the truth" based on "the cumulative effect of false statements." *In re Duncan,* 562 F.3d at 695; *In re Beaubouef,* 966 F.2d at 178.

***3** Based on the series of omissions in Chu's Schedules and SOFA, the bankruptcy court found that Chu acted with at least reckless indifference to the truth in violation of § 727(a)(4). Chu argues that the bankruptcy court aggregated his mistakes to reach a finding of at least reckless indifference to the truth if not fraudulent intent. We note that the evidence in the record, including the Rule 2004 examination findings and the trial testimony, supports the bankruptcy court's findings; we therefore disagree with Chu's argument.

The bankruptcy court also found that Chu "failed to explain satisfactorily ... any loss or deficiency of assets to meet [his] liabilities." 11 U.S.C. § 727(a) (5). The plaintiff in a discharge adversary proceeding carries the initial burden to show that the debtor possessed "substantial, identifiable assets" that are now "unavailable for distribution to creditors." *In re Chu*, No. 12–37962–HDH–7, at *7 (citing *In re Henley*, 480 B.R. 708, 787 (Bankr. S.D. Tex. 2012); *In re Hermanson*, 273 B.R. 538, 545 (Bankr. N.D. Ill. 2002)). Once the unavailable assets are established, the burden shifts to the debtor to show a "satisfactory" explanation. *Id.* (citing *In re Reed*, 700 F.2d 986, 992–93 (5th Cir. 1983)).

[3] Chu argues on appeal that the State failed to satisfy its burden of proof to show that he possessed "substantial, identifiable assets" that are now "unavailable for distribution to creditors." Before the district court, however, Chu argued that his explanation was "satisfactory." In doing so, he implicitly assumed that the State had met its burden of proof. Thus, Chu has waived any argument on appeal that the State did not meet its burden of proof under the Section 727(a)(5) analysis.

[4] In any event, we agree with the bankruptcy court's conclusion with respect to § 727(a)(5). In its analysis under § 727(a)(5), the bankruptcy court considered the State's allegations that Chu failed to explain the following:

> [T]he loss or transfer of an Omega watch, another watch or watches, and/or antique jewelry and gold that he valued at $34,500 on a personal financial statement in September 2009, as well as certain personal effects valued at $41,000 on a personal financial statement in September 2009.

Id. The court further noted that in his amended Schedules, Chu disclosed $11,000 worth of household items, books and pictures worth $1,000, and a ring worth $500. Expressing that it was "troubled" by Chu's "inability at trial to offer any viable explanation as to what happened to the previously delineated assets," the bankruptcy court concluded that Chu failed to fulfill his burden to show a satisfactory explanation in order to halt a denial of discharge under Section 727(a)(5).

The Section 727(a)(5) violation, coupled with the bankruptcy court's determination that Chu violated Section 727(a)(4), convinced the bankruptcy court to deny Chu's discharge and further convinced the district court to affirm the findings of the bankruptcy court. After reviewing the briefs and record, and after hearing the oral arguments of the parties, we find no reversible error on the part of the district court.

IV.

In sum, we find that the district court has made no reversible error and AFFIRM.

All Citations

--- Fed.Appx. ----, 2017 WL 543227

Footnotes

* Pursuant to 5th Cir. R. 47.5, the court has determined that this opinion should not be published and is not precedent except under the limited circumstances set forth in 5th Cir. R. 47.5.4.

1 Specifically, the bankruptcy court found that:

1. Chu admitted to leaving his brother, Wilson Chu, off his schedules as a creditor, and failed to disclose prepetitionloans made by Wilson Chu to him.
2. Chu failed to disclose on his SOFA over $317,144 earned in 2010 as income.
3. Chu did not disclose that U.S. Bank foreclosed on a piece of valuable machinery used in his dental practice withina year of the bankruptcy filing.
4. Chu did not disclose that he cashed in life insurance policies worth approximately $190,000 in either 2011 or 2012.
5. Chu did not disclose the true value of whole life insurance policies worth between approximately $51,000 and$62,000, rather claiming them to have no cash value.
6. Chu did not disclose that he sold a $20,000 Cartier watch to a third-party buyer.
7. Chu did not disclose in his original filings that he sold his Mercedes for $46,000 in November of 2011.
8. Chu did not disclose that he sold a Toyota Sequoia for $17,000 in November 2011.
9. Chu has failed to explain a $33,500 discrepancy between his September 30, 2009 personal financial statementwhich lists “Antique, Gold & Jewelry” in an amount of $35,000 and his Schedule B listing for the same category in an amount of $1,500.
10. Chu failed to list his accountant, Ted Hong, and bookkeeper, Anna Chu, on his SOFA.
11. Chu did not disclose numerous loans he took out against his New York Life insurance policy between Novemberof 2011 and December of 2012, totaling more than $90,000.

Chu v. State of Texas, No. 3:14–CV–03584–P, at *6 (N.D. Tex. Sept. 8, 2015) (quoting *In re Chu*, No. 12-37962–HDH–7, at *5).

2 Title I, Section 371.1617(b), of the Texas Administrative Code provides that administrative sanctions involving “recoupment, assessment of damages, penalties, recoupment of audit overpayments, or other financial recovery” in the event of a Medicaid overpayment effectively create a “final debt in favor of the State.” TEX. ADMIN. CODE ANN . § 371.1617(b) (West 2016). It is therefore possible for a debt in favor of the State under Texas administrative law to fall outside the exception in 11 U.S.C. § 523(a)(7).

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848 F.3d 655
United States Court of Appeals, Fifth Circuit.

In the MATTER OF: Jeremy WIGGAINS, Debtor
Tanya Wiggains, Appellant
v.
Diane G. Reed, Appellee

No. 15-11249
|
FILED February 14, 2017

Synopsis

Background: Chapter 7 trustee brought adversary proceeding to avoid, as fraudulent transfer, debtor's prepetition partition of residence that he owned as community property with his nondebtor-wife. The United States Bankruptcy Court for the Northern District of Texas, Stacey G.C. Jernigan, J., 2015 WL 1954438, entered judgment in favor of trustee. Following sale of this property, wife moved for award of portion of sales proceeds based on her Texas homestead interest in property. The Bankruptcy Court, Jernigan, J., 535 B.R. 700, determined that wife was limited to what she would receive by virtue of debtor-husband's capped homestead exemption in property. Appeal was taken from both decisions directly to the Court of Appeals.

Holdings: The Court of Appeals, Leslie H. Southwick, Circuit Judge, held that:

[1] bankruptcy court did not clearly err, in proceedingto avoid Chapter 7 debtor's prepetition partition of community property as fraudulent transfer, in finding that debtor-husband had acted with intent to hinder or delay his creditors;

[2] section of Bankruptcy Code governing circumstancesunder which trustee may sell both estate's interest and interest of any co-owner in property in which debtor had interest prepetition did not apply to residence which was in nature of community property prior to being partitioned, and which was brought into bankruptcy estate in its entirety upon avoidance of partition transaction as fraudulent transfer; and

[3] there was nothing special or unique about nondebtor-spouse's homestead interest in residential property acquired by debtor-husband a mere nine months in advance of bankruptcy that would make it confiscatory, in violation of the Takings Clause, to prevent nondebtorspouse from receiving out of proceeds from sale of this property any more than she would receive by virtue of capped homestead exemption.

Affirmed.

West Headnotes (23)

[1] **Bankruptcy**
Conclusions of law; d e novo review
Bankruptcy
Clear error

On direct appeal from judgment of bankruptcy court, the Court of Appeals would review fact findings for clear error and bankruptcy court's conclusions of law de novo. Fed. R. Bankr. P. 8013.

Cases that cite this headnote

[2] **Bankruptcy**
Clear error

Finding of fact is "clearly erroneous" only if, on entire evidence, appellate court is left with definite and firm conviction that mistake has been committed. Fed. R. Bankr. P. 8013.

Cases that cite this headnote

[3] **Federal Courts**
Conflicting or undisputed evidence

"Clear error" review is especially rigorous when the Court of Appeals reviews lower court's assessment of trial testimony, because trier of fact has seen and judged the witnesses.

Cases that cite this headnote

[4] **Federal Courts**
Conflicting or undisputed evidence

When there are two permissible views of the evidence, fact-finder's choice between them cannot be "clearly erroneous."

Cases that cite this headnote

[5] **Statutes**

Statute as a Whole; R elation of Parts to Whole and to One Another

In interpreting statute, court starts with the language of statute, reading it as a whole and being mindful of linguistic choices made by Congress.

Cases that cite this headnote

[6] **Statutes**

Plain language; p lain, ordinary, common, or literal meaning

When statute's language is plain and unambiguous, it must be given effect.

Cases that cite this headnote

[7] **Bankruptcy**

Intent of debtor

Transfer is avoidable as actually fraudulent to creditors if it was made with intent to defraud creditors, but also if it was made with intent to hinder or to delay creditors; Congress' use of disjunctive word "or" indicates that any one of these three states of mind will suffice. 11 U.S.C.A. § 548(a)(1)(A).

Cases that cite this headnote

[8] **Bankruptcy**

Fraudulent transfers

Bankruptcy court did not clearly err, in proceeding to avoid Chapter 7 debtor's prepetition partition of community property as fraudulent transfer, in finding that debtor-husband had acted with intent to hinder or delay his creditors in partitioning community property only one hour prior to commencement of his bankruptcy case; timing of execution of partition agreement and debtor's forthright admission that this transaction was intended to safeguard as much property as possible for benefit of his nondebtor-spouse by preventing it from entering bankruptcy estate supported bankruptcy court's finding as to debtor's intent. 11 U.S.C.A. § 548(a)(1)(A).

Cases that cite this headnote

[9] **Bankruptcy**

Fraudulent transfers

In fraudulent transfer avoidance proceeding, because transferor's actual intent is rarely susceptible to direct proof, courts look to circumstances of the transfer to infer intent. 11 U.S.C.A. § 548(a)(1)(A).

Cases that cite this headnote

[10] **Bankruptcy**

Fraudulent transfers

When debtor admits that he acted with requisite intent to hinder, delay or defraud creditors in making challenged transfer, there is no need for court to rely on circumstantial evidence or inferences in determining whether debtor had that intent, and whether transfer is avoidable as actually fraudulent transfer. 11

U.S.C.A. § 548(a)(1)(A).

Cases that cite this headnote

[11] **Bankruptcy**

Particular cases and issues

Deference to bankruptcy court's fact finding is particularly appropriate on issues of intent, which often depend on assessing a witness' credibility. Fed. R. Bankr. P. 8013.

Cases that cite this headnote

[12] **Homestead**

Nature of estate or right

"Homestead," in both the popular and legal sense, means the homeplace or family home, and also property which is protected because it is family home.

Cases that cite this headnote

[13] **Homestead**

Family relation in general

Homestead

Exceptions from exemptions in general

Texas constitution grants to a spouse a legal interest in homestead that will stand firm against all claims except for three types of constitutionally permitted liens against homesteads, namely, those that secure purchase money debts, tax debts, or debts for home improvements. Tex. Const. art. 16, § 50.

Cases that cite this headnote

[14] **Homestead**

Exceptions from exemptions in general

Texas homestead laws are almost absolute in their protections against forced sale. Tex. Const. art. 16, § 50; Tex. Prop. Code Ann. § 41.001(a).

Cases that cite this headnote

[15] **Homestead**

Nature and extent of right created

Homestead

Family relation in general

Despite its vigor and breadth, protection that Texas homestead laws provide to spouses is not in nature of economic interest; homestead interest gives protective legal security rather than vested economic rights. Tex. Const. art. 16, § 50; Tex. Prop. Code Ann. § 41.001.

Cases that cite this headnote

[16] **Homestead**

Nature and extent of right created

Homestead

Family relation in general

Under Texas law, a spouse has only a possessory interest in real property by virtue of its homestead character. Tex. Const. art. 16, § 50; Tex. Prop. Code Ann. § 41.001.

Cases that cite this headnote

[17] **Homestead**

Proceeds of Homestead

Homestead

Loss or relinquishment of right in general

Under Texas law, just as former homestead loses its homestead character when its owner abandons it, so the proceeds from sale of that former homestead lose their homestead character and become proceeds of former homestead. Tex. Prop. Code Ann. § 41.001.

Cases that cite this headnote

[18] **Bankruptcy**

Encumbered property; l imited or joint interests

Descent and Distribution

Contingent or Inchoate Rights

Dower or curtesy rights, within meaning of bankruptcy statute authorizing trustee to sell estate property free and clear of any vested or contingent rights in nature of dower or curtesy, are inchoate rights that do not vest until a spouse's death. 11 U.S.C.A. § 363(g).

Cases that cite this headnote

[19] **Descent and Distribution**

Dower and Curtesy

“Dower” refers to the interest that widow takes in estate of her deceased husband, while “curtesy” is the corresponding right of husband.

Cases that cite this headnote

[20] **Bankruptcy**

Encumbered property; l imited or joint interests

Section of Bankruptcy Code governing circumstances under which trustee may sell both estate's interest and interest of any coowner in property in which debtor had interest prepetition did not apply to residence which was in nature of community property prior to being partitioned one hour in advance of debtor's Chapter 7 filing, and which was brought into bankruptcy estate in its entirety upon avoidance of partition transaction as fraudulent transfer; statute did not require that debtor's nondebtor-spouse receive any share of proceeds from sale of residence beyond what she would receive as result of capped homestead exemption that had been claimed by debtor. 11 U.S.C.A. §§ 363(h, j), 522(p), 548(a)(1)(A).

Cases that cite this headnote

[21] **Bankruptcy**

Encumbered property; l imited or joint interests

Eminent Domain

Contracts in general; c reditors' rights

There was nothing special or unique about nondebtor-spouse's homestead interest in residential property acquired by debtorhusband a mere nine months in advance of his Chapter 7 filing that would make it either onerous or confiscatory, in violation of the Takings Clause, to prevent nondebtor-spouse from receiving out of proceeds from sale of this property any more than she would receive by virtue of capped homestead exemption claimed by debtor. U.S. Const. Amend. 5; 11 U.S.C.A. § 522(p).

Cases that cite this headnote

[22] **Bankruptcy**

Effect of State Law

To extent that there was any conflict between the Bankruptcy Code's cap on state law homestead available to debtor in recently acquired residential property, which applied to limit what nondebtor-wife would receive upon sale of this property, and Texas homestead interest granted to wife, bankruptcy law controlled. U.S. Const. art. 6, cl. 2; 11 U.S.C.A. § 522(p); Tex. Const. art. 16, § 50; Tex. Prop. Code Ann. § 41.001.

Cases that cite this headnote

[23] **Bankruptcy**

Effect of state law in general

Once state law property interests are defined, federal law controls the consequences in bankruptcy.

Cases that cite this headnote

***658** Appeal from the United States Bankruptcy Court for the Northern District of Texas, Stacey G.C. Jernigan, U.S. Bankruptcy Judge

Attorneys and Law Firms

Gerrit M. Pronske, Esq., Melanie Pearce Goolsby, Pronske Goolsby & Kathman, P.C., Dallas, TX, for Appellant.

David W. Elmquist, Esq., Reed & Elmquist, P.C., Waxahachie, TX, for Appellee.

Before JOLLY, BARKSDALE, and SOUTHWICK, Circuit Judges.

Opinion

LESLIE H. SOUTHWICK, Circuit Judge:

The bankruptcy court held that an agreement between the debtor and his spouse that partitioned their homestead property was a fraudulent transfer. Consequently, the non-debtor spouse had no interest in the proceeds from the sale of the homestead. This court granted the parties' joint request to permit an appeal directly to this court. We AFFIRM.

FACTUAL AND PROCEDURAL BACKGROUND

Jeremy Wiggains and his wife Tanya, married since 2007, purchased an expensive home in an exclusive Dallas suburb in late 2012. During their brief residency, the couple made valuable improvements as part of their investment strategy to increase profits from a future sale of the home.

In the summer of 2013, the Wigginses began marketing their home. In August 2013, they signed a sales contract for $3.4 million. A few days before they received the purchase offer, two significant events occurred. First, the Wiggainses, upon the advice of counsel, executed and filed a "Partition Agreement," which sought to recharacterize their home from community property to separate property, one half belonging to each spouse. The Partition Agreement further provided that each spouse would have "sole and exclusive authority, management, and control of their separate property...."

Second, Mr. Wiggains filed for bankruptcy under Chapter 7 of the Bankruptcy Code one hour after recording the Partition Agreement. He claimed an exemption for his separate interest in the home under Texas law, which is subject to the $155,675 homestead exemption cap of Section 522(p) of the Bankruptcy Code, enacted in 2005 as part of the Bankruptcy Abuse Prevention and Consumer Protection Act ("BAPCPA") to address the socalled "mansion loophole." After various objections by the Trustee and certain creditors, Mr. Wiggains agreed to limit his homestead exemption to $130,675. Mrs. Wiggains did not separately file for bankruptcy.

The family resided at the home until it was sold by the Chapter 7 Trustee for $3.4 million, netting $568,668.41 in cash proceeds after payment of all liens, claims, ***659** and encumbrances. The net from the sale was further decreased by the disbursement of $130,675 to Mr. Wiggains pursuant to his homestead exemption.[1]

On May 5, 2014, Mrs. Wiggains initiated an adversary proceeding seeking a declaratory judgment recognizing that the Partition Agreement gave her a one-half separate property interest in the net proceeds from the sale. The Trustee counterclaimed to avoid the Partition Agreement and for a declaration that the remaining proceeds from the sale were property of the estate. The bankruptcy court held a one-day trial on these issues on October 21, 2014.

At trial, Mr. Wiggains testified that he entered into the Partition Agreement, upon the advice of counsel, with the purpose of excluding his wife's community-property interest in the homestead from his bankruptcy estate. He understood his bankruptcy exemption was statutorily capped at $155,675, an amount which he correctly believed the net sale proceeds would exceed. Although the couple discussed the possibility that both would declare bankruptcy so that they could receive the double homestead exemption of $311,350, Mr. Wiggains testified that he thought entering into the Partition Agreement was the right thing to do as he did not believe his wife was obligated on his business debts. Whether she would have been liable is not an issue raised here.

In its April 2015 decision, the bankruptcy court held that Mr. Wiggains's "sole actual intent in entering the Partition Agreement was to avoid the effect of the limitation placed on his homestead exemption by section 522(p) of the Bankruptcy Code," and the court equated such intent with "gamesmanship for the purpose of placing reachable assets outside of creditors' reach." The bankruptcy court also stated that Mr. Wiggains's "articulated intent to preserve for his family as much money as possible is the same as an intent to shield as much money as possible from creditors...."

The bankruptcy court declared the Partition Agreement avoidable as a fraudulent transfer, leaving the amount of the net sale proceeds in excess of Mr. Wiggains's exemption to be nonexempt property of the estate. The bankruptcy court also determined that Mrs. Wiggains had "no right or interest in the Homestead Net Sale Proceeds by virtue of the Partition Agreement." A principal factor in these conclusions was that the couple executed the Partition Agreement "in the shadow of an imminent bankruptcy filing" for no other reason than to shield a portion of Mr. Wiggains's assets from his creditors, which the bankruptcy court determined "can only be reasonably interpreted as an act done with intent to hinder and/or delay creditors."

In its initial decision, the bankruptcy court did not decide whether Mrs. Wiggains might be entitled to some distribution from the net sale proceeds under Section 363(j) of the Bankruptcy Code on account of her separate homestead interest, notwithstanding the avoidance of the Partition Agreement. Notably, Section 363(j) requires the Trustee, after a sale of certain types of property, to apportion and distribute sale proceeds to a debtor's spouse or co-owner. 11 U.S.C. § 363(j). On ***660** April 20, 2015, Mrs. Wiggains filed a motion in the underlying bankruptcy case to have compensation paid to her from the net sale proceeds for her separate homestead interest.

On July 1, 2015, which was after amending its initial opinion to make it an interlocutory order and also to consolidate the contested matter into the adversary proceeding, the bankruptcy court held an evidentiary hearing on Mrs. Wiggains's homestead compensation request. Mrs. Wiggains was the only witness during this second hearing. She testified that her family was renting a 6,000–square–foot house (at a cost of $5,000 per month) because they did not have funds to purchase a new homestead; that her husband was employed by a local automobile dealership; and that the family had exhausted all funds derived from the $130,675 homestead exemption. Based on an expert report, which the bankruptcy court found irrelevant, Mrs. Wiggains argued she was entitled to as much as 95% of the balance of the net sale proceeds.

The bankruptcy court concluded that Mrs. Wiggains failed to carry her burden to show entitlement to any compensation from the sale of the homestead under Section 363(j) or any other provision of the Bankruptcy Code. The bankruptcy court noted that the proffered evidence was "not particularly compelling," and did not show that the "Homestead had anything more than general intrinsic value to her." On September 4, 2015, the bankruptcy court entered its final judgment avoiding the Partition Agreement, a declaratory judgment that the Trustee was entitled to the balance of the net sale proceeds, and its judgment that Mrs. Wiggains was not entitled to a distribution from the net sale proceeds pursuant to Section 363(j).

After filing a timely notice of appeal to the district court on September 22, 2015, Mrs. Wiggains filed with this court a request, which was joined by the Trustee, to allow a direct appeal here under 28 U.S.C. § 158(d). We granted the request on December 16, 2015.

DISCUSSION

trier of fact has seen and judged the witnesses." *Moore v. CITGO Ref. & Chems. Co.,* 735 F.3d 309, 315 (5th Cir. 2013) (quotation marks omitted). "Where there are two permissible views of the evidence, the factfinder's choice between them cannot be clearly erroneous." *First Nat'l Bank LaGrange v. Martin (In re Martin),* 963 F.2d 809, 814 (5th Cir. 1992) (quotation marks omitted).

Mr. Wiggains acted with actual intent to hinder or delay his creditors by executing the Partition Agreement. Specifically, she challenges the bankruptcy court's factual finding by arguing the court (1) failed to engage in a contextual analysis to determine her husband's intent in executing the Partition Agreement, and (2) erroneously discounted her husband's legitimate intent to preserve her homestead interest.

[5] [6] *661 We start with the language of the statute, "reading it as a whole and mindful of the linguistic choices made by Congress." *Whatley v. Resolution Trust Corp.,* 32 F.3d 905, 909 (5th Cir. 1994). Where a statute's language is "plain and unambiguous, it must be given effect." *BMC Software, Inc. v. C.I.R.,* 780 F.3d 669, 674 (5th Cir. 2015) (quotation marks omitted). By statute, a bankruptcy trustee may avoid any pre-petition transfer of assets by a debtor "that was made or incurred on or within 2 years before the date of the filing of the petition" if the debtor made the transfer "with actual intent to hinder, delay, or defraud" any past or future creditor. 11 U.S.C. § 548(a)(1)(A).

[7] The phrase "intent to hinder, delay, or defraud" is not defined in the Bankruptcy Code. We find relevant meaning in the fact that the phrase is stated in the disjunctive, which signifies that an intent to hinder or

[1] [2] [3] [4] We review the fact findings in an orderto delay or to defraud is sufficient. *See* 5 COLLIER [2]

I. The Avoidance of the Partition Agreement Mrs. Wiggains contends the bankruptcy court clearly erred when it found from a bankruptcy court for clear error and its conclusions of law *de novo*. *Total Minatome Corp. v. Jack/Wade Drilling, Inc. (In re Jack/Wade Drilling, Inc.),* 258 F.3d 385, 387 (5th Cir. 2001). "A finding of fact is clearly erroneous only if on the entire evidence, the court is left with the definite and firm conviction that a mistake has been committed." *Robertson v. Dennis (In re Dennis),* 330 F.3d 696, 701 (5th Cir. 2003) (quotation marks omitted). "Clear error review is especially rigorous when we review a lower court's assessment of trial testimony, because the ON BANKRUPTCY ¶ 548.04[1][a] (Alan N. Resnick & Henry J. Sommer, eds., 16th ed. 2016). Ours is not a novel interpretation. The Supreme Court repudiated common misconceptions that surround a debtor's prebankruptcy activities by declaring that "[a] conveyance is illegal if made with an intent to defraud the creditors of the grantor, but equally it is illegal if made with an intent to hinder and delay them." *Shapiro v. Wilgus,* 287 U.S. 348, 354, 53 S.Ct. 142, 77 L.Ed. 355 (1932). Other courts examining a debtor's intent when deciding whether to deny discharge under Section

727(a)(2)(A) also construe "hinder, delay, or defraud" as being three separate states of mind. *See Retz v. Samson (In re Retz),* 606 F.3d 1189, 1200 (9th Cir. 2010) (finding it "sufficient if the debtor's intent is to hinder or delay a creditor"); *Smiley v. First Nat'l Bank of Belleville (In re Smiley),* 864 F.2d 562, 568 (7th Cir. 1989) (denying discharge where it "[wa]s clear that [the debtor] intended to hinder or delay his creditors, even if he had no intent to defraud them").

[8] [9] The Trustee stipulated there was no intent to defraud, so our focus turns to whether the Bankruptcy Court clearly erred in its assessment that Mr. Wiggains had actual intent to hinder or delay his creditors. We start from the reality that a transferor's actual intent is rarely susceptible to direct proof. *See In re Dennis,* 330 F.3d at 701. Given these evidentiary difficulties, courts have looked to the circumstances of the transfer to infer intent. *See id.* at 701–02. When fraud is suggested, this court has recognized six "badges of fraud" to help identify that intent—factors such as inadequate consideration, close relationship between grantor and grantee, or financial condition of the debtor before and after the transfer. *See Soza v. Hill (In re Soza),* 542 F.3d 1060, 1067 (5th Cir. 2008). Though some of those factors are also useful in determining the intents to hinder or delay, the bankruptcy court did not try, nor found it necessary, to fit its analysis within the category of fraudulent badges. Neither will we. Without a list of factors, we seek to determine whether there is sufficient evidence of improper intent.

***662** Mrs. Wiggains directs us to three bankruptcy court opinions that examined the context of a transfer to determine intent. The first two present scenarios in which the bankruptcy courts denied a debtor's discharge based on a finding that the debtor acted with actual intent to hinder or delay his creditors. *Brooke Credit Corp. v. Lobell (In re Lobell),* 390 B.R. 206, 219–20 (Bankr. M.D. La. 2008); *Bank of Oklahoma, N.A. v. Boudrot (In re Boudrot),* 287 B.R. 582, 587–88 (Bankr. W.D. Okla. 2002). Having no direct testimony of their respective debtor's intent to hinder or delay, the bankruptcy courts undertook a contextual analysis to reach these conclusions. *See In re Lobell,* 390 B.R. at 219 (concluding that the debtor acted with intent to hinder her creditor based on "evidence of several badges of fraud"); *In re Boudrot,* 287 B.R. at 587 (finding "substantial evidence that [the debtors] were motivated by a desire to hinder, delay or defraud" their creditors).

The third case on which Mrs. Wiggains relies more closely aligns with the facts in this case, namely, a situation in which a debtor's intent is rather clear. There, the bankruptcy court found the debtor transferred his property with the intent to hinder, delay, or defraud his creditors. *See Albuquerque Nat'l Bank v. Zouhar (In re Zouhar),* 10 B.R. 154, 158 (Bankr. D.N.M. 1981) (transfer under a previous, but not substantively different, version of the Bankruptcy Act). Unlike the debtors in *Lobell* and *Boudrot*, the debtor in *Zouhar* "candidly admitted the purpose of" his transfer was "to shield the [ ] assets from his creditors." *Id.* at 156. He also "forthrightly admitted that he ... merely utilized this method as a device to shield his assets from his creditors." *Id.* at 157. The bankruptcy court found that the debtor's "candid admission" was "supported by the sequence of events," including the debtor's purchase of a home approximately two months before filing for bankruptcy. *Id.*

[10] In summary, in the first two cases the bankruptcy courts analyzed the circumstances surrounding the allegedly fraudulent transfers because of ambiguity about intent. In the third case, *Zouhar*, as well as here, there was direct evidence of a debtor's actual intent to hinder or delay. "Actual intent ... may be inferred from the actions of the debtor and may be shown by circumstantial evidence." *In re Dennis,* 330 F.3d at 701–02 (alteration omitted) (quoting *Pavy v. Chastant (In re Chastant),* 873 F.2d 89, 91 (5th Cir. 1989)). We agree with another court that held: "When a debtor admits that he acted with the [necessary] intent ... there is no need for the court to rely on circumstantial evidence or inferences in determining whether the debtor had" that intent. *See First Beverly Bank v. Adeeb (In re Adeeb),* 787 F.2d 1339, 1343 (9th Cir. 1986).

Mrs. Wiggains argues that the bankruptcy court read an illegitimate motivation in her husband's express testimony and erroneously found that his intent was to shield assets from his creditors. In support of this argument, she refers to her husband's response to the question of whether the Partition Agreement was intended to keep their homestead out of the bankruptcy estate: "I guess that's semantics. At the time we felt like it wasn't necessarily keeping anything out. At the time we honestly felt like it was more preserving [Mrs. Wiggains's] own rights."

We agree with Mr. Wiggains's characterization; semantics and labeling are indeed involved. Keeping property in the hands of his wife is the mirror of keeping property out of the hands of creditors. It is true, as Mrs. Wiggains argues, that the property was divided to allow her to get value from the homestead. That benign purpose, though, was being pursued at the ***663** moment before Mr. Wiggains's filing of a bankruptcy petition that would have caused the entire property to go into the bankruptcy estate for the benefit of creditors, leaving no portion, beyond Mr. Wiggains's reduced homestead exemption, to endure for the couple's benefit. If not for the creditors who could make claims on the net proceeds, there was no stated need for the partition.

We have previously recognized "the line between legitimate pre-bankruptcy planning and [impermissible intent] ... is not clear." *Swift v. Bank of San Antonio (In re Swift),* 3 F.3d 929, 931 (5th Cir. 1993). Courts' efforts to label their analytical approach for determining whether otherwise lawful pre-bankruptcy planning exceeds the bounds of propriety provide us a colorful cast of characterizations. *See Wolkowitz v. Beverly (In re Beverly),* 374 B.R. 221, 245 (9th Cir.BAP 2007) ("In classical terms, it is the Sword of Damocles."); *Morgan Fiduciary, Ltd. v. Citizens & S. Int'l Bank,* 95 B.R. 232, 234 (S.D. Fla. 1988) (smell test); *Zouhar,* 10 B.R. at 157 (slaughtered-hog test). We have no metaphors to contribute, so we press on.

Mr. Wiggains's testimony alone reflects his clear intent to hinder the creditors, though couched in terms of allowing his wife to receive value from the home. The bankruptcy court in essence held that the necessary effect of this transfer was to deprive creditors. The bankruptcy court considered the evidence and made the finding that the intent to enter into the Partition Agreement in order to preserve value from a home for the non-debtor spouse was not legally independent from the intent to hinder and delay Mr. Wiggains's creditors in bankruptcy. The bankruptcy court based its findings of fact largely upon Mr. Wiggains's own testimony evincing the couple's strategic decision to place a portion of his assets beyond the reach of creditors.

Generally, "a court can hardly expect one who fraudulently transfers property to step up and admit it under oath." 5 COLLIER ON BANKRUPTCY ¶ 548.04[1][b]. Here, the timing of the transfer, coupled with the fact the partition was one of several options admittedly considered to allow as much value as possible to be retained outside of the bankruptcy estate, are relevant extrinsic evidence of improper intent even without any admissions. From the standpoint of the creditors, which is the proper perspective, the Partition Agreement sought to reduce drastically the amount available to creditors. *See Hinsley v. Boudloche (In re Hinsley),* 201 F.3d 638, 644 (5th Cir. 2000).

[11] Deference to the bankruptcy court's findings is particularly appropriate on the issue of intent. Such a determination often depends on assessing a debtor's credibility. *See Perry v. Dearing (In re Perry),* 345 F.3d 303, 309 (5th Cir. 2003). "We will not attempt to reassess the credibility of witnesses whom we have not had an opportunity to see on the stand." *Texas Mortg. Servs. Corp. v. Guadulupe Sav. & Loan Assoc. (In re Texas Mortg. Servs. Corp.),* 761 F.2d 1068, 1078 (5th Cir. 1985). "Moreover, when the bankruptcy court's weighing of the evidence is plausible in light of the record taken as a whole, a finding of clear error is precluded, even if we would have weighed the evidence differently." *Bradley v. Ingalls (In re Bradley),* 501 F.3d 421, 434 (5th Cir. 2007). We find no clear error in the bankruptcy court's assessment of this debtor's intent, that by placing a portion of the homestead beyond the reach of his creditors on the eve of bankruptcy, he was seeking to hinder or delay.

***664** *II. Homestead Interest under Section 363(j) of the Bankruptcy Code*

Mrs. Wiggains argues that by denying her distribution of $448,491.71 from the net sale proceeds, the bankruptcy court misapplied our caselaw that protects a non-debtor spouse's separate homestead interest. She also contends that Section 363(j) of the Bankruptcy Code is available as a mechanism for distribution of proceeds to her as a nondebtor spouse.

[12] **[13]** **[14]** " 'Homestead,' in both the popular and legal sense, means the 'homeplace' or family home, and also property which is protected because it is the family home." *Estate of Johnson v. C.I.R.,* 718 F.2d 1303, 1307 n.12 (5th Cir. 1983). Protection for homesteads in Texas is extensive.[3] *See* TEX. CONST. art. XVI, § 50. "From the beginning of Texas' statehood in 1845, its constitutions have provided homestead protection to its residents." *England v. FDIC (In re England),* 975 F.2d 1168, 1172 (5th Cir. 1992). The Texas constitution grants to a spouse a legal interest in the homestead that will stand firm against all claims except for "the three types of constitutionally permitted liens against homesteads," namely, those that secure purchase money, for taxes, or for home improvement debts. *Heggen v. Pemelton,* 836 S.W.2d 145, 148 (Tex. 1992).

The constitutional protection is codified in the Texas Property Code: "A homestead ... [is] exempt from seizure for the claims of creditors," subject to certain exceptions not relevant here. TEX. PROP. CODE § 41.001(a). Several other Texas statutes protect spouses across a range of circumstances involving the abandonment, sale, and conveyance of a homestead. *See Kim v. Dome Entm't Ctr., Inc. (In re Kim),* 748 F.3d 647, 653 n.11 (5th Cir. 2014).

[15] **[16]** **[17]** Despite its vigor and breadth, the protection does not grant a spouse an *economic* interest. "The homestead interest ... gives protective legal security rather than vested economic rights." *Heggen,* 836 S.W.2d at 148 (quoted in *Kim,* 748 F.3d at 661). A "spouse has only a possessory interest in the real property by virtue of its homestead character." *Kim,* 748 F.3d at 661. "Texas law has consistently distinguished *homestead* from *former homestead* and has done so for well over a century." *England,* 975 F.2d at 1173 (emphasis in original). Going one step further, we recognized that "[j]ust as the former homestead loses its homestead character when its owner abandons it, so the proceeds of the sale of that former homestead lose their homestead character and become proceeds of *former* homestead." *Id.* (emphasis in original).

With this background, we turn to the final issue: even after we accept that her husband had the intent to hinder and delay his creditors, must we recognize that Mrs. Wiggains has her own interest for which compensation is due beyond what was paid to her husband?

Much of the analytical work has already been done for us in two of our relatively recent opinions. The earlier of the two involved a non-debtor spouse who sought compensation for her separate interest in a homestead she shared with her husband. *See Kim,* 748 F.3d at 650. The couple had acquired the residence prior to BAPCPA's passage, unlike in the present case when the purchase occurred well after BAPCPA ***665** was on the scene. *See id.* at 657. We first addressed Mrs. Kim's argument that the bankruptcy court lacked the authority to order a forced sale of the property. *Id.* at 653. We held this argument foreclosed by the clear statutory language of Section 363 and Supreme Court precedent. *Id.* at 654–55.

Next we focused on whether Mrs. Kim would be entitled to compensation for her homestead interest beyond the amount her husband elected as a statutory exemption under Section 522(p). *Id.* at 656. This is in essence our question too. In seeking compensation, Mrs. Kim relied upon a hypothetical scenario in which the Supreme Court assumed, "only for the sake of illustration, that a homestead estate is the exact economic equivalent of a life estate...." *See United States v. Rodgers,* 461 U.S. 677, 698, 103 S.Ct. 2132, 76 L.Ed.2d 236 (1983) (emphasis omitted). In *Kim*, though, we commented that "it is not entirely clear that Texas courts would place exactly the same economic value on homestead rights as it would on a life estate"; we were bold to say that the hypothetical "would seem to overvalue homestead rights...." *Kim,* 748 F.3d at 661–62.

Mrs. Kim maintained that a constitutional taking would occur if she were "not compensated for the loss of her homestead rights in" the marital property. *Id.* at 657. We acknowledged that such a "constitutional argument is likely limited to cases ... in which the real property that constituted the homestead was acquired before" BAPCPA's passage. *Id.* We never reached either the constitutional issue or whether Section 363(j) was a basis for compensation because of the limited briefing. *Id.* at 663.

The other relevant decision is *Thaw v. Moser (In re Thaw),* 769 F.3d 366 (5th Cir. 2014). There, we highlighted the "important limitation" our *Kim* holding placed on a Takings Clause argument in this context, namely, that the argument is "likely limited to cases ... in which the real property that constituted the homestead was acquired before the BAPCPA was enacted." *Id.* at 369 (quoting *Kim,* 748 F.3d at 657). The homestead property in *Thaw*— as here—was purchased after BAPCPA was adopted. *Id.* at 369–70. We held this timing to be "dispositive" (no longer using the qualifier "likely"), and Mrs. Thaw was foreclosed from "press[ing] a Takings Clause claim under *Rodgers* and *In re Kim*." *Id.* at 370.

Consequently, a Takings Clause argument relating to the Wiggains's homestead, acquired post-BAPCPA, must fail. Still, the bankruptcy court was correct in stating there may be an alternative "Takings Clause-type Constitutional argument, if the statute operates in such a way to confiscate a property interest." *Wiggains v. Reed (In re Wiggains),* 535 B.R. 700, 717 (Bankr. N.D. Tex. 2015). The bankruptcy court was relying on our *Thaw* discussion of the Supreme Court's *Rodgers* decision, which held that if a statute allowed for a "gratuitous confiscation" of property, due process concerns would arise. *Thaw,* 769 F.3d at 370 (discussing *Rodgers,* 461 U.S. at 697, 103 S.Ct. 2132).

There was no "gratuitous confiscation" in *Thaw* because the proceeds from a sale were to be apportioned between the creditors and the non-debtor spouse. *Id.* at 371 (citing 11 U.S.C. § 363(j)). An additional protection from confiscation, we held, is that Section 363(i) provides a non-debtor spouse a right of first refusal to purchase the homestead property. *Id.* (citing 11 U.S.C. § 363(i)). We determined these "safeguards" were sufficient to prevent a forced sale of the *Thaw* property from being a "gratuitous confiscation." *Id.*

Our analysis did not end there. Mrs. Thaw also argued that another Supreme ***666** Court decision, this one involving regulatory takings, required that she be compensated. *See Palazzolo v. Rhode Island,* 533 U.S. 606, 121 S.Ct. 2448, 150 L.Ed.2d 592 (2001). There the Court recognized "[t]he Takings Clause ... in certain circumstances allows a landowner to assert that a particular exercise of the State's regulatory power is so unreasonable or onerous as to compel compensation." *Id.* at 627, 121 S.Ct. 2448. The *Thaw* court determined that "*Palazzolo*'s narrow exception" did not apply to Mrs. Thaw's request for compensation as a non-debtor spouse for her separate homestead interest. *Thaw,* 769 F.3d at 371. "Just as the

Bankruptcy Code protects a non-debtor from gratuitous confiscation, it makes the sale of the property not so unreasonable or onerous as to compel compensation." *Id.* (quotation marks omitted).

One final argument we did not address in *Thaw* was how Section 363 would apply to apportion any proceeds. We refused because any ruling would be an advisory opinion. *Id.* at 372 n.3. Among the reasons it would have been advisory is that there were no proceeds to apportion, as the bankruptcy court held the debtor had forfeited his homestead exemption by acting with an "intent to hinder, delay, and defraud his creditors...." *Id.* at 368.

No such forfeiture occurred here, and there are proceeds from a sale of the homestead. We therefore examine Section 363(j) to determine whether it guides distribution of net proceeds from the sale of a homestead where a non-debtor spouse claims a separate homestead interest. Section 363(j) provides:

> After a sale of property to which subsection (g) or (h) of this section applies, the trustee shall distribute to the debtor's spouse or the co-owners of such property, as the case may be, and to the estate, the proceeds of such sale, less the costs and expenses, not including any compensation of the trustee, of such sale, according to the interests of such spouse or coowners, and of the estate.

11 U.S.C. § 363(j). We examine the two referenced subsections.

[18] [19] Subsection (g) applies to "any vested or contingent right in the nature of dower or curtesy."[4] 11 U.S.C. § 363(g). Dower or curtesy rights are inchoate rights that do not vest until a spouse's death. They have no relevance here.

The only other reference in Section 363(j) is to subsection (h). It applies to "the interest of any co-owner in property in which the debtor had, at the time of the commencement of the case, an undivided interest as a tenant in common, joint tenant, or tenant by the entirety...." 11 U.S.C. § 363(h). The bankruptcy court held that, under Section 541(a)(2), all interests of the debtor and his spouse in the community property became part of the estate. In that court's view, the residence was not property in which the debtor and a co-owner had an interest. Therefore, subsection (h) had no application.

In defending the ruling, the Trustee first properly denies that either *Kim* or *Thaw* ever held that Section 363(j) actually controls. The issue was not adequately raised in *Kim*, and we expressed no opinion. *Kim*, 748 F.3d at 663. It is true that in *Thaw*, we stated that Section 363 "is designed to minimize takings concerns," *Thaw*, 769 F.3d at 371, meaning that it provides for compensation at least some of the time when those concerns might otherwise arise. We also said that Section 363(j) ***667** would control the apportionment of proceeds from the sale of a Texas homestead between the estate and the non-debtor spouse. *Id.* In our conclusion, we held that Section 363 "governs the distribution, if any," to the non-debtor spouse. *Id.* at 372. Whatever all that meant, it is evident that in *Thaw* we never addressed the precise terms of Section 363(j) and applied them. Instead, we now interpret the discussion to be a placeholder, a recognition that Section 363(j) is where to look when considering issues such as those that are before us now.

[20] The Trustee argues that Section 363(j) is actually inapplicable because neither of its predicate subsections, (g) and (h), has any relevance to Texas homestead interests. We agree with the bankruptcy court and the Trustee that subsection (g), which covers dower and curtesy, does not apply. As to subsection (h), the Trustee argues it is inapplicable when the bankruptcy estate is one of the owners of the relevant property:

> Sections 363(f) and (h) only apply to sales of property of an entity *other than* the estate. Since the estate owns the interest of both the debtor *and* the non-debtor spouse, there *is no* other entity to be concerned with § 363(h). Therefore, that subsection simply does not apply with respect to the non-debtor spouse.
>
> The failure of § 363(h) to apply its four requirements to a non-debtor spouse's interest in community property is no legislative oversight. In § 363(i), Congress allowed a "first right of refusal" to co-owners when property is sold under § 363(h), and *also allowed* such a first right of refusal to the non-debtor spouse with respect to community property that is property of the estate. If Congress had intended for the four requirements of § 363(h) to apply to community

property, it could have included "the spouse's interest in community property" in § 363(h) as it did in § 363(i).

In re Hendrick, 45 B.R. 976, 987–88 (M.D. La. 1985) (emphasis in original).

Agreeing with *Hendrick* as to subsection (h), the Trustee also argues that *Hendrick* is correct about Section 363(i), which, as we earlier discussed, provides a non-debtor spouse a right of first refusal to purchase homestead property. The Trustee argues that subsection is the protection for a non-debtor spouse when dealing with a couple's homestead.

This court once stated its agreement with the *Hendrick* analysis, though in a nonprecedential opinion. *See Solomon v. Milbank (In re Solomon)*, 129 F.3d 608, 1997 WL 680934, at *3 (5th Cir. 1997) (unpublished). Though *Solomon* is not controlling, we can adopt its analysis on this point. We do. Despite Mrs. Wiggains's argument, *Solomon* is consistent with *Thaw* and *Kim* inasmuch as nothing in those two precedents require reading Section 363(j) to apply to a sale of a homestead held in Texas as community property. Section 363(j), of course, and its reference to subsection (h), apply nationwide. The difficulty of applying those parts of Section 363 to a Texas homestead in no way affects its general utility.

[21] Having eliminated these possibilities, the bankruptcy court then considered whether there was "something special and unique about a non-debtor spouse's homestead interest" to make limiting the award to the value of the debtor spouse's Section 552(p) cap (here, the $155,675, reduced to $130,675) either confiscatory or onerous. *In re Wiggains*, 535 B.R. at 720. The bankruptcy court said that "certain, special circumstances" may entitle a non-debtor spouse to "just compensation" from a forced sale of their homestead. *Id.*

***668** As previously stated, there is no doubt that a homestead interest "gives protective legal security rather than vested economic rights." *Kim*, 748 F.3d at 659 (quoting *Heggen*, 836 S.W.2d at 148). To explain the nature of this protection, we borrow from a common idiom of property law that describes property as a "bundle of sticks." Rather than being another stick in the bundle, a party's homestead interest "is a protective safe in which the bundle is put." *Venn v. Reinhard (In re Reinhard)*, 377 B.R. 315, 319 (Bankr. N.D. Fla. 2007). If the safe is empty, as is the case here and in other community-property states where the entire homestead property is brought in as a part of the bankruptcy estate, it can hardly be argued that an otherwise voluntary sale of a homestead entitles a nondebtor spouse to compensation for the contents of her empty safe.

We agree with the bankruptcy court that this case does not present the type of exceptional circumstance that may entitle a non-debtor spouse to compensation beyond the statutory cap of their spouse's homestead exemption. Well before Mr. Wiggains filed his bankruptcy petition, the couple actively sought to sell the home so they could reap the equity they gained in their brief nine months of ownership of the luxury investment property. The Wiggainses actively participated in the sales process, even when the Trustee had the sole authority to sell the homestead, and they did not object when the Sale Order was entered. There is nothing confiscatory about that process.

Palazzolo also cannot provide Mrs. Wiggains the relief she now seeks. She offers very little argument that the sale of her interest in the property is "so unreasonable or onerous as to compel compensation" under the Takings Clause. *See Palazzolo*, 533 U.S. at 627, 121 S.Ct. 2448. The short amount of time that Mrs. Wiggains and her family resided in their Texas homestead, an investment property, combined with the family's posh lifestyle and ongoing exorbitant living expenses, does not present the appropriate factual basis that would otherwise entitle her to compensation. In any event, we noted in *Thaw* that the foundation of this Takings Clause argument likely crumbles for a home purchased post-BAPCPA where the party seeking compensation "was on constructive notice of how the Bankruptcy Code would operate in the event of [the debtor's] bankruptcy." *Thaw*, 769 F.3d at 371–72. Such is the case here.

[22] **[23]** Our ruling in no way denigrates the importance of a Texas homestead interest. It is constitutionally protected; it provides "a secure asylum of which the family

Footnotes

cannot be deprived by creditors." *England*, 975 F.2d at 1174 (quoting *Herman Iken & Co. v. Olenick*, 42 Tex. 195, 198 (1874)). On the other hand, "the intent and purpose of the BAPCPA was to limit the dollar amount of homestead exemptions." *Kim*, 748 F.3d at 658. If there is a clash of policies here, the Supremacy Clause controls. *See Rodgers*, 461 U.S. at 701, 103 S.Ct. 2132. "Once statelaw property interests are defined, federal law controls the consequences.” *United States v. Elashi*, 789 F.3d 547, 552 (5th Cir. 2015).

When it became clear that Mr. Wiggains would file bankruptcy to satisfy his outstanding debts, the couple entertained various options and made their best estimate on ultimate financial benefits by having only Mr. Wiggains file after the Partition Agreement was recorded. Allowing Mrs. Wiggains to sidestep the statutory limits for homestead exemptions and obtain approximately $500,000 in proceeds that otherwise are for creditors would lay waste to ***669** the provisions of the Bankruptcy Code involved here.

AFFIRMED.

All Citations

848 F.3d 655

1 Mr. Wiggains initially filed a motion to sell the homestead but lacked authority to do so under Section 363(b) of the Bankruptcy Code. Subsequently, the Trustee brought an expedited motion to sell the property, to which Mr. Wiggains did not object. After a hearing held on September 6, 2013, the bankruptcy court authorized the sale under the terms of the purchase contract and free and clear of any liens and encumbrances pursuant to Section 363(f)(3).

2 Mrs. Wiggains asserted at oral argument that were we to read the phrase "intent to hinder, delay, or defraud" in the disjunctive, a circuit split with the Eighth Circuit would arise. The Eighth Circuit, though, merely noted it had "been reluctant to deny a homestead exemption without a finding of intent to defraud." *Addison v. Seaver (In re Addison)*, 540 F.3d 805, 812 (8th Cir. 2008) (citing *Sholdan v. Dietz*, 108 F.3d 886, 888 (8th Cir. 1997)). In *Sholdan*, the Eighth Circuit did not conclude that an intent to hinder or delay was inadequate to render a transfer fraudulent; instead, the panel determined the facts did not support such a finding. *Sholdan*, 108 F.3d at 888. Notably, the panel stated it did "not mean to say that the test of 'hinder or delay' might not prevail under another set of facts." *Id.*

3 "The Texas homestead laws are almost absolute in their protections against forced sale." *United States v. Rodgers*, 461 U.S. 677, 711, 103 S.Ct. 2132, 76 L.Ed.2d 236 (1983). "Texas cases have consistently held that the fundamental purpose of the Texas homestead laws is to secure a *place of residence* against financial disaster." *England v. FDIC (In re England)*, 975 F.2d 1168, 1174 (5th Cir. 1992).

4 Dower "refers to the interest a widow takes in the estate of her deceased husband." *Estate of Johnson*, 718 F.2d at 1305 n.9. "Curtesy is the corresponding right of the husband...." *Id.*

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2017 WL 695103
Only the Westlaw citation is currently available.
This case was not selected for publication in West's Federal Reporter.
See Fed. Rule of Appellate Procedure 32.1 generally governing citation of judicial decisions issued on or after Jan. 1, 2007.
See also U.S.Ct. of App. 9th Cir. Rule 36-3. United States Court of Appeals, Ninth Circuit.

In re: David A. Armstrong, Debtor,
David A. Armstrong, Appellant,
v.
Kristi Kaplon, Appellee.

No. 15-56475
|
Submitted February 16, 2017[*] Pasadena, California
|
Filed February 22, 2017

Appeal from the United States District Court for the Central District of California, John A. Kronstadt, District Judge, Presiding, D.C. No. 2:14-cv-09349-JAK

Attorneys and Law Firms

Philip Dennis Dapeer, Attorney, Philip D. Dapeer, A Law Corp, Westlake Village, CA, for Appellant

James Richard Felton, Esquire, Managing Senior Counsel, Greenberg & Bass LLP, Encino, CA, Steven S. Fleischman, Esquire, Attorney, Jason R. Litt, Esquire, Attorney, Horvitz & Levy LLP, Burbank, CA, for Appellee

Before: M. SMITH and OWENS, Circuit Judges, and HELLERSTEIN,[**] District Judge.

MEMORANDUM[***]

***1** Appellant David Armstrong appeals from the district court's order affirming a final order of the bankruptcy court, which held that a criminal restitution order imposed against Armstrong was nondischargeable pursuant to 11 U.S.C. § 523(a)(7). We have jurisdiction pursuant to 28 U.S.C. § 158(a) and 28 U.S.C. § 1291, and we affirm.

Section 523(a)(7) of the Bankruptcy Code states that a debtor may not discharge any debt "to the extent such debt is for a fine, penalty, or forfeiture payable to and for the benefit of a governmental unit, and is not compensation for actual pecuniary loss[.]" In *Kelly v. Robinson*, 479 U.S. 36, 107 S.Ct. 353, 93 L.Ed.2d 216 (1986), the Supreme Court held that "§ 523(a)(7) preserves from discharge *any* condition a state criminal court imposes as part of a criminal sentence." *Id.* at 50, 107 S.Ct. 353 (emphasis added). This includes criminal restitution orders such as the one imposed on Armstrong. As the Supreme Court held:

> Because criminal proceedings focus on the State's interests in rehabilitation and punishment, rather than the victim's desire for compensation, we conclude that restitution orders imposed in such proceedings operate "for the benefit of" the State. Similarly, they are not assessed "for ... compensation" of the victim. The sentence following a criminal conviction necessarily considers the penal and rehabilitative interests of the State. Those interests are sufficient to place restitution orders within the meaning of § 523(a)(7).

Id. at 53. The Supreme Court based this broad holding upon a "deep conviction that federal bankruptcy courts should not invalidate the results of state criminal proceedings." *Id.* at 47, 107 S.Ct. 353.

We have followed *Kelly*. *See In re Silverman*, 616 F.3d 1001, 1008 (9th Cir. 2010) ("As *Kelly* made clear, criminal restitution payments are nondischargeable."); *In re Taggart*, 249 F.3d 987, 994 n.9 (9th Cir. 2001) ("The Supreme Court has held that '§ 523(a)(7) preserves from discharge any condition a state criminal court imposes as part of a criminal sentence.' ") (quoting *Kelly*, 479 U.S. at 50, 107 S.Ct. 353); *In re Levy*, 951 F.2d 196, 198–99 (9th Cir. 1991) (*Kelly* "held that restitution obligations imposed in state criminal proceedings are not dischargeable.").

Nevertheless, Armstrong contends that his criminal restitution is dischargeable because, unlike the state statute at issue in *Kelly*, the California penal code provides for both "restitution" and a "restitution fine." *Compare* Cal. Penal Code § 1202.4(f) ("[I]n every case in which a victim has suffered economic loss as a result of the defendant's conduct, the court shall require that the defendant make restitution to the victim or victims in an amount established by court order, based on the amount of loss claimed by the victim or victims or any other showing to the court.") *with* Cal. Penal Code § 1202.4(b) ("In every case where a person is convicted of a crime, the court shall impose a separate and additional restitution fine, unless it finds compelling and extraordinary reasons for not doing so and states those reasons on the record."). Armstrong argues that the holding of *Kelly* extends only to the "restitution fine," and not to a restitution order issued pursuant to California Penal Code § 1202.4(f).

***2** This argument is squarely precluded by *Kelly*, which categorically held that criminal restitution orders are nondischargeable. 479 U.S. at 49–50, 107 S.Ct. 353. The Court's holding did not hinge upon the specific language or structure of the state law at issue. Rather, it was based upon the desire not to interfere with state courts' "unfettered administration of their criminal justice systems." *Id.* at 44, 107 S.Ct. 353. Here, Armstrong's restitution order served California's penological interests and was imposed as a function of the administration of that state's criminal justice system. It therefore falls within the scope of *Kelly*, even though the California

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penal statute also provides for the imposition of a separate "restitution fine." To hold otherwise "would hamper the flexibility of state criminal judges in choosing the combination of imprisonment, fines, and restitution most likely to further the rehabilitative and deterrent goals of state criminal justice systems." *Id.* at 49, 107 S.Ct. 353.

Armstrong's remaining arguments are unavailing. First, we have no occasion to revisit or challenge *Kelly*. Second, the principle of federalism supports, not subverts, the Supreme Court's interpretation of Section 523(a)(7), for "[t]o allow a debtor to discharge this [restitution] obligation would be abhorrent to the standards of federalism expressed in *Kelly* that bankruptcy statutes should not be interpreted so as to remit state criminal judgments." *In re Warfel*, 268 B.R. 205, 212 (B.A.P. 9th Cir. 2001). Third, the fact that the California statute provides that restitution is to be based on the amount of loss "claimed by the victim or victims" is irrelevant, for "such [is] the nature of restitution." *In re Steiger*, 159 B.R. 907, 912 (B.A.P. 9th Cir. 1993). The fact that restitution "may be determined by reference to the amount of harm caused by the offender ... does not alter its penal character." *Warfel*, 268 B.R. at 210 (citing *Kelly*, 479 U.S. at 51–52, 107 S.Ct. 353).

AFFIRMED.

All Citations

--- Fed.Appx. ----, 2017 WL 695103 (Mem)

* The panel unanimously concludes this case is suitable for decision without oral argument. *See* Fed. R. App. P. 34(a)(2). ** The Honorable Alvin K. Hellerstein, United States District Judge for the Southern District of New York, sitting by designation.

*** This disposition is not appropriate for publication and is not precedent except as provided by Ninth Circuit Rule 36-3.

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563 B.R. 289
United States Bankruptcy Appellate Panel
of the Ninth Circuit.

In re: Steven John Wharton and Josephina Jessie Wharton, Debtors.
Steven John Wharton; Josephina Jessie Wharton, Appellants,
v.
Lenard Schwartzer, Chapter 7 Trustee, Appellee.

BAP No. NV–16–1218–JuFY
|
Bk. No. 2:14–bk–18455–ABL
|
Submitted without oral argument on January 19, 2017*
|
Filed February 13, 2017

Synopsis
Background: Chapter 7 trustee moved to compel turnover of motor vehicle and objected to exemption claimed by debtors in vehicle. The United States Bankruptcy Court for the District of Nevada, August B. Landis, J., sustained objection and granted trustee's request for turnover, and debtors appealed.

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

[1] reply brief that Chapter 7 trustee filed when debtors,in response to trustee's motion to compel turnover of motor vehicle, amended their exemption schedule to claim motor vehicle as exempt, qualified as timely objection to exemption claimed by debtors in vehicle;

[2] by authenticating a security agreement in his brother'sfavor at time when he had rights in vintage automobile that was to serve as security for brother's $80,000 prepetition loan, debtor voluntarily transferred a security interest in vehicle to brother, and was thus barred from claiming vehicle as exempt; and

[3] security interest that debtor-husband had granted to hisbrother in debtor's vintage automobile, in order to secure debtor's obligation for repayment of $80,000 loan from brother, was avoidable by trustee in exercise of his strongarm powers.

Affirmed.

West Headnotes (9)

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

On appeal from bankruptcy court order sustaining trustee's objection to exemption claimed by Chapter 7 debtors, the Bankruptcy Appellate Panel could take judicial notice of pleadings filed in underlying bankruptcy case. Fed. R. Evid. 201.

Cases that cite this headnote

[2] **Bankruptcy**
Proceedings
Bankruptcy
Conclusions of law; d e novo review

Whether brief filed by Chapter 7 trustee in connection with his motion to compel turnover of motor vehicle qualified as timely objection to exemption claimed by debtors in this vehicle, and whether debtors had voluntarily transferred a security interest in this vehicle and were for that reason barred from claiming exemption in vehicle, were issues of law, which the Bankruptcy Appellate Panel would review de novo. 11 U.S.C.A. § 522(g)(1)(A); Fed. R. Bankr. P. 4003(b).

Cases that cite this headnote

[3] **Bankruptcy**
Objections

Claimed exemption to which no objection is timely filed is valid. 11 U.S.C.A. § 522(l).

Cases that cite this headnote

[4] **Bankruptcy**
Objections
Bankruptcy
Time

Reply brief that Chapter 7 trustee filed when debtors, in response to trustee's motion to compel turnover of motor vehicle, amended their exemption schedule to claim motor vehicle as exempt, qualified as timely objection to exemption claimed by debtors in vehicle, where brief was filed within 30 days of debtors' amendment of their exemption schedule and set forth basis for trustee's objection to the exemption claimed. Fed. R. Bankr. P. 4003(b).

Cases that cite this headnote

[5] **Secured Transactions**

Necessity and sufficiency of writing in general

Secured Transactions

Signature

Under Nevada law, debtor authenticated a security agreement in favor of his brother, and satisfied one of statutory alternatives for granting brother a security interest in his vintage car, when he specified, in promissory note that he signed at time of $80,000 loan from his brother, that vehicle would stand as security for his obligation to repay any sums advanced; by virtue of this language, promissory note qualified as security agreement, which debtor authenticated by signing it. Nev. Rev. St. § 104.9203(2)(c)(1).

Cases that cite this headnote

[6] **Bankruptcy**

Waiver or Loss of Exemption

Secured Transactions

Perfection of Security Interest

By authenticating a security agreement in his brother's favor at time when he had rights in vintage automobile that was to serve as security for brother's $80,000 prepetition loan, Chapter 7 debtor voluntarily transferred a security interest in vehicle to brother, and was thus barred, when trustee successfully challenged brother's security interest on strong-arm grounds as not having been noted on certificate of title, from belatedly claiming motor vehicle as exempt. 11 U.S.C.A. §§ 522(g)(1)(A), 544; Nev. Rev. St. § 104.9203(2).

Cases that cite this headnote

[7] **Secured Transactions**

Description of Collateral

Under Nevada law, principal function of description of collateral in security agreement is to enable parties themselves to identify the collateral, and if the parties to agreement understand what collateral is being pledged, then security interest cannot be challenged on basis that security agreement insufficiently describes the collateral.

Cases that cite this headnote

[8] **Bankruptcy**

Perfection or recordation under state law, in general

Bankruptcy

Trustee as representative of debtor or creditors

Security interest that Chapter 7 debtorhusband had granted to his brother in debtor's vintage automobile, in order to secure debtor's obligation for repayment of $80,000 loan from brother, was avoidable by trustee in exercise of his strong-arm powers, where brother, while taking possession of certificate of title and keys, never took any steps to see that his security interest was noted on certificate of title. 11 U.S.C.A. § 544.

Cases that cite this headnote

[9] **Secured Transactions**

Notation on certificate of title

Nevada law requires that any security interest in motor vehicle be noted on certificate of title in order to be perfected.

Cases that cite this headnote

***291** Appeal from the United States Bankruptcy Court for the District of Nevada, Honorable August B. Landis, Bankruptcy Judge, Presiding

Attorneys and Law Firms

Appearances: Appellants Steven John Warton &

Josephina Jessie Wharton on brief pro se; Jason A. Imes on brief for appellee, Lenard Schwartzer, chapter 7 trustee.

Before: JURY, FARIS, and YUN,[**] Bankruptcy Judges.

OPINION

JURY, Bankruptcy Judge:

Chapter 7[1] debtors, Steven John Wharton and Josephina Jessie Wharton (collectively, Debtors), listed a 1965 Corvette as a nonexempt asset in their initial schedules and showed that Steven's brother, Robert Wharton (Robert), held a nonpurchase money security interest in the vehicle. However, Robert's security interest in the vehicle was not perfected under Nevada law. Accordingly, the chapter 7 trustee, Lenard Schwartzer (Trustee), sought turnover of the vehicle.

Debtors negotiated with Trustee to purchase the Corvette, but these negotiations broke down over price and terms of payment. Trustee filed a motion to compel turnover. Debtors then amended their Schedules B and C to claim an exemption in the full value of the Corvette, which was ***292** appraised at $23,000. Trustee objected to the exemption in his reply brief to the turnover motion, but never filed a formal objection to the exemption. Debtors claimed that Trustee's objection raised in the reply was improper and thus no timely objection to their exemption had been made.

After further briefing, the bankruptcy court decided the matter on the basis of stipulated facts presented by the parties. The court sustained Trustee's objection to Debtors' claimed exemption in the Corvette under § 522(g)(1)(A), granted Trustee's motion for turnover, and entered an order consistent with its ruling. Debtors appeal from that order. For the reasons set forth below, we AFFIRM.

I. FACTS[2]

[1] Debtors owned a 1965 Corvette. In July 2011, Steven borrowed $80,000 from Robert. The loan was evidenced by a promissory note signed by Steven and which stated, among other things, that the note was partially secured by the Corvette. In connection with the loan, Steven gave Robert the original title certificate and keys to the vehicle but retained physical possession. Throughout the relevant dates, Steven was listed as the owner on the Corvette's title certificate.

Debtors filed their chapter 7 petition on December 30, 2014. Trustee was appointed to administer their bankruptcy estate. Debtors listed the Corvette in their initial schedules as a nonexempt asset with a value of $63,800 and showed that Robert held a nonpurchase money security interest on the vehicle.

On March 26, 2015, Robert filed a proof of claim (POC) for $45,000, showing $40,000 secured by the Corvette with the remainder unsecured.

Trustee later determined that Robert had not perfected his security interest in the Corvette prepetition under Nevada law because his security interest neither appeared on the state-issued certificate of title nor was he listed as a lienholder. Because the vehicle was in Steven's name and had not been claimed as exempt, Trustee demanded turnover of the Corvette for the benefit of the estate and creditors.

Robert amended his POC to include a copy of the promissory note and cancelled check for the initial loan to Steven. However, he provided no documents that showed his security interest in the Corvette was properly perfected under Nevada law.

During negotiations with Trustee over the Corvette, Debtors had the vehicle appraised by CarMax in Bakersfield, California. CarMax provided an "appraisal offer" of $23,000, and Debtors provided this offer to Trustee. Trustee agreed that Debtors could pay the amount of the appraised value less the 20% commission that it would cost him to sell the vehicle at auction, resulting in a total price of $18,400, with payments made over twelve months. The negotiations later broke down over the price and terms of payment.

As a result, Trustee filed a motion to compel turnover of the Corvette (Turnover Motion), asserting that the vehicle was property of the estate and that Robert's lien was unperfected. Trustee informed the bankruptcy court that he had demanded turnover of the Corvette or payment of its value by emails and a letter but that Debtors failed to cooperate.

***293** Two weeks before the scheduled hearing on the Turnover Motion, Debtors filed amended Schedules B and C listing the vehicle's value at $23,000 based on the CarMax appraisal and listing an exemption of this entire value under Nevada Revised Statute (NRS) 21.090(1)(f).[3] Debtors did not amend Schedule D which showed that Robert held a secured interest in the vehicle.

Debtors also responded to the Turnover Motion, asserting that they did not initially claim an exemption in the vehicle because they believed that it was subject to a valid security interest. They further stated that once the negotiations with Trustee ended, they amended their schedules to reflect the exemption in the Corvette.

In a subsequent reply, Trustee asserted that he could avoid Robert's unperfected lien under §§ 544 and 550. He further argued that Debtors could not exempt the Corvette based on the provisions of § 522(g)(1)(A) because they had voluntarily transferred a security interest to Robert, citing In re Bub, 528 B.R. 555 (Bankr. E.D.N.Y. 2015), and Glass v. Hitt (In re Glass), 60 F.3d 565, 569 (9th Cir. 1995), in support.[4]

Debtors responded to the reply, arguing that there was no transfer of the vehicle but only transfer of the title and the keys. Therefore, according to Debtors, Trustee had not "recovered" the vehicle from a third party since it was always in Debtors' possession. Debtors also pointed out that there was no attempt to defraud or mislead the bankruptcy court as the vehicle had been listed in their schedules.

At the November 19, 2015 hearing on the Turnover Motion, Trustee informed the bankruptcy court that Debtors had claimed an exemption in the vehicle after he filed the motion. As a result, Trustee suggested continuing the matter "about 30 days and—or maybe 45 days," and stated: "I will file a[n] objection to the claim of exemption that could be heard at the same time as a motion to— for turnover of the vehicle." The bankruptcy court set the matter for a January 6, 2016 status conference on Judge Landis's calendar[5] since he was assigned the case and an evidentiary hearing was required.

On January 11, 2016, the bankruptcy court scheduled the matter for an evidentiary hearing on May 2, 2016. At the May 2, 2016 hearing, the parties advised the court that they had agreed to submit the matter on the basis of stipulated facts. The next day, the bankruptcy court entered an order setting May 9, 2016, as the deadline for filing the stipulation regarding the evidentiary record and closing the record as of that date. The court also set further dates for the parties to file their post-hearing briefs.

The parties filed the stipulated facts as required. Trustee filed his post-hearing brief on May 16, 2016. Trustee argued that he raised a timely and sufficient objection to Debtors' claimed exemption in the Corvette under Rule 4003; i.e., Debtors amended their schedules to claim the exemption on November 5, 2015, and he objected ***294** to the exemption on November 12, 2015, in his reply brief to the Turnover Motion. Accordingly, Trustee maintained that his objection was within 30 days of Debtors' amended Schedule C. Trustee further argued that his objection satisfied Rule 4003, which does not require any particular form for an objection to an exemption under the holding in Spenler v. Siegel (In re Spenler), 212 B.R. 625, 629 (9th Cir. BAP 1997). According to Trustee, all that Rule 4003 requires is notice of Trustee's objection and its basis, which must be raised within the applicable time period. Finally, Trustee asserted that Debtors admitted in the stipulated facts that they voluntarily transferred a security interest in the vehicle to Robert. Under these circumstances, Trustee argued that § 522(g)(1)(A) prevented them from claiming the Corvette as exempt.

Debtors filed their post-hearing brief on May 23, 2016. Debtors asserted that Trustee had failed to file a timely objection to their exemption and that at no time during the November 19, 2015 hearing did the bankruptcy court acknowledge that Trustee's reply brief was an objection to Debtors' exemption. They further argued that at the November 19th hearing, Trustee was directed to file and place on calendar an objection within 45 days. Debtors also pointed out that the facts in Spenler were distinguishable from those here. In Spenler, the trustee had filed a document entitled "Trustee's Objection to the Two Individual Retirement Accounts Claimed as Exempt by Debtor" within the 30 day period under Rule 4003. In contrast, Trustee filed no pleading expressly objecting to Debtors' claim of exemption in this case.

Debtors further asserted that § 522(g)(1)(A) was not applicable as there was no transfer of a security interest in the Corvette. According to Debtors, no transfer occurred because the promissory note did not contain a sufficient description of the collateral—a requirement for attachment under NRS 104.9203. For this argument, Debtors relied on the reasoning in Checkett v. Sutton (In re Sutton), 365 B.R. 900 (8th Cir. BAP 2007), In re Seibold, 351 B.R. 741 (Bankr. D. Idaho 2006), and In re

Dolven, 549 B.R. 386 (Bankr. D. Idaho 2016). Finally, Debtors contended that at all times they were acting honestly and simply availed themselves of the exemption provided to them under Nevada law.

On May 27, 2016, Trustee filed a response which reiterated his previous arguments; i.e., his objection to Debtors' exemption set forth in his reply brief was sufficient to meet the requirements of Rule 4003 and § 522(g) applied.

On June 30, 2016, the bankruptcy court issued its oral ruling. First, the court found that Trustee's reply brief in support of the Turnover Motion was sufficient to constitute a timely objection to Debtors' claim of exemption in the Corvette under the holding in Spenler. Next, the bankruptcy court sustained Trustee's objection to Debtors' claimed exemption in the Corvette under § 522(g). According to the court, the agreement between Steven and his brother showed the loan was secured by the value of the Corvette. The bankruptcy court also found that a transfer of the security interest occurred because Debtors gave the title and keys to Robert. The court further noted that Debtors had stipulated that the transfer was voluntary. Finally, the bankruptcy court held that Trustee had recovered the vehicle under §§ 544 and 550 for the benefit of the estate through his actions since Debtors represented that Robert had released his lien. In the end, the bankruptcy court sustained Trustee's objection to the exemption and granted Trustee's Turnover Motion.

On July 6, 2016, the bankruptcy court entered an order consistent with its oral ***295** ruling. Debtors timely appealed from that order.

II. JURISDICTION

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

III. ISSUES

A. Whether the bankruptcy court erred in finding thatTrustee timely objected to Debtors' claimed exemption in the Corvette under Rule 4003;

B. Whether the bankruptcy court erred in denyingDebtors' claimed exemption in the Corvette under § 522(g) (1)(A); and

C. Whether the bankruptcy court erred in grantingTrustee's Turnover Motion.

IV. STANDARD OF REVIEW

[2] The issues raised in this appeal are subject to de novo review. See In re Spenler, 212 B.R. at 628 (proper application of Rule 4003(b) is a question of law which we review de novo); Hitt v. Glass (In re Glass), 164 B.R. 759, 761 (9th Cir. BAP 1994); Graham Oil Co. v. Gordon C. York, Inc. (In re Kramer), 64 B.R. 531, 532 (9th Cir. BAP 1986) (whether the bankruptcy court correctly applied the law to the stipulated facts is a legal issue subject to de novo review); Gaughan v. Smith (In re Smith), 342 B.R. 801, 805 (9th Cir. BAP 2006) (a debtor's right to claim exemptions is question of law reviewed de novo); Conrad v. Ace Prop. & Cas. Ins. Co., 532 F.3d 1000, 1004 (9th Cir. 2008) (interpretation and meaning of security agreements (contracts) is de novo).

De novo means review is independent, with no deference given to the trial court's conclusion. Charlie Y., Inc. v. Carey (In re Carey), 446 B.R. 384, 389 (9th Cir. BAP 2011) (citing McComish v. Bennett, 611 F.3d 510, 519 (9th Cir. 2010)).

V. DISCUSSION

On appeal, Debtors contend that the bankruptcy court erred in granting Trustee's turnover request because the Corvette is an exempt asset. Their arguments regarding the bankruptcy court's error in denying their exemption essentially mirror those made in the bankruptcy court. First, Debtors contend that Trustee's objection to their exemption, which was raised for the first time in his reply brief in connection with the Turnover Motion, was not proper. According to Debtors, Trustee was required to file a separate document objecting to their exemption. Since the time has passed for doing so, Debtors maintain that the court should have allowed their exemption. Second, Debtors assert that § 522(g) is not applicable because they disclosed the vehicle in their schedules and only took the exemption after they obtained an appraisal and realized that they had not fully used their vehicle exemption. We are not persuaded by either of these arguments.

A. Trustee's objection to Debtors' exemption was timely. Rule 4003(b) governs objections to claims of exemption and states in relevant part:

> (1) Except as provided in paragraphs (2) and (3), a party in interest may file an objection to the list of property claimed as exempt within 30 days after the meeting of creditors held under § 341(a) is concluded or within 30 days after any amendment to the list or supplemental schedules is filed, whichever is later. The court may, for cause, extend the time for filing objections if, before the time to object expires, a party in interest files a request for an extension.

[3] ***296** If no objection is filed within the 30 day period proscribed by Rule 4003(b), the debtor's claimed exemption is valid. Taylor v. Freeland & Kronz, 503 U.S. 638, 112 S.Ct. 1644, 118 L.Ed.2d 280 (1992). Taylor dealt with the timeliness of an objection and not its sufficiency. The panel addressed the sufficiency of an objection in Spenler stating:

> Rule 4003(b) proscribes no particular form for an objection to exemption. Nevertheless the purpose behind Rule 4003(b) is clear. Rule 4003(b) was meant to provide the debtor with timely notice that the trustee or other interested party objects to a debtor's claimed exemption.

212 B.R. at 630.

In support of its reasoning, the Spenler panel cited numerous cases where pleadings were "deemed objections" even though they were not styled as an "objection to exemption." For example, in Havas Leasing Co. v. Breen (In re Breen), 123 B.R. 357, 360 (9th Cir. BAP 1991), the panel held that a trustee's motion for relief from the stay which in essence objected to the debtors' claim that their truck was exempt as a tool of the trade constituted an objection filed within the 30 day period for purposes of Rule 4003(b).

In Young v. Adler (In re Young), 806 F.2d 1303, 1305 (5th Cir. 1987), overruled on other grounds by Canfield v. Orso (In re Orso), 283 F.3d 686 (5th Cir. 2002), the debtor amended his statement of financial affairs to include an annuity as personal property and claimed it exempt after the trustee had filed a motion arguing that the annuity was part of the estate. The Fifth Circuit found the motion filed by the trustee constituted a timely objection, noting:

> Debtor does not, and surely cannot, complain that he did not have actual notice of Trustee's objections. To allow Debtor to gain refuge behind Rule 4003(b) when he amended his financial statement **in response** to Trustee's objections would be to elevate form over substance. We cannot countenance such a wooden application of the Bankruptcy Rules.

Id. (emphasis in original).

Finally, in Applebee v. Brawn (In re Brawn), 138 B.R. 327, 333 (Bankr. D. Maine 1992), the debtor asserted a right to a homestead exemption in his motion to avoid the judgment creditors' lien against his homestead property. The judgment creditors filed a response to the motion, stating that the Debtor was not entitled to a homestead exemption. The judgment creditors later filed a pleading styled "Objection to Exemption Claim," which the debtor contended was untimely. The bankruptcy court disagreed, finding that, although the judgment creditors had not filed a distinct objection the first time around, they manifested their intent to contest the debtor's homestead exemption claim and effectively communicated that intent to him and the court well within Rule 4003(b)'s 30–day period.

[4] The holding in Spenler is applicable to this case. Although the better practice would have been for Trustee to file a separate pleading styled as an objection to Debtors' exemption, under Spenler he did not need to do so. Trustee set forth the basis for his objection to Debtors' exemption in his reply brief since Debtors had amended their Schedule C claiming the exemption in response to Trustee's Turnover Motion. Trustee's reply was filed within 30 days of Debtors' amending their Schedule C and nowhere do Debtors complain that they did not have notice of Trustee's objection. Nor could they claim no notice when they responded to Trustee's objection to their exemption prior to the ***297** November 19, 2015 hearing on Trustee's Turnover Motion.

Finally, although Debtors contend otherwise, the November 19th hearing transcript does not convince us that the rule in Spenler is inapplicable under these circumstances. The hearing was a status conference and no substantive rulings were made. Although Trustee offered to file a separate objection to Debtors' exemption, the bankruptcy court did not order him to do so. Accordingly, we hold that Trustee's objection to Debtors' exemption in the Corvette was timely.

B. Since the requirements of § 522(g)(1)(A) were met, Debtors were not entitled to claim an exemption in the Corvette.

Section 522(g)(1), in relevant part, provides:

> [T]he debtor may exempt under subsection (b) of this section property that the trustee recovers under section 510(c)(2), 542, 543, 550, 551, or 553 of this title, to the extent that the debtor could have exempted such property under subsection (b) of this section if such property had not been transferred, if—
>
> (1)(A) such transfer was not a voluntary transfer of such property by the debtor; and
>
> (B) the debtor did not conceal such property ....

It is undisputed that Debtors did not conceal the Corvette, so subsection (B) is not at issue. Rather, our analysis centers on whether Debtors' grant of a security interest in the Corvette to Robert, who failed to properly perfect that interest, was in the nature of a voluntary transfer which prevents Debtors from asserting an exemption in the vehicle upon Trustee's recovery of the vehicle for the benefit of the estate. Without either a transfer or recovery, § 522(g)(1)(A) is inapplicable.

1. The Voluntary Transfer Element Whether Debtors transferred an enforceable security interest in the Corvette to Robert is a matter of Nevada law. See Butner v. United States, 440 U.S. 48, 54–55, 99 S.Ct. 914, 59 L.Ed.2d 136 (1979); Diamant v. Kasparian (In re S. Cal. Plastics, Inc.), 165 F.3d 1243, 1248 (9th Cir. 1999) (to determine the validity, nature and effect of a lien, courts must look to state law).

Under Nevada law, a "security agreement" is "an agreement that creates or provides for a security interest." NRS 104.9102(uuu). A "security interest," in turn, is "an interest in personal property ... which secures payment or performance of an obligation...." NRS 104.1201(ii). Under the Uniform Commercial Code (UCC) as enacted in Nevada, a security interest attaches to collateral when it becomes enforceable against the debtor with respect to the collateral. NRS 104.9203(1). A security interest is enforceable against the debtor and third parties with respect to collateral only if:

> (a) Value has been given;
>
> (b) The debtor has rights in the collateral or the powerto transfer rights in the collateral to a secured party; and
>
> (c) One of the following conditions is met:
>
> (1) the debtor has authenticated a security agreement that provides a description of the collateral ....[6]

NRS 104.9203(2). Unless the creditor's interest has attached to the collateral, the creditor has no enforceable interest in the collateral. Debtors have placed only subsection (c)(1) of NRS 104.9203(2) at issue ***298** in this appeal. Therefore, we consider whether there is an authenticated security agreement that provides an adequate description of the collateral.

[5] The record shows that Steven signed a promissory note in favor of Robert, dated July 1, 2011, and that a loan for $80,000 was made by Robert to Steven. The last sentence of the note states: "Principal and interest due is to be paid in full by August 1, 2016. This note is partially secured by 1965 Corvette automobile." Accordingly, the promissory note qualifies as a security agreement which by its terms "creates or provides for a security interest." NRS 104.9102(uuu); see also Nolden v. Plant Reclamation (In re Amex–Protein Dev. Corp.), 504 F.2d 1056, 1059–60 (9th Cir. 1974) (finding promissory note qualified as a security agreement). Furthermore, the note was signed by Steven and was therefore authenticated. In re Schwalb, 347 B.R. 726, 745 (Bankr. D. Nev. 2006) (" '[S]igning' is 'authentication' under the UCC ...."). In short, the requirement of an authenticated security agreement was met. Debtors do not argue otherwise on appeal.

[6] Instead, Debtors state in conclusory fashion that they did not have a security agreement with Robert, but rather only a promissory note which did not contain a proper description of the collateral. Debtors argue that without a proper description of the collateral, Robert's security interest did not attach and therefore was unenforceable. As a result, Debtors contend that they did not make a transfer within the meaning of § 522(g)(1)(A). We disagree with these assertions. As explained below, Debtors did transfer a security interest to Robert under controlling state law.

First, contrary to Trustee's assertion, Debtors did not stipulate that they transferred a security interest to Robert. Rather, they agreed that they scheduled the Corvette as subject to a security interest held by Robert and that they "delivered the original title certificate and keys to the Corvette to Robert **Wharton** in July 2011."

Whether these facts constitute a "transfer" is a legal conclusion controlled by Nevada law. These stipulated facts are sufficient to show that Steven gave Robert an interest in the 1965 Corvette as a condition of obtaining the $80,000 loan, and that Robert held onto the title and keys to ensure repayment.[7] These facts, coupled with the language in the promissory note, show a "transfer" of "an interest in personal property [that] secure[d] payment ... of an obligation." NRS 104.1201(ii). There was thus a "transfer" of a security interest in the Corvette to Robert under Nevada law and Debtors did agree that it was voluntary. Debtors are bound by these stipulated facts.

See E.H. Boly & Son, Inc. v. Schneider, 525 F.2d 20, 23 n.5 (9th Cir. 1975).

[7] Second, Debtors' contention that the description of the collateral in the promissory note was inadequate is disingenuous. One treatise explains:

> The principal function of the description requirement is to enable the parties themselves to identify the collateral, and if the parties to the agreement understand what collateral was pledged, the security interest cannot be challenged on the basis that the agreement insufficiently describes the collateral.

79 C.J.S. Secured Transactions § 45 (June 2011). Here, there is no doubt that the ***299** parties to the promissory note—Robert and Steven—understood what collateral was pledged—the 1965 Corvette. Therefore, Debtors cannot challenge their transfer of the security interest in the "1965 Corvette" on the basis that the promissory note insufficiently described the collateral. Moreover, a description of collateral under Nevada law is sufficient when "it reasonably identifies what is described." NRS 104.9108(1). This lenient description standard is met by the description of the collateral as a "1965 Corvette".

In sum, Robert's security interest attached to the Corvette as all the requirements for attachment under Nevada law were met: value was given, Debtors had rights in the Corvette, and Steven authenticated (signed) the promissory note (security agreement) that provided an adequate description of the collateral. Robert's lien against the Corvette was thus enforceable. Moreover, Debtors agreed that they voluntarily gave Robert a security interest. Accordingly, the voluntary transfer element under § 522(g)(1)(A) has been met.

The case law cited by Debtors—Sutton, Seibold, and Dolven—do not support a contrary conclusion regarding the transfer element. As shown below, unlike here, in each of those cases no security interest was ever created by the debtor's actions. Accordingly, there was no transfer of an interest to avoid and recover.

Sutton involved a Missouri statute which set forth the requirements for attachment of a security interest which is identical to Nevada's statute: i.e., value must have been given; the debtor must have rights in the collateral; and the debtor must have authenticated a security agreement that provides a description of the collateral (a vehicle). In re Sutton, 365 B.R. at 904. Similar to this case, a family member, Mrs. Sutton's father, loaned money to the debtors to purchase a vehicle. However, there was no underlying security agreement and only a notation on the application for the title on the vehicle which listed Mrs. Sutton's father as a lien holder. The Suttons filed a chapter 7 petition and claimed the entire fair market value of the vehicle exempt and also listed Mrs. Sutton's father as a secured creditor in their Schedule D. Sometime postpetition, the debtors sold the vehicle and the father released whatever interest he had in the vehicle so the sale could close.

After the debtors filed a chapter 7 petition, the trustee sought to avoid the father's interest in the vehicle under § 544(a) and also filed an objection to the debtors' claim of exemption under § 522(g)(1)(A). The father conceded that he did not have a security interest in the vehicle. The bankruptcy court entered judgment in favor of the trustee on his action, but overruled his objection to the debtors' exemption in the vehicle in two separate orders. In the adversary order, the court noted that the debtors had not authenticated a written security agreement in favor of the father and thus the father did not possess an interest in the vehicle. Although the trustee filed the action under § 544(a) to avoid the lien, the court's order did not grant a § 544 avoidance but instead granted judgment for the trustee based on a declaration that no security interest existed. Id. at 906.

In overruling the trustee's objection to the exemption, the bankruptcy court found that since there was no valid security agreement in favor of the father, the debtors did not make a prepetition voluntary transfer of an interest in the vehicle to him and thus § 522(g)(1)(A) was inapplicable. In short, since there was no lien, there was nothing to avoid or recover and thus § 522(g) was not applicable. On appeal, the bankruptcy appellate panel affirmed, essentially ***300** following the same reasoning as the bankruptcy court.

Similarly, Seibold involved a motor vehicle and the lack of an authenticated security agreement. In re Seibold, 351 B.R. at 741. The chapter 7 trustee alleged that the debtor's father had an "unperfected" security interest that could be avoided and obtained a stipulation from him whereby the father surrendered the certificate of title and agreed to file an unsecured claim. The debtor then filed a second amended Schedule C, again asserting an exemption in the vehicle and adding another exemption in the car under a different Idaho statute. The bankruptcy court ultimately ordered the debtor to give possession of the vehicle to the trustee, who sold the vehicle at auction.

After the sale, the debtor filed a motion seeking to enforce her exemptions in the vehicle. The trustee contended that § 551 applied to preserve the lien he had avoided for the benefit of creditors. The bankruptcy court disagreed, concluding that no security interest ever attached under Article 9 of the UCC because there was never a written security agreement authenticated by the debtor. The bankruptcy court held that without the avoidance of an underlying lien, § 551 did not apply. Accordingly, the court granted the debtor's motion to enforce her exemption claims against the funds.

Last, in Dolven the bankruptcy court found that the creditor-bank did not have a lien on real property owned by the debtor because there was no writing containing a legal description of the property—a requirement for a lien under Idaho law. In re Dolven, 549 B.R. at 386. Again, since there was no lien to avoid, the court found that the trustee had not recovered anything to which § 522(g) was relevant.

Unlike any of these cases, Debtors had voluntarily transferred a security interest in the Corvette to Robert which had attached and was enforceable under Nevada law.

2. The Recovery Element

[8] [9] Although Debtors transferred a security interest to Robert, that interest was not perfected. Nevada law requires the secured interest to appear on the state-issued certificate of title. In re Schwalb, 347 B.R. at 746. That was not done here. As a result, Robert's unperfected interest was subject to avoidance under § 544[8] and subject to recovery for the benefit of the estate under § 550. The bankruptcy court properly found Trustee had avoided the interest and recovered it for the estate.

In its oral ruling, the bankruptcy court found that the recovery requirement under § 522(g) had been met even though Trustee had not filed an adversary proceeding. The court noted that it was Trustee's Turnover Motion and the threat of using his avoidance powers under § 544(a) which caused Debtors to amend their Schedules to claim the Corvette exempt and show that Robert's lien had been released. Since Debtors do not challenge any of these findings on appeal, those arguments are ***301** deemed waived. Smith v. Marsh, 194 F.3d 1045, 1052 (9th Cir. 1999).

Moreover, the Ninth Circuit has held that the word "recovers," as used in § 522(g), does not necessarily require a formal adversary action or proceeding; rather, the ordinary meaning of the word suggests that a trustee may "recover" property in a number of ways, including by merely using the threat of avoidance powers to induce a debtor or transferee to return the property to the estate. In re Glass, 60 F.3d at 568. In other words, "[t]he filing of the objection [to the exemption] containing the threat to use avoidance powers which resulted in the reconveyance of the property to the estate was 'some action' " taken by the trustee to recover the property. Id. at 569.

In sum, all the requirements for application of § 522(g)(1) (A) have been met. Accordingly, Debtors are unable to claim an exemption in the Corvette.

C. Ordering turnover of the vehicle was proper. With several exceptions not applicable here, under § 542, a trustee may seek turnover of estate property. Section 542(a) provides:

> Except as provided in subsection (c) or (d) of this section, an entity, other

Footnotes

> than a custodian, in possession, custody, or control, during the case, of property that the trustee may use, sell, or lease under section 363 of this title, or that the debtor may exempt under section 522 of this title, shall deliver to the trustee, and account for, such property or the value of such property, unless such property is of inconsequential value or benefit to the estate.

Steven was the sole owner of the vehicle listed on the title certificate and was in possession of the Corvette at all times. Accordingly, on the petition date, the vehicle became property of Debtors' estate whether it was exempt or not. Taylor, 503 U.S. at 642, 112 S.Ct. 1644 (property that is claimed as exempt is included as property of the estate by § 541(a)). As the bankruptcy court properly found, Debtors were not entitled to exempt the Corvette under § 522(g)(1)(A). Therefore, the bankruptcy court did not err in granting Trustee's Turnover Motion.

VI. CONCLUSION

For the reasons stated above, we AFFIRM.

All Citations

563 B.R. 289

* By order entered on November 7, 2016, a motions panel determined that this appeal was suitable for submission on the briefs and record without oral argument pursuant to Fed. R. Bankr. P. 8019.

** Hon. Scott H. Yun, United States Bankruptcy Judge for the Central District of California, sitting by designation.

1 Unless otherwise indicated, all chapter and section references are to the Bankruptcy Code, 11 U.S.C. §§ 101–1532, and "Rule" references are to the Federal Rules of Bankruptcy Procedure.

2 Many of the facts are taken from the Stipulated Facts Re Motion to Compel Turnover. To the extent necessary, we take judicial notice of the pleadings filed in the underlying bankruptcy case. Atwood v. Chase Manhattan Mortg. Co. (In re Atwood), 293 B.R. 227, 233 n.9 (9th Cir. BAP 2003).

3 This subsection allows an exemption in one vehicle if the judgment debtor's equity does not exceed $15,000 or the creditor is paid an amount equal to any excess above that equity.

4 Glass stands for the proposition that the trustee "recovers" property within the meaning of § 522(g) so long as the trustee has taken some action resulting in the reconveyance of the property of the estate. In re Glass, 60 F.3d at 568–69. No formal adversary proceeding is required. Bub cites Glass and other cases which hold the same.

5 The November 19, 2015 hearing was before Judge Davis, who as duty judge heard a status conference calendar of motions in cases assigned to all judges in the division.

6 None of the other conditions listed in the statute are relevant in this case.

7 To the extent Debtors contend no "transfer" occurred because they had physical possession of the Corvette, they are mistaken. The "transfer" at issue is the transfer of the security interest.

8 Section 544 provides in relevant part:

(a) The trustee shall have, as of the commencement of the case, and without regard to any knowledge of the trustee or of any creditor, the rights and powers of, or may avoid any transfer of property of the debtor or any obligation incurred by the debtor that is voidable by—

(1) a creditor that extends credit to the debtor at the time of the commencement of the case, and that obtains, at such time and with respect to such credit, a judicial lien on all property on which a creditor on a simple contract could have obtained such a judicial lien, whether or not such a creditor exists; ....

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2017 WL 784000
Only the Westlaw citation is currently available.
United States District Court,
N.D. California, San Jose
Division.

James Madison KELLEY, Plaintiff,
v.
JPMORGAN CHASE BANK, N.A., Defendant.

Case No. 16–CV–01141–LHK
|
Signed March 1, 2017

Synopsis

Background: Chapter 11 debtor, proceeding pro se, brought adversary proceeding against successor in interest to failed bank, seeking rescission of loans. The United States Bankruptcy Court for the Northern District of California, Dennis Montali, J., 545 B.R. 1, ruled that debtor's claims were barred by the Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA), and alternatively, debtor's claims were non-meritorious. Debtor appealed.

Holdings: The District Court, Lucy H. Koh, J., held that:

[1] FIRREA barred debtor's non-exhausted claim fordeclaratory judgment of statutory contract invalidity against successor in interest to failed bank;

[2] FIRREA barred debtor's non-exhausted rescissionclaims arising under Truth in Lending Act (TILA) against successor in interest to failed bank; and

[3] FIRREA barred debtor's declaratory relief claimsrelating to failed bank's acts or omissions.

Affirmed.

West Headnotes (9)

[1] Bankruptcy

On appeal, a district court reviews a bankruptcy court's factual findings for clear error and its legal conclusions de novo.

Cases that cite this headnote

[2] Bankruptcy

District court reviews bankruptcy court's legal decisions regarding summary judgment motions de novo.

Cases that cite this headnote

[3] Bankruptcy

District court reviews bankruptcy court's legal decisions regarding subject matter jurisdiction de novo.

Cases that cite this headnote

[4] Banks and Banking

Financial Institution Reform, Recovery, and Enforcement Act (FIRREA) grants the Federal Deposit Insurance Corporation (FDIC) authority to act as receiver or conservator of a failed institution for the protection of depositors and creditors. Federal Deposit Insurance Act, § 2 [1] et seq., as amended, 12 U.S.C.A. § 1811 et seq.

Cases that cite this headnote

[5] Banks and Banking

Financial Institution Reform, Recovery, and Enforcement Act (FIRREA) provides detailed procedures to allow the Federal Deposit Insurance Corporation (FDIC) to consider certain claims against the receivership estate. Federal Deposit Insurance Act, § 2 [1] et seq., as amended, 12 U.S.C.A. § 1811 et seq.

Cases that cite this headnote

[6] Banks and Banking

Where a claim is functionally, albeit not formally, against a depository institution for which the Federal Deposit Insurance Corporation (FDIC) is receiver, it is a "claim" within the meaning of Financial Institution Reform, Recovery, and Enforcement Act's (FIRREA) administrative claims process. Federal Deposit Insurance Act, § 2 [1] et seq., as amended, 12 U.S.C.A. § 1811 et seq.

Cases that cite this headnote

[7] Banks and Banking

Financial Institution Reform, Recovery, and Enforcement Act of (FIRREA) barred
Chapter 11 debtor's non-exhausted claim for declaratory judgment of statutory contract invalidity against successor in interest to failed bank. Federal Deposit Insurance Act, § 2 [1] et seq., as amended, 12 U.S.C.A. § 1811 et seq.

Cases that cite this headnote

[8] Banks and Banking

Financial Institution Reform, Recovery, and Enforcement Act of (FIRREA) barred
Chapter 11 debtor's non-exhausted rescission claims arising under Truth in Lending Act (TILA) against successor in interest to failed bank. Federal Deposit Insurance Act, § 2 [1] et seq., as amended, 12 U.S.C.A. § 1811 et seq.

Cases that cite this headnote

[9] Banks and Banking

Financial Institution Reform, Recovery, and Enforcement Act of (FIRREA) barred
Chapter 11 debtor's declaratory relief claims relating to failed bank's acts or omissions. Federal Deposit Insurance Act § 2[11], 12 U.S.C.A. § 1821(d)(13)(D).

Cases that cite this headnote

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ORDER AFFIRMING BANKRUPTCY COURT'S ENTRY OF JUDGMENT IN FAVOR OF APPELLEE JP MORGAN CHASE BANK, N.A.

LUCY H. KOH, United States District Judge

***1** Appellant James Madison Kelley ("Kelley"), proceeding *pro se*, appeals the Bankruptcy Court's entry of judgment in favor of Appellee JPMorgan Chase Bank, N.A. ("Chase"). The Bankruptcy Court held that it lacked subject matter jurisdiction over Kelley's claims because Kelley's claims against Chase were barred by the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 ("FIRREA"). Alternatively, the Bankruptcy Court held that, even assuming that FIRREA did not bar Kelley's claims, Chase was entitled to summary judgment because Kelley's claims were non-meritorious. For the reasons stated below, the Court AFFIRMS the Bankruptcy Court's entry of judgment in favor of Chase.

I. BACKGROUND

The background of this litigation involves overlapping events over multiple years. In addressing the relevant background, the Court first discusses the factual background of Kelley's loans with Washington Mutual Bank, F.A. ("WaMu"), Kelley's state court lawsuit against WaMu, and the closing of WaMu in 2008. Then, the Court discusses the procedural history of the instant appeal, which includes Kelley's Chapter 11 bankruptcy, Kelley's adversary proceeding against Chase in the Bankruptcy Court, and the Bankruptcy Court's entry of judgment in favor of Chase.

A. Factual Background

In 2005, Kelley took out two loans encumbering property at 14390 Douglass Lane in Saratoga, California ("the

Property”). *See* Appellee Appendix (“Appellee App.”) at 1393–1414. In 2007, Kelley obtained two refinance loans from WaMu, and these two refinance loans are the subject of the instant appeal.

1. Kelley's 2007 Loans and Kelley's Default on the Loans

On July 26, 2007, Kelley executed an adjustable rate note in favor of WaMu in the principal amount of $2,992,265.00 (“First Loan”). *See* Appellee App. at 1192, 1196–1201. On that same day, Kelley executed a “Truth in Lending Disclosure Statement” and a “Notice of Right to Cancel” with respect to the First Loan. *See id.* at 1192, 1229–31. The First Loan is secured by a deed of trust that was recorded against the Property on July 31, 2007. *Id.* at 1205–20.

On or about September 17, 2007, Kelley obtained a home equity line of credit from WaMu in the maximum amount of $250,000.00 (“Second Loan” and, collectively with the First Loan, the “Loans”). *Id.* at 1192. The Second Loan is secured by a deed of trust that was recorded against the Property on October 3, 2007. *Id.* at 1192, 1243–46. Kelley executed an “Important Terms of Our WaMu Equity Plus” with respect to the Second Loan, as well as a “Notice of Right to Cancel Secured Line of Credit.” *Id.* at 1252– 55, 1257–58.

On June 30, 2007, after Kelley defaulted on the Loans, WaMu recorded a notice of default and election to sell with respect to the First Loan. *See id.* at 1356; 1433–34.

2. Kelley's Lawsuit against WaMu in California State Court and WaMu's Closing

On July 28, 2008, Kelley brought suit against WaMu and Louis Helmonds (“Helmonds”), an alleged employee and agent of WaMu, in California state court. *See id.* at 1522. Kelley alleged that WaMu and Helmonds failed to make full disclosures to Kelley at the time that Kelley took out the Loans with WaMu, and that WaMu made deliberate misrepresentations to Kelley to induce Kelley to enter into the Loans. *Id.* at 1522–32. Kelley sued WaMu and Helmonds for fraud; negligent misrepresentation; and violation of California Business and Professional Code § 17200. *Id.*

***2** On September 19, 2008, Kelley filed for Chapter 11 bankruptcy in the United States Bankruptcy Court for the Northern District of California. *See id.* at 1–13. Kelley's bankruptcy proceedings are discussed more fully, *infra*, in the procedural history of this case.

On September 25, 2008, the Office of Thrift Supervision closed WaMu and appointed the Federal Deposit Insurance Corporation (“FDIC”) as Receiver. *Id.* at 1193. On that same date, Chase entered into a Purchase and Assumption Agreement (“P & A Agreement”) with the FDIC. *Id.* Pursuant to Chase's P & A Agreement with the FDIC, Chase acquired WaMu's assets. *Id.*

On October 1, 2008, the FDIC published in the Wall Street Journal a notice to creditors and depositors of WaMu. *Id.* at 1558. The notice explained the FDIC's receivership and the mandatory procedure for submitting to the FDIC a claim against WaMu. *Id.* at 1558.

On February 19, 2009, the FDIC mailed a written notice to Kelley and explained to Kelley the closing of WaMu and the mandatory procedure for submitting to the FDIC a claim against WaMu. *Id.* at 1560. This written notice advised Kelley that “[a]lthough the Claims Bar Date has passed, under federal law the Receiver may consider claims filed after the Claims Bar Date” under certain circumstances. *Id.* The FDIC explained that, in order for the Receiver to consider Kelley's claims against WaMu, Kelley must complete and sign a “Proof of Claim Form” and submit supporting documentation to the FDIC on or before May 20, 2009. *Id.* According to the FDIC, “Kelley did not file an administrative claim with the FDIC as Receiver by the Late Claim Bar Date or any other date.” *Id.* at 1547.

On March 22, 2010, the FDIC as Receiver for WaMu moved in Kelley's state court proceeding for summary judgment against Kelley. *Id.* at 1541. The FDIC argued that, because Kelley had failed to exhaust his administrative remedies with the FDIC as required by FIRREA, FIRREA's jurisdictional bar for unexhausted claims deprived the state court of jurisdiction over Kelley's claims. *Id.* at 1542.

On July 19, 2010, the Superior Court for the County of Santa Clara dismissed Kelley's claims with prejudice. The state court agreed with the FDIC that the state court lacked subject matter jurisdiction over Kelley's claims because Kelley did not exhaust his administrative remedies with the FDIC. *Id.* at 1565–66.

B. Procedural Background

1. Kelley's Chapter 11 Bankruptcy Proceedings As stated above, Kelley filed for Chapter 11 bankruptcy on September 19, 2008. On September 25, 2008, WaMu was closed, and Chase acquired WaMu's assets pursuant to the P & A Agreement, including the Loans at issue. On October 17, 2008, Chase filed in Kelley's Chapter 11 proceedings a proof of claim for the First Loan. *Id.* at 37. Chase filed a proof of claim for the Second Loan on December 2, 2008. *Id.* at 107.

On January 5, 2009, Kelley filed a Chapter 11 plan of reorganization, which proposed selling the Property. *See id.* at 118. The Bankruptcy Court never confirmed Kelley's Chapter 11 plan of reorganization.

On July 15, 2010, Kelley initiated an adversary proceeding against Chase in the Bankruptcy Court. *See id.* at 125. As relevant here, the operative complaint is Kelley's Third Amended Complaint ("TAC"), which was filed on May 30, 2014. *Id.* at 208.

***3** Kelley alleged in his TAC that Helmonds met with Kelley on July 6, 2007 and prepared an application for the First Loan. *Id.* at 212. According to Kelley, WaMu "formally changed the First Loan from a 40–year loan to a 30–year loan" on July 10, 2007, and Kelley "was not informed of the changes." *Id.* at 213. Kelley further alleged that, with regards to both Loans, "Helmonds made affirmative misrepresentations, inaccurate disclosures, did not disclose at the proper time, and concealed critical information that would have alerted [Kelley] to the enormously increased risk of the default in the refinance." *Id.* at 231. Kelley also asserted that "Washington Mutual Bank, F.A." was a " 'straw man' lender name" and that "Washington Mutual Bank, F.A." did not exist. *Id.* at 215.

Kelley's TAC requested that the Bankruptcy Court (1) declare the Loans contractually invalid, (2) declare the Loans rescinded under the Truth in Lending Act ("TILA"), and (3) declare that Chase did not validly hold claim to the Loans because Chase did not receive the Loans after WaMu's receivership. *Id.* at 230–34.

2. The Parties' Summary Judgment Motions and the Bankruptcy Court's Grant of Summary Judgment in Favor of Chase

On June 19, 2016, Kelley moved in the Bankruptcy Court for summary judgment against Chase. *Id.* at 435.[1] Kelley argued that the Loans were invalid because "Washington Mutual Bank, F.A." merged with "Washington Mutual Bank" in April 2005, and therefore "Washington Mutual Bank, FA" became "no longer a separate operating entity." *Id.* at 443. According to Kelley, "the Note and Deed of Trust reflect the name Washington Mutual Bank, F.A. who was not capable of contracting." *Id.* Moreover, Kelley asserted that WaMu made misrepresentations to Kelley at the time that Kelley entered the Loans, including that Kelley "was required to agree to a prepayment penalty," that Kelley "was not notified of [an] interest rate change," and that "[t]he Notices of Right to Cancel were withheld" from Kelley. *Id.* at 444. According to Kelley, these deficiencies made the Loan contracts void as a matter of law. *See id.* at 445–46. Further, Kelley asserted that, pursuant to Kelley's right to rescind under TILA, Kelley rescinded the First Loan on August 24, 2009, and Kelley rescinded the Second Loan on June 24, 2010. *Id.* at 446–49. Finally, Kelley argued that Chase did not have ownership of the Loans because it was not possible for the Loans to be owned by "Washington Mutual Bank, F.A. at the time of its failure" and "the FDIC/Chase transaction did not transfer ownership to Chase." *Id.* at 451. Kelley also argued that the note respecting the First Loan was falsely endorsed "in blank by Cynthia Riley, Vice President of Washington Mutual Bank, F.A." *See id.* at 450–53.

On July 22, 2015, Chase filed an opposition to Kelley's motion for summary judgment. *See id.* at 1133. Kelley filed a reply in support of his motion for summary judgment on July 29, 2015. *Id.* at 1707.

***4** On September 23, 2015, Chase filed in the Bankruptcy Court a motion for summary judgment against Kelley. *Id.* at 1815. Chase's motion asserted that FIRREA divested the Bankruptcy Court of jurisdiction over Kelley's claims and, in any event, that Kelley's Loans were valid and that Chase owned Kelley's Loans. *See id.* at 1821. On October 27, 2015, Kelley opposed Chase's motion for summary judgment. *Id.* at 2350. On November 3, 2015, Chase filed a reply in support of its motion for summary judgment. *Id.* at 2411.

On January 21, 2016, the Bankruptcy Court issued a decision denying Kelley's motion for summary judgment and granting Chase's motion. *In re Kelley*, 545 B.R. 1 (Bankr. N.D. Cal. 2016). The Bankruptcy Court found that FIRREA's jurisdictional bar applied to each of Kelley's claims. *Id.* at 7–8. Because Kelley did not exhaust his claims with the FDIC within the deadline for filing a claim, the Bankruptcy Court held that FIRREA deprived the Bankruptcy Court of subject matter jurisdiction. *Id.* at 7–8. In the alternative, the Bankruptcy Court held that Kelley's claims were without merit, even assuming Kelley's claims were not barred by FIRREA. *Id.* at 10–13. Specifically, the Bankruptcy Court held that Kelley's claims for TILA rescission were untimely, that Kelley "ha[d] not demonstrated that he c[ould] tender an amount necessary to rescind the loans," that "[n]othing support[ed] [Kelley's] implication that [WaMu's] change of name meant that Washington Mutual Bank, F.A. itself ceased to exist," and that Chase was the holder of the notes underlying the First and Second Loans. *Id.*

On February 20, 2016, the Bankruptcy Court issued a judgment dismissing Kelley's claims against Chase with prejudice. *Id.* at 2590.

On March 10, 2016, the Bankruptcy Court converted Kelley's bankruptcy case from Chapter 11 to Chapter 7. *Id*. at 2688–89.

4. Kelley's Appeal of the Bankruptcy Court's Order to this Court

On March 8, 2016, Kelley filed in this Court a notice of appeal from the Bankruptcy Court's January 21, 2016 order denying Kelley's motion for summary judgment and entering judgment in favor of Chase. *See* ECF No. 1.

This Court's initial scheduling order stated that Kelley was to serve a brief within 28 days after entry of the appeal. ECF No. 2. This Court issued an order to show cause on August 11, 2016, because Kelley did not file a brief within 28 days of entering his appeal. ECF No. 13. On August 22, 2016, Kelley responded to the order to show cause, and this Court vacated the order to show cause on August 29, 2016. ECF No. 19.

On September 12, 2016, Kelley filed an opening brief. ECF No. 22 ("Appellant Br."). On October 20, 2016, Chase filed its response brief. ECF No. 25 ("Appellee Br.").

On November 2, 2016, Kelley filed a reply. ECF No. 39 ("Reply Br.").

II. STANDARD OF REVIEW

[1] [2] [3] On appeal, a district court reviews a bankruptcy court's factual findings for clear error and its legal conclusions *de novo*. *See In re Tucson Estates*, 912 F.2d 1162, 1166 (9th Cir. 1990). Thus, the Court reviews the Bankruptcy Court's legal decisions regarding the summary judgment motions *de novo*. *See In re Focus Media, Inc.*, 378 F.3d 916, 922 (9th Cir. 2004). "Summary judgment is appropriate 'if the record shows that there is no genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law." *Id.* (quoting *In re Kaypro*, 218 F.3d 1070, 1073 (9th Cir. 2000)). Further, the Court reviews the Bankruptcy Court's legal decisions regarding subject matter jurisdiction *de novo*. *In re Marshall*, 264 B.R. 609, 618 (C.D. Cal. 2001).

III. DISCUSSION

***5** The Bankruptcy Court held that FIRREA applied to Kelley's claims and that it lacked jurisdiction over Kelley's claims because Kelley had failed to exhaust his administrative remedies with the FDIC. For the reasons discussed below, the Court agrees with the Bankruptcy Court that Kelley's claims are barred by FIRREA. Moreover, the Court agrees with the Bankruptcy Court that, even assuming that FIRREA does not bar Kelley's claims, Kelley's claims are non-meritorious. The Court first reviews FIRREA's jurisdictional bar, and then the Court examines each of Kelley's claims.

A. Overview of FIRREA's Jurisdictional Bar

[4] [5] FIRREA "grants the FDIC authority to 'act as receiver or conservator of a failed institution for the protection of depositors and creditors.' " *Benson v. JPMorgan Chase Bank, N.A.*, 673 F.3d 1207, 1211 (9th Cir. 2012) (quoting *Sharpe v. FDIC*, 126 F.3d 1147, 1154 (9th Cir. 1997)). The statute "provides detailed procedures to allow the FDIC to consider certain claims against the receivership estate." *Id.*

Specifically, "[a]s set forth in FIRREA, once the FDIC is appointed receiver for a failed depository institution, it must publish a notice to all of 'the depository institution's creditors' with instructions 'to present their claims, together with proof, to the receiver' by a specific date." *Rundgren v. Wash. Mut. Bank*, 760 F.3d 1056, 1060 (9th Cir. 2014) (quoting 12 U.S.C. § 1821(d)(3)(B)(i)). "The FDIC must also mail the notice 'to any creditor shown on the institution's books,' and 'upon discovery of the name and address of a claimant not appearing on the institution's books,' the FDIC must mail the notice to the claimant 'within 30 days after the discovery of such name and address.' " *Id.* (quoting § 1821(d)(3)) (internal citations omitted). "Late claims 'shall be disallowed and such disallowance shall be final, unless the claimant did not receive notice of the appointment of the receiver in time to file such claim before [the designated] date,' and 'such claim is filed in time to permit payment of such claim.' " *Id.* (quoting § 1821(d)(5)(C)) (internal citations omitted). If the FDIC receives a claim, the FDIC " 'shall determine whether to allow or disallow the claim and shall notify the claimant of any determination with respect to such claim.' " *Id.* (quoting § 1821(d)(5)(A)). If the FDIC disallows a timely submitted claim, " 'the claimant may request administrative review' " or the claimant may " 'file suit on such claim' " in the district court." *Id.* (quoting § 1821(d)(6)(A)).

Importantly, "FIRREA strips courts of jurisdiction over claims that have not been exhausted through th[e] process" described above. *Id.* at 1060–1061. FIRREA provides:

> Limitation on judicial review. Except as otherwise provided in this subsection, no court shall have jurisdiction over—
>
> (i) any claim or action for payment from, or anyaction seeking a determination of rights with respect to, the assets of any depository institution for which the [FDIC] has been appointed receiver, including assets which the [FDIC] may acquire from itself as such receiver; or
>
> (ii) any claim relating to any act or omission of suchinstitution or the [FDIC] as receiver.

§ 1821(d)(13)(D). The Ninth Circuit has explained that "[s]ection 1821(d)(13)(D) is drafted broadly to preclude courts from exercising jurisdiction over...'any claim relating to any act or omission' of a failed bank, without respect to the identity of the claimant.' " *Rundgren*, 760 F.3d at 1061.

[6] Moreover, the Ninth Circuit has held that when a plaintiff's claim "is based on the conduct of [a] failed institution," FIRREA's jurisdictional bar applies even if the plaintiff is asserting the claim "against a purchasing bank" of the failed institution, rather than the failed institution itself. *See Benson*, 673 F.3d at 1214. "Where a claim is *functionally*, albeit not *formally*, against a depository institution for which the FDIC is receiver, it is a 'claim' within the meaning of FIRREA's administrative claims process." *Id.* at 1214 (internal quotation marks omitted); *see also In re Prior*, 521 B.R. 353, 364–65 (Bankr. E.D. Cal. 2014) (applying *Rundgren* and *Benson* in the bankruptcy court and holding that FIRREA barred a debtor's claims against a lender that were functionally against a failed bank for which the FDIC was receiver).

B. FIRREA Applies to Kelley's Claims against Chase

***6** The Court next turns to whether FIRREA applies to Kelley's claims against Chase. As set forth in the factual background section above, after the FDIC was appointed Receiver for WaMu, the FDIC followed the notice procedures required by FIRREA and published notice to WaMu's creditors in the Wall Street Journal. *See* Appellee App. at 1558. Moreover, on February 19, 2009, the FDIC mailed a written notice to Kelley and explained to Kelley that, in order for the Receiver to consider Kelley's claims against WaMu, Kelley must complete and sign a "Proof of Claim Form" and submit supporting documentation to the FDIC on or before May 20, 2009. *Id.* at 1560. In Kelley's state court case against WaMu, the FDIC informed the state court that "Kelley did not file an administrative claim with the FDIC as Receiver by the Late Claim Bar Date or any other date." *Id.* at 1547. The state court accordingly held that Kelley's claims against WaMu and Helmonds were barred by FIRREA.

The question here is whether Kelley's claims in the Bankruptcy Court against Chase are "claim[s]" that "relat[e] to 'any act or omission' of an 'institution for which the [FDIC] has been appointed receiver," such that FIRREA's administrative claims process applies. *Rundgren*, 760 F.3d at 1061. If so, then Kelley's claims against Chase in the Bankruptcy Court are, like Kelley's claims against WaMu in state court, barred by FIRREA. As stated above, Kelley's TAC against Chase in the Bankruptcy Court asserted claims for declaratory judgment of (1) "Statutory Contract Invalidity," (2) TILA Rescission of the Loans; and (3) that Chase was not the owner of the Loans. *See Id.* at 230–34. The Court considers each of Kelley's claims in turn to determine whether FIRREA applies.

1. Kelley's Claim for Declaratory Judgment of "Statutory Contract Invalidity"

[7] Kelley's brief on appeal to this Court focuses primarily on Kelley's claim for declaratory judgment of "Statutory Contract Invalidity." *See* Appellant Br. at 13. In the

Bankruptcy Court, Kelley's TAC and summary judgment motion asserted that the Loans were contractually invalid because WaMu and its agents made numerous misrepresentations to Kelley at the time that Kelley took out the Loans. *See, e.g.*, Appellee App. at 231 (alleging, in Kelley's TAC, that there was no "meeting of the minds" because "Helmonds made affirmative misrepresentations" to Kelley). In Kelley's brief on appeal to this Court, Kelley relies on the argument that his Loans are contractually invalid because Kelley's Loans bear the name "Washington Mutual Bank, FA." Appellant Br. at 13. According to Kelley, "Washington Mutual Bank, FA" changed its name to "Washington Mutual Bank" on April 4, 2005. *Id.* Kelley thus contends that "Washington Mutual Bank, FA" is a "fictitious entity" that is not capable of contracting because "Washington Mutual Bank, FA" "ceased to exist as a bank by that name on April 4, 2005." *Id.* For the reasons discussed below, the Court agrees with the Bankruptcy Court that FIRREA bars Kelley's claim for declaratory judgment of "Statutory Contract Invalidity."

The Ninth Circuit has held that claims for declaratory relief are "claims" capable of resolution through FIRREA's administrative claims procedure. *See* *Rundgren,* 760 F.3d at 1056 (holding that FIRREA "bars judicial review of any non-exhausted claim, monetary or nonmonetary, which is susceptible of resolution through the claims procedure,' " including claims for declaratory relief); *see also* *Willner v. Dimon,* ––– F.3d ––––, 2017 WL 634704, (4th Cir. Feb. 16, 2017) (relying on *Rundgren* and holding that "a request for a declaratory judgment is a 'claim' within the meaning of FIRREA because the FDIC can provide declaratory relief"); *Westberg v. F.D.I.C.,* 741 F.3d 1301, 1305 (D.C. Cir. 2014) ("[§ 1821(d)(3)(D)] subsection (ii)'s reference to 'any claim' includes a request for declaratory relief.").

Kelley's claim for "Statutory Contract Invalidity" against Chase also "relates to 'any act or omission' " of an 'institution for which the [FDIC] has been appointed receiver.' " *Rundgren,* 760 F.3d at 1060 (quoting § 1821(d) (13)(D)) (internal citations omitted). Specifically, Kelley asserts that his Loans are "void" because the Loan contracts that Kelley took out with WaMu bear the name "Washington Mutual Bank, FA," which Kelley asserts is a "fictitious bank." *See* Appellant Br. at 12– 13. Kelley also alleges that the Loans are invalid because WaMu and its agent made numerous misrepresentations to Kelley at the time that Kelley took out the Loans with WaMu. *See, e.g.*, Appellee App. at 232–34. Kelley's factual allegations rest solely on the alleged misconduct of WaMu, a depository institution for which the FDIC is Receiver. Kelley alleges no independent misconduct of Chase, which did not issue the Loans to Kelley. *See id.* The Ninth Circuit has repeatedly recognized that "[a] claimant cannot circumvent the exhaustion requirement by suing the purchasing bank based on the conduct of the failed institution." *Rundgren,* 760 F.3d at 1064. Rather, "[w]here a claim is *functionally*, albeit not *formally*, against a depository institution for which the FDIC is receiver," the claim fails within FIRREA's jurisdictional bar. *Id.* (quoting *Benson,* 673 F.3d at 1214). Thus, because Kelley's claim for declaratory judgment of "Statutory Contract Invalidity" is "functionally" against WaMu, it is barred by FIRREA.

***7** Indeed, in *Rundgren*, the Ninth Circuit held that FIRREA applied to bar claims that relied on nearly identical factual allegations to those asserted by Kelley. In *Rundgren*, the plaintiffs alleged that "WaMu falsified the[ir] loan application, highly exaggerated [their] income and assets without their knowledge, misled the Rundgrens as to the terms of the note, secured a false appraisal, and rushed [the Rundgrens] through the signing process, among other things." *Id.* at 1059. The Rundgrens filed suit against Chase and sought "a declaratory judgment that the loan transaction was void and unenforceable and that Chase could not proceed" with a nonjudicial foreclosure sale. *Id.* The Ninth Circuit held that the Rundgrens' request for declaratory judgment against Chase was a "claim" that "relate[d] to any act or omission of WaMu," and was thus barred by FIRREA. *See* *id.* at 1059– 60. Specifically, the Ninth Circuit held that "all claims in the complaint rest[ed] on the theory that WaMu took deceptive and fraudulent actions to induce [the Rundgrens] to enter into a loan agreement, and their mortgage and note are therefore unenforceable." *Id.* at 1064. The Rundgrens' claims thus "relate[d] to WaMu's acts or omissions for purposes of § 1821(d)(13)(D)" and FIRREA "stripped the district court of jurisdiction to consider the Rundgrens' complaint." *Id.* at 1065; *see also* *Willner,* ––– F.3d at ––––, 2017 WL 634704, at *6 (holding that FIRREA barred a plaintiff's declaratory judgment action against Chase where the plaintiff argued that WaMu "made misrepresentations" to the plaintiff and where the plaintiff argued that "Washington Mutual Bank, F.A." "did not exist when the [plaintiffs] closed on the Loan").

Like the plaintiffs in *Rundgren*, Kelley asserts that his Loans are "void" because of actions taken by WaMu at the time that Kelley took out his Loans with WaMu. Thus, as the Ninth Circuit held in *Rundgren*, Kelley's claim for "Statutory Contract Invalidity" is functionally pleaded against the "acts and omissions" of WaMu, and FIRREA applies to Kelley's claim. As set forth above, the parties do not dispute that the FDIC sent notice to Kelley of the FIRREA administrative claims process, and that Kelley did not submit a claim to the FDIC within the time provided. *See* Appellee App. at 1547. Accordingly, the Bankruptcy Court did not err in holding that FIRREA deprived the Bankruptcy Court of subject matter jurisdiction over Kelley's declaratory judgment claim for "Statutory Contract Invalidity."

Finally, even assuming that FIRREA does not apply, the Bankruptcy Court's grant of summary judgment was nonetheless appropriate because Kelley's argument for "Statutory Contract Invalidity" is not meritorious. As stated above, Kelley argues on appeal that the Loans are contractually invalid because "Washington Mutual Bank, FA" is a "fictitious bank" that ceased to exist at the time of WaMu's name change in 2005.[2] *See* Appellant Br. at 13. However, "courts have repeatedly rejected" the theory that "WaMu's name change in 2005" meant that "WaMu therefore ceased to exist as a legal entity." *See Burke v. JPMorgan Chase Bank, N.A.*, 2015 WL 2198319, at *4 n.1 (N.D. Cal. May 11, 2015); *Lanini v. JPMorgan Chase Bank*, 2014 WL 1347365, at *3 (E.D. Cal. Apr. 4, 2014) ("In plaintiffs' view, Chase cannot foreclose because it claims the beneficiary of the loan is Washington Mutual Bank, F.A., a nonexistent entity....The court rejects any claim that the name change somehow precludes Chase's authority to foreclose."). The Bankruptcy Court did not err in granting summary judgment in favor of Chase on Kelley's claim for declaratory judgment of "Statutory Contract Invalidity."

C. Kelley's Claims for TILA Rescission of the Loans

***8 [8]** Kelley also asserts claims against Chase seeking declaratory judgment that Kelley rescinded the Loans pursuant to TILA (hereinafter, Kelley's "TILA Rescission claims"). "TILA's 'buyer's remorse' provision allows borrowers three business days to rescind, without penalty, a consumer loan that uses their principal dwelling as security." *Garza v. Am. Home Mortg.*, 2009 WL 188604, at *3 (E.D. Cal. Jan. 27, 2009) (citing 15 U.S.C. § 1635(a)). TILA, and its accompanying regulations, "require the lender to provide a form stating the specific date on which the three-day rescission period expires." *Id.* "A borrower's right of rescission is extended from three days to three years if the lender (1) fails to provide notice of a borrower's right of rescission or (2) fails to make a material disclosure." *Reagen v. Aurora Loan Servs., Inc.*, 2009 WL 3789997, at *6 (E.D. Cal. Nov. 10, 2009) (citing 12 C.F.R. § 226.23(a)(3)).

According to Kelley, WaMu failed to make required disclosures under TILA when Kelley took out the Loans in 2007. *See* Appellee App. at 235–37. Kelley states that he sent notice to Chase and rescinded the First Loan on August 24, 2009 and the Second Loan on June 24, 2010. *Id.* at 446–49. In granting summary judgment in favor of Chase, the Bankruptcy Court held that FIRREA applied to bar Kelley's TILA Rescission claims and that, in the alternative, Kelley's TILA Rescission claims were without merit. For the reasons discussed below, the Court agrees with the Bankruptcy Court.

As with Kelley's declaratory relief claim for "Statutory Contract Invalidity" discussed above, Kelley's claims for declaratory relief of "TILA Rescission" are "claims" that "relate to WaMu's acts or omissions for purposes of § 1821(d)(13)(D)." *See Rundgren*, 760 F.3d at 1065. Indeed, the Ninth Circuit recently held that FIRREA applied to bar a nearly identical cause of action. *See Grady v. Levin*, 655 Fed.Appx. 601 (9th Cir. 2016). In *Grady*, the plaintiffs "entered into a loan with the Bank of Elmwood" in 2008. *Id.* at 601. The Bank of Elmwood failed, the FDIC was appointed as Receiver for the Bank of Elmwood, and the Bank of Elmwood's assets were acquired by Tri City National Bank. *Id.* The plaintiffs in *Grady* attempted to bring a claim for TILA rescission against Tri City National Bank, but the Ninth Circuit found that FIRREA applied to bar the plaintiffs' claim. *Id.* at 602. Specifically, the Ninth Circuit held that, because the plaintiffs had not "exercise[d] their right to rescind within [TILA's] unconditional three-day period, the timeliness of [the plaintiffs'] notice of rescission [wa]s entirely contingent on the *Bank of Elmwood*'s alleged 'fail[ure] to satisfy [TILA's] disclosure requirements." *Id.* (emphasis added). Thus, the plaintiffs' claim "plainly qualif[ied] as '*functionally*, albeit not *formally* against [the] failed bank.' " *Id.* (quoting *Benson*, 673 F.3d at 1215); *see also Tellado v. IndyMac Mortg. Servs.*, 707 F.3d 275, 280 (3d Cir. 2013) (holding that FIRREA applied to a plaintiff's claim against a purchasing bank because "[w]ithout [the failed bank's] wrongdoing, the [plaintiffs] would have no right to cancel and therefore no claim").

The same is true with regards to Kelley's TILA Rescission claims. As stated above, Kelley alleges that WaMu failed to satisfy TILA's disclosure requirements at the time that Kelley took out the Loans in 2007. *See* Appellee App. at 235–36. Kelley alleges that he rescinded the First and Second Loans on August 24, 2009 and June 24, 2010, respectively. *Id.* at 446–49. Accordingly, Kelley did not rescind his loans "within the unconditional three-day period" provided by TILA. *See Grady*, 655 Fed.Appx. at 602. Accordingly, like the TILA rescission claim at issue in *Grady*, the "the timeliness of [Kelley's] notice[s] of rescission [are] entirely contingent on" *WaMu*'s failure to satisfy the requirements of TILA at the time that Kelley took out the Loans with WaMu. Kelley's TILA Rescission claims are "*functionally*, albeit not *formally*" against WaMu's conduct, and FIRREA's jurisdictional bar applies. *Id.*

***9** Finally, even assuming that Kelley's TILA Rescission claims are not barred by FIRREA, the Bankruptcy Court did not err in its alternative holding that Chase was entitled to summary judgment on Kelley's TILA Rescission claims because Kelley's TILA Rescission claims are without merit. As set forth above, "[a] borrower's right of rescission is extended from three days to three years if the lender (1) fails to provide notice of a borrower's right of rescission or (2) fails to make a material disclosure." *Reagen*, 2009 WL 3789997, at *6 (E.D. Cal. Nov. 10, 2009) (citing 12 C.F.R. § 226.23(a)(3)). Federal Reserve Board regulations provide that "[t]he term 'material disclosures' means the required disclosures of the annual percentage rate, the finance charge, the amount financed, the total payments, the payment schedule, and the disclosures and limitations referred to in § 226.32(c) and (d)." *Id.* (quoting 12 C.F.R. § 226.23(a)(3) n.48).

In its motion for summary judgment before the Bankruptcy Court, Chase submitted evidence that Kelley signed a "Notice of Right to Cancel" with respect to both Loans. *See* Appellee App'x 1192–93, 1229. Further, Kelley received and signed documents entitled "Truth in Lending Disclosure Statements," "Important Terms of Our WaMu Equity Plus," and "WaMu Equity Plus Agreement and Disclosure," which disclosed the material terms of the Loans. *See* Appellee App'x at 1205–55. Accordingly, because Kelley received the disclosures required by TILA, the three year period does not apply, and Kelley's right to rescind expired after three days. *See Reagen*, 2009 WL 3789997, at *6. As stated above, Kelley took out the Loans in 2007, and Kelley did not attempt to rescind the Loans until over two years later. Thus, the Bankruptcy Court did not err in holding that Kelley's rescissions were untimely.

Further, the Bankruptcy Court also held that, even assuming that Kelley's rescissions were timely, Kelley's TILA Rescission claims failed because Kelley could not demonstrate that Kelley could tender an amount necessary to rescind the Loans. *See In re Kelley*, 545 B.R. at 12 ("[Kelley's] own schedules and monthly operating reports demonstrate that he has no current ability to pay back the amount he received to achieve complete rescission."). The Ninth Circuit has recognized "that where 'it is clear from the evidence that the borrower lacks capacity to pay back what she has received (less interest, finance charges, etc.), the court does not lack discretion to do before trial what it could do after,' i.e., refuse to enforce rescission." *Merritt v. Countrywide Fin. Corp.*, 759 F.3d 1023, 1031 (9th Cir. 2014) (quoting *Yamamoto v. Bank of N.Y.*, 329 F.3d 1167, 1171–73 (9th Cir. 2003)). Kelley asserts that he has the capacity to pay back the amount to achieve rescission because Kelley can sell the Property. *See* Appellant Br. at 22, n.9. However, Kelley has proposed selling the Property for over seven years, Kelley has retained real estate agents, and Kelley has continually failed to sell the Property. *See In re Kelley*, 545 B.R. at 12; *see also* Appellee App'x at 119 (proposal to sell Property in Kelley's 2009 plan of reorganization); *id.* at 105 (bankruptcy court's 2008 approval of Kelley's retention of a real estate agent). Thus, the Bankruptcy Court did not err in its alternative holding that "it is clear from the evidence that [Kelley] lacks capacity to pay back what [he] has received," and thus summary judgment in favor of Chase was appropriate on Kelley's TILA Rescission claims. *Yamamoto*, 329 F.3d at 1171–73.

D. Kelley's Declaratory Judgment Claims Regarding Chase's Ownership of the Notes and Deeds of Trust

Lastly, Kelley's remaining claims seek declaratory relief that Chase does not own the Loans at issue. *See* Appellee App. 237–39. Kelley's allegations and arguments as to his remaining claims are hard to discern, and Kelley does not address these claims clearly in his brief on appeal to this Court. However, these claims appear to be based on the same alleged misconduct of WaMu discussed above. For example, Kelley asserts that the First and Second Loans were fraudulently endorsed because the notes have the "blank endorsement of Cynthia A. Riley," who was acting as an agent of "Washington Mutual Bank, F.A." *See id.* at 237–39, 451. Further, Kelley asserts in his TAC that the First Loan was "not held or owned by Washington Mutual Bank at the time of the receivership," and that "[t]he Second Loan could not have been transferred by the Receiver from [WaMu] to Chase in September 2008." *Id.* at 238–39; *see also* Appellant Br. at 30 (arguing that the "[L]oans were not held by Washington Mutual Bank at the time of the Receivership").

To the extent that Kelley's declaratory relief claims regarding Chase's ownership of the notes and deeds of trust are rooted in the actions of WaMu, they are barred by FIRREA for the reasons discussed above. District courts have held that FIRREA's jurisdictional bar applies to similar factual allegations. In *Berg v. JPMorgan Chase, N.A.*, the plaintiffs took out a home loan with WaMu, and the plaintiff's loan was purchased by Chase pursuant to the P & A Agreement. 2015 WL 894460, at *1 (E.D. Pa. Mar. 3, 2015). After Chase filed a mortgage foreclosure action against the Bergs in state court, the Bergs filed a separate quiet title action against Chase. *Id.* The Bergs' quiet title action alleged that the note underlying their home loan "had been materially altered by the unauthorized endorsement" of Cynthia Riley, and that the note was thus unenforceable. *Id.* The district court held that FIRREA barred the Berg's quiet title action against Chase because "[t]he alleged defect in the Note exists only because the Note was endorsed in blank with a stamp bearing a Washington Mutual employee's name." *Id.* at *3. "Absent Washington Mutual's conduct," the district court explained, the Bergs "would have no right to challenge the validity of the Note and thus no claim." *Id.* at *3. Thus, "[b]ecause the Bergs' claim is based entirely on an act of the depository institution, Washington Mutual, § 1821(d)(13)(D)(ii) deprive[d] the Court of subject matter jurisdiction." *Id.*

[9] Accordingly, to the extent that Kelley's claims against Chase are rooted in the assertion that Washington Mutual Bank, F.A. "could not authorize Cynthia Riley to blank endorse anything because it did not exist in 2007 or thereafter," Kelley's claims are "based entirely on an act of the [failed] depository institution, Washington Mutual," and are not based on any independent misconduct of Chase. *see id.* Thus, as with the claims at issue in *Berg*, Kelley's remaining declaratory relief claims "relate to WaMu's acts or omissions for purposes of § 1821(d)(13) (D)" and are barred by FIRREA. *See Rundgren*, 760 F.3d at 1065; *see also Berg*, 2015 WL 894460, at *3 ("Because the Bergs' claim is based entirely on an act of the depository institution, Washington Mutual, § 1821(d)(13) (D)(ii) deprives the Court of subject matter jurisdiction.").

However, to the extent that Kelley's remaining claims contest Chase's proof of claims in the Bankruptcy Court and allege independent misconduct by Chase, FIRREA does not bar Kelley's claims. *See Rundgren*, 760 F.3d at 1061–63 (noting that FIRREA does not bar true "affirmative defenses," but FIRREA did bar the "plaintiffs bringing an independent action against [Chase], raising common law and statutory claims based on WaMu's alleged fraud"). Nonetheless, the Bankruptcy Court's grant of summary judgment in favor of Chase on these claims was appropriate because Kelley's claims regarding Chase's ownership of the Loans are not meritorious. As stated above, courts have repeatedly rejected Kelley's argument regarding the legal effect of WaMu's name change in 2005. *See Lanini*, 2014 WL 1347365, at *3 (rejecting "any claim that [WaMu's] name change somehow precludes Chase's authority to foreclose"). Moreover, it is undisputed that Chase entered into a P & A Agreement with the FDIC on September 25, 2008, and that "the FDIC transferred to Chase 'all right, title and interest of the Receiver in and to all of the assets of WaMu." *See Heflebower v. JPMorgan Chase Bank, NA*, 2013 WL 5476806, at *6 (E.D. Cal. Sept. 30, 2013). "In other words, Chase purchased WaMu's loans, including the right to collect payments against the loans, and the right to foreclose on them for failure of borrower to tender payments." *Id.*; *see also Jones v. JP Morgan Chase Bank, N.A.*, 2012 WL 4815468, at *1 (N.D. Cal. Oct. 9, 2012) ("[C]ourts in this district have found, interpreting the same P & A agreement, that Chase purchased WaMu's loans, including the right to foreclose on them."). Chase submitted evidence in the Bankruptcy Court that Chase owns and is in possession of the notes and deeds of trust underlying Kelley's Loans, and Chase produced evidence that Kelley's signature appears on these documents. *See* Appellee App. 1192–93.

***11** In sum, the evidence shows that, Kelley "contracted to borrow funds from WaMu," that Kelley's "Loan[s] w[ere] subsequently sold to Chase under the P&A Agreement," and that "Chase [is] legally and justly entitled to collect and retain loan repayments from" Kelley. *Heflebower*, 2013 WL 5476806, at *6. Accordingly, the

Footnotes
Bankruptcy Court did not err in granting summary judgment in favor of Chase.

IV. CONCLUSION

For the foregoing reasons, the Bankruptcy Court's entry of judgment in favor of Chase is AFFIRMED.

IT IS SO ORDERED.

All Citations

--- B.R. ----, 2017 WL 784000

1 Kelley moved in the Bankruptcy Court for partial summary judgment against Chase. Kelley did not move for summary judgment on Kelley's sixth claim, which was entitled "First Loan Payment and Discharge of Debt." *See* Appellant App. at 241–42. Chase moved for full summary judgment against Kelley. However, the parties' summary judgment motions before the Bankruptcy Court do not appear to address Kelley's claim for "First Loan Payment and Discharge of Debt," and this claim also was not addressed by the Bankruptcy Court in its order granting summary judgment. Further, the parties do not address this claim on appeal to this Court. Accordingly, the Court will not address this claim, and will consider the issue waived. *See In re Wade*, 2014 WL 5088258, at *3 (N.D. Cal. Oct. 9, 2014) (noting that issues not raised before the Bankruptcy Court, or not raised before the district court on appeal from the Bankruptcy Court, are waived).

2 Kelley also asserts that the Loan was illegally "table funded" because "the actual Lender" was an investor, not WaMu. "Table funding" refers to a transaction in which "a loan is funded by a contemporaneous advance of loan funds and an assignment of the loan to the person advancing the funds." *Easter v. Am. W. Fin.*, 381 F.3d 948, 955 (9th Cir. 2004) (quoting 24 C.F.R. § 3500.2). " 'Table funding,' when it includes a kickback from the 'true lender' to the ostensible lender," is prohibited by the Real Estate Settlement Procedures Act ("RESPA"). *Warwick v. Bank of N.Y Mellon*, 2016 WL 2997166, at *18 (C.D. Cal. May 23, 2016). However, as with Kelley's other contractual invalidity arguments, Kelley's "table funding" argument relies solely on the conduct of WaMu, and is thus barred by FIRREA. Regardless, even assuming that the claim is not barred by FIRREA, Kelley has not presented evidence showing that his Loans were table funded and, in any event, "to the extent that RESPA provides for a private cause of action, which Plaintiffs ha[ve] not directly pled, the damages are for treble damages and attorneys' fees, not the nullification of the loan," which is the remedy that Kelley seeks. *Id.* at *19.

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848 F.3d 953
United States Court of Appeals, Eleventh Circuit.

IN RE: R. Scott APPLING, Debtor.
R. Scott Appling, Plaintiff–Appellant,
v.
Lamar, Archer & Cofrin, LLP, Defendant–Appellee.

No. 16-11911
|
(February 15, 2017)

Synopsis

Background: Law firm brought adversary proceeding to except debt from discharge on "false pretenses, false representation, or actual fraud" theory. The United States Bankruptcy Court for the Middle District of Georgia, No. 3:13-bkc-03042-JPS, James P. Smith, Chief Judge, 527 B.R. 545, entered judgment in favor of firm, and debtor appealed. The District Court, No. 3:15-cv-00031-CAR, C. Ashley Royal, J., 2016 WL 1183128, affirmed. Debtor appealed.

Holdings: The Court of Appeals, William Pryor, Circuit Judge, held that:

[1] term "respecting," as used in dischargeability exceptionfor debts obtained by materially false statements in writing "respecting the debtor's or an insider's financial condition," had to be given its ordinary meaning as referring to statements having a direct relation to, or impact on, the debtor's or an insider's financial condition;

[2] "statement respecting the debtor's or an insider'sfinancial condition," as used in dischargeability exception, could not be interpreted narrowly as simply another way to refer to financial statement; and

[3] false statements that debtor allegedly made to membersof law firm regarding an anticipated federal income tax refund, in order to convince firm to continue with legal representation despite mounting unpaid legal bills, were statements "respecting the debtor's financial condition," which, not being in writing, did not provide basis to except debt from discharge.

Reversed and remanded.

Rosenbaum, Circuit Judge, filed concurring opinion.

West Headnotes (14)

[1] **Bankruptcy**
Conclusions of law; d e novo review

On appeal from district court's decision in its bankruptcy appellate capacity, the Court of Appeals assesses bankruptcy court's judgment anew, employing same standard of review that the district court itself used.

Cases that cite this headnote

[2] **Bankruptcy**
Conclusions of law; d e novo review

Bankruptcy
Clear error

Bankruptcy court's factual findings are reviewed for clear error; its legal conclusions, de novo. Fed. R. Bankr. P. 8013.

Cases that cite this headnote

[3] **Bankruptcy**
Necessity of writing

Debt incurred by a fraudulent statement respecting the debtor's financial condition can be discharged in bankruptcy, if statement is oral and not in writing. 11 U.S.C.A. § 523(a)(2)(B).

Cases that cite this headnote

[4] **Bankruptcy**
Necessity of writing

Bankruptcy
False pretenses; c onduct, concealment, omission or silence; i mplied representations

If debtor's statements regarding an anticipated federal income tax return, statements which debtor made in order to persuade law firm to continue representing him in nonbankruptcy matter, were not statements "respecting his financial condition," then debtor could discharge his resulting debt to firm only if he disproved an element of fraud under the "false pretenses, false representation, or actual fraud" dischargeability exception; however, if statements were statements "respecting his financial condition," then debtor could discharge the debt without disproving any element of fraud because statements were not in writing. 11 U.S.C.A. § 523(a)(2)(A, B).

Cases that cite this headnote

[5] **Bankruptcy**
Construction and Operation

Interpretation of the Bankruptcy Code starts where all such inquiries must begin, with language of the Code itself. 11 U.S.C.A. § 101 et seq.

Cases that cite this headnote

[6] **Statutes**
Undefined terms

When statutory terms are left undefined, courts look to their ordinary, everyday meanings, unless the context indicates that they bear a technical sense.

Cases that cite this headnote

[7] **Statutes**
Similarity or difference

Statutory word or phrase is presumed to bear the same meaning throughout statutory text.

Cases that cite this headnote

[8] **Bankruptcy**
Financial condition; v alue

Term "respecting," as used in dischargeability exception for debts obtained by materially false statements in writing "respecting the debtor's or an insider's financial condition," had to be given its ordinary meaning as referring to statements having a direct relation to, or impact on, the debtor's or an insider's financial condition, something which a materially false statement regarding a single asset could have. 11 U.S.C.A. § 523(a)(2)(B).

Cases that cite this headnote

[9] **Statutes**
Language

Judges have a responsibility to interpret the whole of statutory text.

Cases that cite this headnote

[10] **Bankruptcy**
Financial condition; v alue

"Statement respecting the debtor's or an insider's financial condition," as used in dischargeability exception, could not be interpreted narrowly as simply another way to refer to financial statement; term "financial statement" was technical term, which Congress would have used if that was what it meant. 11 U.S.C.A. § 523(a)(2)(B).

Cases that cite this headnote

[11] **Statutes**
Statute as a Whole; R elation of Parts to Whole and to One Another

Statutes
Superfluousness

When interpreting statute, court should, if possible, give effect to every word and every provision, and none should be needlessly given an interpretation that causes it to duplicate another provision or to have no consequence.

Cases that cite this headnote

[12] **Bankruptcy**
Financial condition; v alue

Term "statement," as used in dischargeability exception for debts obtained by materially false statements in writing respecting the debtor's or an insider's financial condition, meant any expression or embodiment in words, as opposed to a nonactionable omission. 11 U.S.C.A. § 523(a)(2)(B).

Cases that cite this headnote

[13] Statutes

Absence of Ambiguity; A pplication of Clear or Unambiguous Statute or Language

When language of statute is clear, court need not look any further in interpreting it.

Cases that cite this headnote

[14] Bankruptcy

Necessity of writing

False statements that debtor allegedly made to members of law firm regarding an anticipated federal income tax refund, in order to convince firm to continue with legal representation despite mounting unpaid legal bills, were statements “respecting the debtor's financial condition,” which, not being in writing, did not provide basis to except any resulting debt from discharge, even if they were knowingly made by debtor with intent to deceive firm, and if firm justifiably, or even reasonably, relied thereon. 11 U.S.C.A. § 523(a)(2)(B).

Cases that cite this headnote

Appeal from the United States District Court for the Middle District of Georgia, D.C. Docket Nos. 3:15–cv– 00031–CAR, 3:13–bkc–03042–JPS

Attorneys and Law Firms

Paul Whitfield Hughes, Michael B. Kimberly, Jonathan Weinberg, Mayer Brown, LLP, Washington, DC, Daniel L. Wilder, Law Offices of Emmett L. Goodman, Jr. LLC, Macon, GA, for Plaintiff–Appellant.

David William Davenport, Robert C. Lamar, Lamar Archer & Cofrin, Atlanta, GA, for Defendant–Appellee.

Before WILLIAM PRYOR and ROSENBAUM, Circuit Judges, and MARTINEZ,[*] District Judge.

Opinion

WILLIAM PRYOR, Circuit Judge:

This appeal presents a question that has divided the federal courts: Can a statement about a single asset be a “statement respecting the debtor's ... financial condition”? 11 U.S.C. § 523(a)(2). Ordinarily, a debtor cannot discharge any debt incurred by fraud, *id.* § 523(a) (2)(A), but a debtor can discharge a debt incurred by a false statement respecting his financial condition unless that statement is in writing, *id.* § 523(a)(2)(B). R. Scott Appling made false oral statements to his lawyers, Lamar, Archer & Cofrin, LLP, that he expected a large tax refund that he would use to pay his debt to the firm. After Lamar obtained a judgment against Appling for the debt, Appling filed for bankruptcy and Lamar initiated an adversary proceeding to have the debt ruled nondischargeable. The bankruptcy court and the district court ruled that Appling's debt could not be discharged under section 523(a)(2)(A) because it was incurred by fraud. But we disagree. Because Appling's statements about his tax refund “respect[ ] [his] ... financial condition,” *id.* § 523(a)(2)(B)(ii), and were not in writing, *id.* § 523(a)(2)(B), his debt to Lamar can be discharged in bankruptcy. We reverse and remand.

I. BACKGROUND

R. Scott Appling hired the law firm Lamar, Archer & Cofrin, LLP, to represent him in litigation against the former owners of his new business. Appling agreed to pay Lamar on an hourly basis with invoices for fees and costs due monthly. Appling became unable to keep current on the mounting legal bill and as of March 2005, owed Lamar $60,819.97. Lamar threatened to terminate the firm's representation and place an attorney's lien on all work product unless Appling paid the outstanding fees.

Appling and his attorneys held a meeting in March 2005. The bankruptcy court found that during this meeting Appling stated he was expecting a tax refund of “approximately $100,000,” which would be enough to pay current and future fees. Lamar contends that in reliance on this statement, it continued its representation and did not begin collection of its overdue fees.

When Appling and his wife submitted their tax return, they requested a refund of only $60,718 and received a refund of $59,851 in October. The Applings spent this money on their business. They did not pay Lamar.

Appling and his attorneys met again in November 2005. The bankruptcy court found that Appling stated he had not yet received the refund. Lamar contends that in reliance on this statement, it agreed to complete the pending litigation and forego immediate collection of its fees but refused to undertake any additional representation. In March 2006, Lamar sent Appling his final invoice for a principal amount due of $55,303.66 and $6,185.32 in interest.

Five years later, Lamar filed suit against Appling in a superior court in Georgia. In October 2012, Lamar obtained a judgment for $104,179.60. Three months later, the Applings filed for bankruptcy.

Lamar initiated an adversary proceeding against Appling in bankruptcy court. The bankruptcy court ruled that because Appling made fraudulent statements on which Lamar justifiably relied, Appling's debt to Lamar was nondischargeable, 11 U.S.C. § 523(a)(2)(A). The district court affirmed. The district court rejected Appling's argument that his oral statements "respect[ed] ... [his] financial condition," 11 U.S.C. § 523(a)(2)(B), and should have been dischargeable. The district court ruled that "statements respecting the debtor's financial condition involve the debtor's net worth, overall financial health, or equation of assets and liabilities. A statement pertaining to a single asset is not a statement of financial condition." The district court agreed with the bankruptcy court that Appling made material false statements with the intent to deceive on which Lamar justifiably relied.

II. STANDARD OF REVIEW

[1] [2] When we sit as the second appellate court to review a bankruptcy case, *In re Glados, Inc.*, 83 F.3d 1360, 1362 (11th Cir. 1996), we "assess the bankruptcy court's judgment anew, employing the same standard of review the district court itself used," *In re Globe Mfg. Corp.*, 567 F.3d 1291, 1296 (11th Cir. 2009). "Thus, we review the bankruptcy court's factual findings for clear error, and its legal conclusions *de novo*." *Id.*

III. DISCUSSION

The Bankruptcy Code gives a debtor a fresh start by permitting him to discharge his pre-existing debts. But there are many exceptions to discharge. And some of those exceptions protect victims of fraud.

Section 523(a)(2) creates two mutually exclusive exceptions to discharge:

> **(a)** A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt—
>
> ...
>
> **(2)** for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by—
>
> **(A)** false pretenses, a false representation, or actualfraud, *other than a statement respecting the debtor's or an insider's financial condition*;
>
> **(B)** use of a *statement in writing*—
>
> (i) that is materially false;
>
> (ii) *respecting the debtor's or an insider's financial condition*;
>
> (iii) on which the creditor to whom the debtor isliable for such money, property, services, or credit reasonably relied; and
>
> (iv) that the debtor caused to be made or publishedwith intent to deceive; ...

11 U.S.C. § 523(a)(2) (emphasis added).

[3] The Code treats debts incurred by a statement "respecting the debtor's ... financial condition" differently from other debts. *Id.* All fraud "other than a statement respecting the debtor's ... financial condition" is covered by subsection (A). *Id.* § 523(a)(2)(A). Under subsection (A), a debtor cannot discharge a debt obtained by any type of fraudulent statement, oral or written. *Id.* A creditor also need prove only justifiable reliance. *Field v. Mans*, 516 U.S. 59, 61, 116 S.Ct. 437, 133 L.Ed.2d 351 (1995). But if a statement is made "respecting the debtor's ... financial condition," then subsection (B) governs. 11 U.S.C. § 523(a)(2)(B)(ii). To avoid discharge of a debt induced by a statement respecting the debtor's financial condition, a creditor must show reasonable reliance and that the statement was intentional, materially false, and in writing. *Id.* § 523(a)(2)(B). Thus, a debt incurred by an oral, fraudulent statement respecting the debtor's financial condition can be discharged in bankruptcy.

[4] We must determine whether Appling's statements about a single asset are "statement[s] respecting [his] ... financial condition." *Id.* § 523(a)(2). The bankruptcy court found that Appling made false oral statements about his anticipated tax refund to receive an extension of credit from Lamar. If these statements *do not* respect his financial condition, Appling can discharge his debt to Lamar in bankruptcy only if he disproves an element of fraud. *Id.* § 523(a)(2)(A). But if the statements *do* respect his financial condition, Appling can discharge his debt to Lamar because the statements were not in writing. *Id.* § 523(a)(2)(B).

The circuits and other federal courts are split on this question. The Fourth Circuit has held that a "debtor's assertion that he owns certain property free and clear of other liens is a statement respecting his financial condition." *Engler v. Van Steinburg*, 744 F.2d 1060, 1061 (4th Cir. 1984). Several bankruptcy courts—including one in this Circuit, *In re Aman*, 492 B.R. 550, 565 & n.47 (Bankr. M.D. Fla. 2010)—have agreed. *See, e.g.*, *In re Carless*, No. 10–42988, slip op. at *3–4, 2012 WL 32700 (Bankr. D.N.J. Jan. 6, 2012); *In re Nicolai*, No. 05–29876, slip op. at *1, 2007 WL 405851 (Bankr. D.N.J. Jan. 31, 2007); *In re Hambley*, 329 B.R. 382, 399 (Bankr. E.D.N.Y. 2005); *In re Priestley*, 201 B.R. 875, 882 (Bankr. D. Del. 1996); *In re Kolbfleisch*, 97 B.R. 351, 353 (Bankr. N.D. Ohio 1989); *Matter of Richey*, 103 B.R. 25, 29 (Bankr. D. Conn. 1989); *In re Rhodes*, 93 B.R. 622, 624 (Bankr. S.D. Ill. 1988); *In re Howard*, 73 B.R. 694, 702 (Bankr. N.D. Ind. 1987); *In re Panaia*, 61 B.R. 959, 960–61 (Bankr. D. Mass. 1986); *In re Roeder*, 61 B.R. 179, 181 n.1 (Bankr. W.D. Ky. 1986); *In re Prestridge*, 45 B.R. 681, 683 (Bankr. W.D. Tenn. 1985). But the Fifth, Eighth, and Tenth Circuits have held that a statement about a single asset does not respect a debtor's financial condition because it "says nothing about the overall financial condition of the person making the representation or the ability to repay debt." *In re Bandi*, 683 F.3d 671, 676 (5th Cir. 2012); *see also In re Lauer*, 371 F.3d 406, 413–14 (8th Cir. 2004); *In re Joelson*, 427 F.3d 700, 706 (10th Cir. 2005). And some bankruptcy courts in other circuits have agreed. *See, e.g.*, *In re Feldman*, 500 B.R. 431, 437 (Bankr. E.D. Penn. 2013); *In re Banayan*, 468 B.R. 542, 575–76 (Bankr. N.D.N.Y. 2012); *In re Campbell*, 448 B.R. 876, 886 (Bankr. W.D. Penn. 2011).

[5] **[6]** "[I]nterpretation of the Bankruptcy Code starts 'where all such inquiries must begin: with the language of the statute itself.' " *Ransom v. FIA Card Servs. N.A.*, 562 U.S. 61, 69, 131 S.Ct. 716, 178 L.Ed.2d 603 (2011) (quoting *United States v. Ron Pair Enters., Inc.*, 489 U.S. 235, 241, 109 S.Ct. 1026, 103 L.Ed.2d 290 (1989)). Because the Code does not define the relevant terms, we look to "their ordinary, everyday meanings—unless the context indicates that they bear a technical sense." Antonin Scalia & Bryan A. Garner, *Reading Law: The Interpretation of Legal Texts* 69 (2012); *see also In re Piazza*, 719 F.3d 1253, 1261 (11th Cir. 2013) (applying this canon to the Bankruptcy Code). The text and context establish that a statement about a single asset can be a "statement respecting the debtor's ... financial condition." 11 U.S.C. § 523(a)(2).

[7] "Financial condition" likely means one's overall financial status. Elsewhere in the statute, the Bankruptcy Code defines "insolvent" as the "financial condition such that the sum of such entity's debts is greater than all of such entity's property." *Id.* § 101(32)(A). In this context, the statute uses "financial condition" to describe the overall state of being insolvent, not any particular asset on its own. Because "[a] word or phrase is presumed to bear the same meaning throughout a text," Scalia & Garner, *supra*, at 170, we should interpret "financial condition" in section 523(a)(2) in the same way. Whether by its ordinary meaning or as a term of art, "financial condition" likely refers to the sum of all assets and liabilities.

But even if "financial condition" means the sum of all assets and liabilities, it does not follow that the phrase "statement *respecting* the debtor's ... financial condition," *Id.* § 523(a)(2) (emphasis added), covers only statements that encompass the entirety of a debtor's financial condition at once. Read in context, the phrase "statement *respecting* the debtor's ... financial condition," *id.* includes a statement about a single asset. We must not read the word "respecting" out of the statute. *See* Scalia & Garner, *supra*, at 174 ("If possible, every word ... is to be given effect.").

[8] "Respecting" is defined broadly as "[w]ith regard or relation to; regarding; concerning." *Respecting*, *Webster's New International Dictionary* 2123 (2d ed. 1961); *see also Respecting*, *Oxford English Dictionary* (online ed.) ("With respect to; with reference to; as regards."). For example, documents can "relate to" or "concern" someone's health without describing their entire medical history. Articles can "reference" the Constitution without quoting its entire text. Likewise, a statement can "respect" a debtor's "financial condition" without describing the overall financial situation of the debtor. The Supreme Court has interpreted "with respect to" in a statute to mean "direct relation to, or impact on." *Presley v. Etowah Cty. Comm'n*, 502 U.S. 491, 506, 112 S.Ct. 820, 117 L.Ed.2d 51 (1992). And the Court has interpreted "respecting" in the First Amendment to include any partial step toward the establishment of religion. *Lemon v. Kurtzman*, 403 U.S. 602, 612, 91 S.Ct. 2105, 29 L.Ed.2d 745 (1971). A statement about a single asset "relates to" or "impacts" a debtor's overall financial condition. And knowledge of one asset or liability is a partial step toward knowing whether the debtor is solvent or insolvent.

If the statute applied only to statements that expressed a debtor's overall financial condition, Congress could have said so. Lamar argues that "the preposition 'respecting' has no magic, expansive effect in the statute, it is simply a required grammatical device necessary to connect two related terms." Perhaps this argument would have more sway if the statute said "statement *of* the debtor's financial condition." But Congress did not use this language. Congress also did not say "statement indicating" or "revealing" or "disclosing" or "encompassing" the debtor's financial condition, phrases that would connote a full or complete expression of financial condition.

[9] Lamar dismisses the focus on the word "respecting" as "nothing more than a game of semantics," but judges have a responsibility to interpret the whole text. And "[s]ometimes the canon [of ordinary meaning] governs the interpretation of so simple a word as a preposition." Scalia & Garner, *supra*, at 71. A statement about a single asset is still a statement *respecting* a debtor's financial condition.

[10] Lamar argues that because the legislative history often used "financial statement" in place of "statement respecting the debtor's ... financial condition," 11 U.S.C. § 523(a)(2), we should read the statute to apply only to financial statements, but the word "statement" should also be given its ordinary meaning. Mere proximity of "statement" to "financial condition" is not enough to limit the meaning of the text. "Statement" is defined as "[t]hat which is stated; an embodiment in words of facts or opinions; a narrative; recital; report; account." *Statement*, *Webster's New International Dictionary* 2461 (2d ed. 1961). The definition of financial statement is technical and would exclude a statement about a single asset: "A balance sheet, income statement, or annual report that summarizes an individual's or organization's financial condition on a specified date or for a specified period by reporting assets and liabilities." *Financial Statement*, *Black's Law Dictionary* (10th ed. 2014). Setting aside the problems with legislative history, Lamar's argument works against it. Precisely because "[t]he term 'financial statement' has a strict, established meaning," *Joelson*, 427 F.3d at 709, we should expect the statute to say "financial statement" if it conveys that meaning. But the statute instead says "statement." To limit the definition to only "financial statements," Congress need only say so. *Cf.* 11 U.S.C. § 1125 (using the term "disclosure statement"); *Id.* § 101(49)(A)(xii) ("registration statement").

[11] The surplusage cannon supports our determination that "statement" should be given its ordinary meaning. "If possible, every word and every provision is to be given effect .... None should needlessly be given an interpretation that causes it to duplicate another provision or to have no consequence." Scalia & Garner, *supra*, at 174; *see also* *Reiter v. Sonotone Corp.*, 442 U.S. 330, 339, 99 S.Ct. 2326, 60 L.Ed.2d 931 (1979). In subsection (B), the statute says "use of a statement in writing." 11 U.S.C. § 523(a)(2)(B). Because a formal financial statement is almost always a written document (it is hard to imagine an oral recitation of all assets and liabilities), reading the statute to cover only financial statements would render the writing requirement surplusage.

[12] And in the context of a statute about fraud, the ordinary meaning of the word "statement" makes sense. Section 523(a)(2) creates two similar exceptions to discharge for debts incurred by fraud. Subsection (A) references specific common-law torts. *See* *Field*, 516 U.S. at 69, 116 S.Ct. 437 (" '[F]alse pretenses, a false representation, or actual fraud,' carry the acquired meaning of terms of art .... [T]hey imply elements that the common law has defined them to include." (quoting 11 U.S.C. § 523(a)(2)(A))). Subsection (B) enumerates its own elements which are analogous, but not identical to the common law elements. For example, where the common law requires justifiable reliance, section 523(a)(2)(B)(iii) requires reasonable reliance. *Field*, 516 U.S. at 72–75, 116 S.Ct. 437. Similarly, where the common law requires either an affirmative representation or an intentional omission, section 523(a)(2)(B) requires a "statement," as opposed to an omission. True, if Congress wanted to exclude omissions from subsection (B), it could have used the term "representation" and avoided the confusion with the term "financial statement." But Congress would not have said "false representation" without implying the common law term of art. *See Field*, 516 U.S. at 69, 116 S.Ct. 437. Accordingly, "statement" means an expression or embodiment in words, as opposed to a nonactionable omission.

Lamar also argues that the "only way to give Section 523(a)(2)(A) meaning is to interpret it to provide a distinction between oral and written representations," but this argument reveals a fundamental misunderstanding of the statute. Section 523(a)(2)(A) covers most fraud. But section 523(a)(2)(B) covers statements respecting financial conditions. Lamar states that "certain oral misrepresentations must be non-dischargeable." They are. Any debt incurred by an oral misrepresentation that is not "respecting the debtor's financial condition" is nondischargeable under subsection (A). Appling provides a list of examples, including false representations about job qualifications and lies about the purpose and recipient of a payment. The question is how broadly to define the phrase "statement respecting the debtor's ... financial condition," not whether allowing discharge of debts incurred by oral misrepresentations about finances is a good idea. The statute allows the discharge of debts incurred by oral statements so long as they "respect" the debtor's "financial condition." Lamar's argument is based on policy, not statutory structure.

[13] When the language of the statute is clear, we need not look any further. *See Puerto Rico v. Franklin Cal. Tax– Free Tr.*, ––– U.S. ––––, 136 S.Ct. 1938, 1946, 195 L.Ed.2d 298 (2016) (When "the statute's language is plain," "that is also where the inquiry should end." (internal quotations omitted)); *United States v. Great Northern Ry. Co.*, 287 U.S. 144, 154, 53 S.Ct. 28, 77 L.Ed. 223 (1932) ("[W]e have not traveled, in our search for the meaning of the lawmakers, beyond the borders of the statute."). A distaste for dishonest debtors does not empower judges to disregard the text of the statute. Because the text is not ambiguous, we hold that "statement[s] respecting the debtor's ... financial condition" may include a statement about a single asset.

This result is also perfectly sensible. The requirement that some statements be made in writing promotes accuracy and predictability in bankruptcy disputes that often take place years after the facts arose. Lamar refers to our interpretation as a "giant fraud loophole." But the requirement of a writing is not at all unusual in the history of the law. From the Statute of Frauds to the Uniform Commercial Code, law sometimes requires that proof be in writing as a prerequisite to a claim for relief. This requirement may seem harsh after the fact, especially in the case of fraud, but it gives creditors an incentive to create writings before the fact, which provide the court with reliable evidence upon which to make a decision. In the context of a debt incurred by fraud, a lender concerned about protecting its rights in bankruptcy can easily require a written statement from the debtor before extending credit. Lamar, a law firm, could have required Appling to put his promise to spend his tax return on their legal fees in writing before continuing to represent him.

[14] This rule strikes a reasonable balance between the " 'conflicting interests' of discouraging fraud and of providing the honest but unfortunate debtor a fresh start." *In re Vann*, 67 F.3d 277, 284 (11th Cir. 1995) (quoting *Grogan v. Garner*, 498 U.S. 279, 287, 111 S.Ct. 654, 112 L.Ed.2d 755 (1991)). The code does not unfairly reward dishonest debtors, but instead imposes different requirements of proof for different kinds of statements. A statement respecting a debtor's financial condition must be in writing, which helps both the honest debtor prove his honesty and the innocent creditor prove a debtor's dishonesty. And providing an incentive for creditors to receive statements in writing may reduce the incidence of fraud. Because a statement about a single asset can be a "statement respecting the debtor's ... financial condition," and because Appling's statements were not in writing, his debt can be discharged under section 523(a)(2)(B).

IV. CONCLUSION

We **REVERSE** the order ruling that Appling's debt to Lamar is nondischargeable and **REMAND** for further proceedings consistent with this opinion.

ROSENBAUM, Circuit Judge, concurring:

Sometimes things are not as they seem. Today we conclude that the phrase "statement respecting ... the debtor's financial condition" in 11 U.S.C. § 523(a)(2) warrants a broad reading. As a result, Appling, the debtor in this case, will receive a discharge of the debt he incurred by lying about how he would pay for the legal services he dishonestly obtained. That certainly seems to frustrate a "primary purpose" of the Bankruptcy Act to provide relief to only the "honest debtor." *See Local Loan Co. v. Hunt,* 292 U.S. 234, 244, 54 S.Ct. 695, 78 L.Ed. 1230 (1934) (citation and internal quotation marks omitted).

But in actuality, the broad reading we give to the phrase "statement respecting ... the debtor's financial condition" better promotes congressional intent to give a fresh start to only the "honest debtor" than does a narrow construction of the same phrase. This is so because the very same phrase appears in both §§ 523(a)(2)(A) and (B), and it must have the same meaning in both subsections. Though a narrow construction of the phrase in subsection (A) seems to further congressional intent to protect only the "honest debtor," a broad interpretation of the phrase in subsection (B) better comports with congressional intent. And the reality is that a broad construction of the phrase "statement respecting ... the debtor's financial condition" in subsection (B) advances congressional intent to provide relief for only the "honest debtor" more than a narrow interpretation of the same phrase in subsection (A).

Because the words of the phrase alone are ambiguous, we must construe the phrase with an eye towards congressional intent in enacting the Bankruptcy Act. When we do that, it is clear that "statement respecting ... the debtor's financial condition" must have the broad meaning that the panel attributes to it.

I.

There's no getting around it. Standing alone, the words of the phrase "statement respecting ... the debtor's financial condition" are not unambiguous. True, the panel seems to think they are and argues that the words clearly mean any statement about any finance, asset, or liability that the debtor may have. But other courts have concluded that the language "statement respecting ... the debtor's financial condition" refers to only statements about a debtor's overall financial circumstances—which do not include statements about only a single asset or liability.

Among the courts that appear to have understood the phrase to mean the opposite of what we conclude today is the Supreme Court, though the Supreme Court has not expressly addressed the meaning of the language. In *Field v. Mans,* 516 U.S. 59, 116 S.Ct. 437, 133 L.Ed.2d 351 (1995), the Court held that a creditor need show only justifiable reliance on a fraudulent misrepresentation in order to except the debt incurred as a result of that reliance, from discharge under § 523(a)(2)(A). In reaching this conclusion, the Supreme Court discussed § 523(a) (2)(A) and (B)'s references to "a statement respecting the debtor's ... financial condition" and conveyed its understanding that the words "financial condition" in § 523(a)(2) are a prohibition on excepting from discharge under both subsections (A) and (B) "debts traceable to ... a materially false *financial statement*," *id.* at 64, 116 S.Ct. 437 (emphasis added), apparently meaning "financial statement" as a term of art referring to a statement of net worth, not a statement about a single asset or liability. So at least at the time it decided *Field*, the Supreme Court appeared to have a different understanding of the phrase "a statement respecting the debtor's ... financial condition" than we embrace today.

To be sure, I do not suggest that *Field*'s discussion of the meaning of "a statement respecting the debtor's ... financial condition" purports to instruct courts on the proper meaning of § 523(a)(2)(A). But the Supreme Court's understanding as conveyed in *Field* demonstrates that the language of the phrase is fairly susceptible of more than one meaning.

Three other circuits have likewise concluded that the phrase "a statement respecting the debtor's ... financial condition" must be construed narrowly, to refer to only those statements about a debtor's overall net worth—though they do not appear to have determined the language of the phrase to have an unambiguous meaning. *See, e.g., In re Bandi,* 683 F.3d 671 (5th Cir. 2012); *In re Lauer,* 371 F.3d 406 (8th Cir. 2004); *In re Joelson,* 427 F.3d 700 (10th Cir. 2005).

But while the language itself of the phrase in question may not be unambiguous, that doesn't mean that § 523(a)(2) is ambiguous in the overall statutory scheme. When we construe a statute, we must do so not only by looking to the language itself, but also by reference to "the specific context in which that language is used, and the broader context of the statute as a whole." *Yates v. United States,* ––– S.Ct. ––––, 135 S.Ct. 1074, 1081–82, 191 L.Ed.2d 64 (2015) (citation and quotation marks omitted). And when we do that, it is clear that we must give the phrase "a statement respecting the debtor's ... financial condition" a broad construction.

The Supreme Court has repeatedly emphasized that the Bankruptcy Code "limits the opportunity for a completely unencumbered new beginning to the 'honest but unfortunate debtor.' " *Grogan v. Garner,* 498 U.S. 279, 287, 111 S.Ct.

654, 112 L.Ed.2d 755 (1991) (quoting *Hunt*, 292 U.S. at 244, 54 S.Ct. 695). For this reason, only honest debtors receive the benefit of the general policy that exceptions to discharge are to be construed strictly against the creditor and liberally in favor of the debtor. *In re St. Laurent*, 991 F.2d 672, 680 (11th Cir. 1993). Indeed, we have said that "the malefic debtor may not hoist the Bankruptcy Code as protection from the full consequences of fraudulent conduct." *Id.* at 680–81.

So to the extent that the language "statement respecting ... the debtor's financial condition" is fairly and reasonably susceptible of a construction that better furthers congressional intent to protect only the honest debtor, we are obliged to apply that interpretation. When it comes to § 523(a)(2), a broad construction is reasonable and better accomplishes this purpose than a narrow one.

As the panel notes, the phrase "statement respecting ... the debtor's financial condition" appears in both subsections (A) and (B). We therefore presume it to have the same meaning in both subsections. *See Mohasco Corp. v. Silver*, 447 U.S. 807, 826, 100 S.Ct. 2486, 65 L.Ed.2d 532 (1980) ("[W]e cannot accept respondent's position without unreasonably giving the word 'filed' two different meanings in the same section of the statute.").

But though the words have the same meaning in both subsections (A) and (B), they have opposite effects on whether a debtor may discharge a debt for something obtained through the use of a "statement respecting ... the debtor's financial condition." Under subsection (A), which refers to oral statements, if a statement falls within the meaning of "statement respecting ... the debtor's financial condition," the debt incurred as a result of that statement is dischargeable. Meanwhile, under subsection (B), which refers to written statements, if a statement comes within the meaning of "statement respecting ... the debtor's financial condition," the debt incurred as a result of that statement is not dischargeable, provided that the other conditions in subsection (B) are satisfied.

So if the phrase has a broad meaning, more false oral statements will have the effect of exempting a debt incurred as the result of a misrepresentation, from the exception to discharge (meaning that such debts will be discharged), than if we construe the phrase narrowly. But fewer false written statements will result in excusing a debt for a fraudulently obtained asset, service, or loan. And since it seems likely that, at least in arm's length transactions, most significant debts are obtained as the result of written representations about finances, as opposed to oral ones, a broader interpretation of the phrase is less likely to benefit dishonest debtors than a narrow construction of it.

II.

For these reasons, I agree with the panel that we must construe the phrase "statement respecting ... the debtor's financial condition" broadly. To be sure, doing so has the effect of allowing Appling's debt for legal services, which the bankruptcy court concluded he obtained by lying to Lamar about the tax refund, to be discharged. But in the overall statutory scheme, the broad interpretation better promotes Congress's concern to provide relief to "honest debtors" only. **All Citations**

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Footnotes

* Honorable Jose E. Martinez, United States District Judge for the Southern District of Florida, sitting by designation.

End of Document

848 F.3d 963
United States Court of Appeals, Eleventh Circuit.

IN RE: Jon E. LUNSFORD, Sr., Debtor.
Jon E. Lunsford, Sr., Plaintiff-Appellant,
v. Process Technologies Services, LLC, Defendant-Appellee.

No. 16-11578
|
(February 15, 2017)

Synopsis
Background: Investor in debtor's limited liability company (LLC) brought adversary proceeding to except debt from discharge. The United States Bankruptcy Court for the Northern District of Georgia, No. 12-bkc-80136CRM, entered judgment in favor of investor, and debtor appealed. The District Court, No. 1:15-cv-02323-SCJ, affirmed. Debtor appealed.

Holdings: The Court of Appeals, William Pryor, Circuit Judge, held that:

[1] dischargeability exception for debts "for the violationof" federal securities laws or any state securities law was not limited in its application only to debts arising from debtor's own violation of federal or state securities laws, and

[2] debtor was not entitled to amend his answer tonondischargeability complaint in order to assert defense that was barred by preclusive effect of prior state court judgment.

Affirmed.

West Headnotes (6)

[1] Bankruptcy

Conclusions of law; d e novo review

Bankruptcy

Clear error

On appeal from district court's decision in its bankruptcy appellate capacity, the Court of Appeals assesses bankruptcy court's judgment anew, employing the same standard of review as the district court itself used, and reviewing bankruptcy court's factual findings for clear error, and its legal conclusions de novo. Fed. R. Bankr. P. 8013.

Cases that cite this headnote

[2] Bankruptcy

Particular Debts or Liabilities

Dischargeability exception for debts "for the violation of" federal securities laws or any state securities law was not limited in its application only to debts arising from debtor's own violation of federal or state securities laws, but applied to obligation that was allegedly imposed on debtor in a purely representative capacity, as a person responsible for state securities law violations committed by his limited liability company (LLC), in selling unregistered securities and in misrepresenting to prospective investor the extent of its asset holdings. 11 U.S.C.A. § 523(a)(19)(A).

Cases that cite this headnote

[3] Bankruptcy

Particular Debts or Liabilities

Dischargeability exception for debts "for the violation of" federal securities laws or any state securities law precludes discharge regardless of whether debtor violated securities laws, as long as the securities violation caused debtor's debt. 11 U.S.C.A. § 523(a)(19)(A).

Cases that cite this headnote

[4] Bankruptcy

Pleading

Debtor was not entitled to amend his answer to nondischargeability complaint in order to assert defense that was barred by preclusive effect of prior state court judgment; any such amendment would be futile. 11 U.S.C.A. § 523(a).

Cases that cite this headnote

[5] Judgment

Operation and effect in general

Federal court gives preclusive effect to state court judgment to the same extent as would courts of the state in which judgment was entered. 28 U.S.C.A. § 1738.

Cases that cite this headnote

[6] Judgment

Scope and Extent of Estoppel in General

Under Mississippi law, collateral estoppel precludes party from relitigating a specific issue actually litigated, determined by, and essential to the judgment in former action, even though a different cause of action is the subject of the subsequent action.

Cases that cite this headnote

Appeal from the United States District Court for the Northern District of Georgia, D.C. Docket Nos. 1:15cv-02323-SCJ; 12-bkc-80136-CRM

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Before WILIAM PRYOR and ROSENBAUM, Circuit Judges, and UNGARO,[*] District Judge.

Opinion

WILLIAM PRYOR, Circuit Judge:

This appeal requires us to decide whether a bankruptcy court made a finding of fact that a debtor violated state securities laws. After a business venture went awry, Process Technologies obtained a judgment in state court against Jon Lunsford for violations of state securities laws. Lunsford then filed for bankruptcy. A debtor ordinarily may discharge debts in bankruptcy, 11 U.S.C. § 727, but not if the debt "is for the violation of ... securities laws" and results from a court judgment, § 523(a)(19)(A)– (B). Process Technologies filed an adversary proceeding in which it complained that section 523(a)(19)(A) barred Lunsford from discharging the debt. Lunsford answered that his liability arose from a third party's violation of securities laws and that the bar under section 523(a)(19) (A) from a discharge applies only when the debtor violates securities laws. Lunsford also sought leave to amend his answer to assert that Process Technologies fraudulently obtained the judgment. Lunsford's arguments fail: the bankruptcy court made a finding of fact that Lunsford violated securities laws; alternatively, section 523(a)(19) (A) applies irrespective of debtor conduct; and Lunsford is estopped from arguing that the award was procured by fraud. We affirm the order that excepted the debt from discharge and denied leave to amend.

BACKGROUND

In 2009, Process Technologies Services, LLC, met with MIPCO, LLC, and its president, Jon Lunsford, to discuss purchasing securities in MIPCO. MIPCO sent Process Technologies documents that stated that MIPCO maintained $1.2 million in tangible assets and $500,000 in intangible assets. Not knowing that title problems plagued the tangible assets and that MIPCO had not acquired the intangible assets, Process Technologies invested $300,000.

After discovering the asset problems, Process Technologies sued in a chancery court in Mississippi to rescind the sale. The chancery court ordered the parties to arbitrate the dispute. Lunsford filed for bankruptcy, but the bankruptcy court stayed the action pending the arbitration. The arbitrator ruled in favor of Process Technologies and awarded the company $606,892. The chancery court confirmed the award and entered a final judgment against Lunsford, MIPCO, and another individual as jointly and severally liable. Lunsford neither objected to the confirmation nor appealed to the Supreme Court of Mississippi.

The bankruptcy court then lifted the stay of its proceeding, and Process Technologies filed an adversary proceeding, complaining that Lunsford could not discharge the debt because the debt was "for the violation" of securities laws, 11 U.S.C. § 523(a)(19)(A). After Lunsford filed an answer, he sought leave to amend that answer to assert that Process Technologies fraudulently obtained the arbitrator's award. The bankruptcy court then directed Lunsford to pursue that argument in the chancery court. Lunsford filed a motion for relief from judgment in the chancery court, but the chancery court declined to set aside its judgment.

Lunsford's motion for relief from judgment having been resolved, the bankruptcy court ruled that section 523(a)(19)(A) prohibited Lunsford from discharging the debt. The bankruptcy court determined that the arbitrator "found that [Lunsford] violated the [Mississippi Securities] Act. More specifically, the Arbitrator found that [Lunsford] violated the Act by offering and selling an unregistered security. The Arbitrator also found that [Lunsford] violated the Act by making an offer that contained untrue statements." The bankruptcy court ruled that the arbitration award constituted a judgment "for a violation" of securities laws against Lunsford because "there is a determination outside the Bankruptcy Court that [Lunsford] violated securities laws" and because the state courts confirmed the arbitration award.

Lunsford appealed to the district court on the ground that section 523(a)(19)(A) bars discharge only when the debtor committed a securities violation, not when his liability arose from a third-party's violation. The district court held that section 523(a)(19)(A) applies irrespective of debtor conduct and that Lunsford is not entitled to amend his complaint.

STANDARD OF REVIEW

[1] This court is the second appellate court to review decisions from the bankruptcy court. *In re Glados, Inc.*, 83 F.3d 1360, 1362 (11th Cir. 1996). We "assess the bankruptcy court's judgment anew, employing the same standard of review the district court itself used." *In re Globe Mfg. Corp.*, 567 F.3d 1291, 1296 (11th Cir. 2009). "Thus, we review the bankruptcy court's factual findings for clear error, and its legal conclusions *de novo*." *Id.*

DISCUSSION

We divide our discussion in two parts. First, we explain that Lunsford cannot discharge his debt because the bankruptcy court made a finding of fact that Lunsford violated securities laws and, in the alternative, section 523(a)(19)(A) applies irrespective of whether Lunsford violated securities laws. Second, we explain that Lunsford is not entitled to leave to amend his complaint.

A. Lunsford Cannot Discharge the Debt.

Section 523(a)(19)(A) provides that a person cannot discharge a debt in bankruptcy if the debt "is for the violation of securities laws":

> (a) A [bankruptcy] discharge ... does not discharge an individual debtor from any debt—
>
> ...
>
> (19)
>
> *that*—
>
> (A) *is*
>
> *for*—
>
> (i) *the violation of* any of the Federal securities laws (as that term is defined in section 3(a)(47) of the Securities Exchange Act of 1934), any of the State *securities laws*, or any regulation or order issued under such Federal or State securities laws; or
>
> (ii) common law fraud, deceit, or manipulationin connection with the purchase or sale of any security; *and*
>
> (B) results, before, on, or after the date on which the petition was filed, from—
>
> (i) any judgment, order, consent order, or decreeentered in any Federal or State judicial or administrative proceeding;

(ii) any settlement agreement entered into by thedebtor; or

(iii) any court or administrative order for anydamages, fine, penalty, citation, restitutionary payment, disgorgement payment, attorney fee, cost, or other payment owed by the debtor.

11 U.S.C. § 523(a)(19) (emphases added).

Lunsford argues that the bankruptcy court and the arbitrator never found that he violated securities laws, only that he is liable for a third party's violation of securities laws. Relying on this premise, Lunsford argues that the bar under section 523(a)(19)(A) from a discharge applies only if he violated securities laws. We reject both arguments.

1. The Bankruptcy Court Made a Finding ofFact That Lunsford Violated Securities Laws.

Lunsford concedes that section 523(a)(19)(A) prohibits discharge if the bankruptcy court found that Lunsford violated securities laws, but he argues that the bankruptcy court "adopted the arbitrator's award" and applied collateral estoppel only to determine that it was "possible" to conclude that Lunsford violated securities laws. He maintains that the bankruptcy court never made a specific finding of culpability. We agree that the district court "adopted" the findings of the arbitrator, but by adopting those findings, the bankruptcy court determined that Lunsford violated securities laws.

The bankruptcy court stated that it "should focus not on the underlying facts but on the nature of the judgment at issue" to avoid "the need to re-litigate the matter [of culpability] in bankruptcy court," but the bankruptcy court did not, as Lunsford contends, fail to make findings of fact. Instead, by precluding relitigation of facts, "the bankruptcy court utilized issue preclusion to reach *conclusions about facts* that the court would then consider as 'evidence of nondischargeability.' " *In re Halpern*, 810 F.2d 1061, 1064 (11th Cir. 1987) (emphasis added). In adopting the arbitrator's award, the district court adopted the facts that the arbitrator found. The bankruptcy court could not have applied section 523(a)(19)(A) without first finding a violation because the section applies only if there exists a "violation" of securities laws that a "debt ... is for."

Lunsford contends that the bankruptcy court could not have found that Lunsford violated securities laws because the arbitrator did not find as much, but the findings of the bankruptcy court rest on ample support from the arbitrator's award. On the first page of its award, the arbitrator stated that "the use of 'MIPCO' will include Mr. Lunsford ... unless ... referenced individually." Later, the arbitrator determined that section 75–71–401 of the Mississippi Code, part of the Mississippi Securities Act, "makes it unlawful for any person to offer or sell a security unless it is registered, an exempt transaction, or a federal security." The arbitrator found that "MIPCO" violated securities laws because "the securities were unregistered and MIPCO has not established that the ... transactions were exempt from registration," and nobody disputes that the securities were not federal. The arbitrator did not limit these findings to MIPCO, so the bankruptcy court had sufficient reason to determine that the arbitrator made a specific finding that Lunsford violated securities laws. Because Lunsford agrees that section 523(a)(19) (A) prohibits discharge of debts where a debtor violated securities laws, Lunsford cannot discharge his debt.

2. Alternatively, Section 523(a)(19)(A) Applies Irrespective of Debtor Conduct.

[2] Even if the bankruptcy court had not made a finding that Lunsford violated securities laws, we would reject his argument that the Bankruptcy Code prohibits discharge of a debt that is for the violation of state securities laws only when the debtor violated the securities laws, not when the debtor's liability arises from securities violations committed by a third party. The text of section 523(a) (19)(A) makes no such distinction; the statute applies irrespective of debtor conduct.

The text and structure of section 523(a)(19)(A) unambiguously prevent discharge of debts "for the violation" of securities laws irrespective of debtor conduct. The term "for" in section 523(a)(19)(A) denotes causation. The Supreme Court has interpreted the term "debt for" to mean " 'debt as a result of,' 'debt with respect to,' 'debt by reason of,' and the like." *Cohen v. de la Cruz*, 523 U.S. 213, 220, 118 S.Ct. 1212, 140 L.Ed.2d 341 (1998) (citing *American Heritage Dictionary* 709 (3d ed. 1992); *Black's Law Dictionary* 644 (6th ed. 1990)). Although section 523(a)(19)(A) includes the slightly different phrase "debt that is for," this alteration only serves as a drafting tool to enable the division found in section 523(a)(19). Section 523(a)(19)(A) employs the phrase "debt that is for," and section 523(a)(19)(B) employs the phrase "debt that ... results ... from." But "debt for" is used in similar but undivided subparts of 523(a). § 523(a)(1)–(2), (4)–(6), (9), (12)–(13), (16)–(17). Congress did not materially alter the phrase "debt for" when it inserted a pronoun and a linking verb, so "debt that is for" retains the same meaning as "debt for" and refers to debt caused by a violation of securities laws. *See* Antonin Scalia & Bryan Garner, *Reading Law: The Interpretation of Legal Texts* 170 (2012).

[3] Because Congress also did not restrict section 523(a)(19)(A) to subsets of causation, we should not construct such a limit. If Congress had wanted to limit section 523(a)(19)(A) based on debtor conduct, it could have done so as it did with other provisions in the statute. Even within section 523(a)(19), the text considers debtor conduct, but it considers debtor conduct in a provision not pertinent to this appeal. For a debt to be excepted from discharge, it must be "for" a violation of securities laws, § 523(a)(19)(A), but it must also "result[ ] ... from" a court order or "any settlement agreement entered into *by the debtor*," § 523 (a)(19)(B)(i)–(ii) (emphasis added). Other subsections similarly limit application based on debtor conduct. Debts cannot be discharged if they are "for willful and malicious injury *by the debtor* to another entity," § 523(a)(6) (emphasis added), or "for death or personal injury *caused by the debtor's* operation of a motor vehicle," § 523(a)(9) (emphasis added). Nor can debts be discharged if they are "obtained by use of a statement in writing ... that *the debtor caused* to be made or published," § 523(a)(2)(B)(iv) (emphasis added), or are "for a tax or a customs duty with respect to which the *debtor made* a fraudulent return," § 523(a)(1)(C) (emphasis added). Because Congress rendered discharge in some subsections dependent on debtor conduct but never did so for section 523(a)(19)(A), we infer that the limit does not extend to section 523(a)(19)(A). *See* Scalia & Garner, *supra*, at 107; *Russello v. United States*, 464 U.S. 16, 23, 104 S.Ct. 296, 78 L.Ed.2d 17 (1983). The whole text establishes that section 523(a)(19)(A) precludes discharge regardless of whether the debtor violated securities laws as long as the securities violation caused the debt.

The Tenth Circuit arrived at a contrary conclusion, but even if we found its reasoning persuasive, its decision involved circumstances inapplicable here. After Oklahoma obtained judgments for unjust enrichment against investors in a Ponzi scheme, the Tenth Circuit held that the debtors could discharge their debts because "[t]he judgments at issue [we]re not 'for a violation' of securities laws but for unjust enrichment resulting from someone else's violation of those statutes." *Okla. Dep't of Sec., ex. rel. Faught v. Wilcox*, 691 F.3d 1171, 1173, 1175 (10th Cir. 2012). In contrast, Lunsford's debt does not arise from a judgment against him for unjust enrichment. Lunsford was a party to the same decision in which the state courts entered a judgment against MIPCO for a violation of securities laws.

The Ninth Circuit also arrived at a contrary decision, but it too is unpersuasive. In that decision, a client had prepaid an attorney with funds derived from violations of securities laws. By the time the matter settled, the attorney had not billed enough work to justify all the prepaid funds, but after a receiver ordered the attorney to disgorge those funds, the attorney filed for bankruptcy to shield the funds. *In re Sherman*, 658 F.3d 1009, 1010 (9th Cir. 2011), *abrogated on other grounds by Bullock v. BankChampaign, N.A.*, ––– U.S. ––––, 133 S.Ct. 1754, 185 L.Ed.2d 922 (2013). The Ninth Circuit acknowledged that the plain language of section 523(a)(19)(A) did not limit application based on debtor conduct, but determined that the text was ambiguous in the light of circuit precedent that had held that similar portions of section 523 required inquiry into debtor conduct. To further the supposed "purpose" of the Bankruptcy Code to allow a "fresh start" and to protect "the honest but unfortunate debtor," the Ninth Circuit limited section 523(a)(19)(A) to debts caused by the debtor. *In re Sherman*, 658 F.3d at 1013–15 (quoting *Local Loan Co. v. Hunt*, 292 U.S. 234, 244, 54 S.Ct. 695, 78 L.Ed. 1230 (1934)). We depart from the Ninth Circuit because it grounded its decision on precedent that does not bind us and followed prescriptions of general statutory purpose over the text.

B. Lunsford Is Not Entitled to Leave to Amend His Complaint.

[4] Lunsford argues that Process Technologies fraudulently obtained the arbitration award. He maintains that because "the bankruptcy court is not obligated to recognize a judgment procured by fraud and perjury," he should be granted leave to amend. We disagree.

[5] **[6]** Lunsford is not entitled to leave to amend his complaint because Mississippi law precludes him from relitigating the claim of fraud. We "give preclusive effect to a state court judgment to the same extent as would courts of the state in which the judgment was entered." *Battle v. Liberty Nat'l Life Ins. Co.,* 877 F.2d 877, 882 (11th Cir. 1989). In Mississippi, collateral estoppel precludes Lunsford "from relitigating a specific issue actually litigated, determined by, and essential to the judgment in a former action, even though a different cause of action is the subject of the subsequent action." *Dunaway v. W.H. Hopper & Assoc., Inc.*, 422 So.2d 749, 751 (Miss. 1982). Twice, state courts rebuffed Lunsford's claim of fraud. And because his argument, if successful, would have defeated the complaint against him, the decision of the state court as to the claim of fraud was essential to the judgment against Lunsford. Lunsford is not entitled to leave to amend his complaint to allege a futile claim barred by an earlier judgment. *Bryant v. Dupree,* 252 F.3d 1161, 1163 (11th Cir. 2001).

CONCLUSION

We **AFFIRM** the judgment against Lunsford.

ROSENBAUM, Circuit Judge, concurring:
Sometimes one reason is enough. That's the case here. As Judge Pryor ably demonstrates, Lunsford cannot discharge the debt of $606,892 under 11 U.S.C. § 523(a)(19)(A) because the bankruptcy court correctly determined that the arbitration award found that he violated securities laws. This is not a close question; the answer is clear. I would have stopped there.

The panel opinion, however, goes on to reach an alternative holding—concluding that "section 523(a)(19) (A) precludes discharge regardless of whether the debtor violated securities laws as long as the securities violation caused the debt." Maj. Op. at 968. That alternative holding may or may not prove to be correct, but by reaching it in this case, where we do not need to do so, we have needlessly created confusion about how that holding should be applied in cases where an innocent third party has a judgment against it that results from someone else's securities fraud.

The panel suggests that we might not apply § 523(a)(19) (A)'s discharge preclusion if the situation that arose in *Oklahoma Department of Securities, ex. rel. Faught v. Wilcox,* 691 F.3d 1171 (10th Cir. 2012), presented itself in our Circuit. *See* Maj. Op. at 968–69. But this suggestion creates confusion as to how our alternative holding should be applied in cases involving innocent third parties.

In *Wilcox*, a Ponzi schemer defrauded investors of millions of dollars and pled guilty to various crimes related to her activities. *Wilcox,* 691 F.3d at 1173. The scheme also violated Oklahoma's securities laws. *Id.* Following the schemer's conviction, the Oklahoma Department of Securities sued more than 150 investors—including several who were entirely innocent—to recover the funds distributed in the Ponzi scheme. *Id.* The Oklahoma trial court granted summary judgment for the Department on grounds of unjust enrichment and ordered return of the investors' profits.[1] *Id.* Some of the investors filed for bankruptcy and sought to discharge the debt from the Department's judgment against them. *Id.* Because the bankruptcy and district courts concluded that these debts fell under § 523(a)(19)(A), they declined to discharge them. *Id.*

The Tenth Circuit reversed. Though it noted that the investors "were not charged with securities violations," *id.* at 1175 (citation and quotation marks omitted), the Tenth Circuit nonetheless observed that the valid statecourt judgment against them "require[d] them to repay profits distributed to them *as a result of* [the schemer's] Ponzi scheme," *id.* at 1174 (emphasis added)—in other words, as a result of a third party's securities violations.

So under the Majority's reasoning, though the judgments that were the cause of the debts at issue in *Wilcox* were for unjust enrichment, they nonetheless also seem to be "debt as a result of," *see* Maj. Op. at 967–68 (citations and quotation marks omitted), a securities-fraud violation and therefore non-dischargeable under § 523(a)(19)(A). Yet the panel suggests that § 523(a)(19)(A)'s preclusion did not apply to the *Wilcox* investors' situation because " '[t]he judgments at issue [in *Wilcox*] [we]re not "for a violation" of securities laws but for unjust enrichment resulting from someone else's violation of those statutes.' " *Id.* at 968 (quoting *Wilcox,* 691 F.3d at 1175). This internal inconsistency in the panel's reasoning will no doubt create confusion about how courts and litigants in this Circuit are to construe and apply our alternative holding.

Maybe the panel reaches this conclusion because the judgment against the *Wilcox* investors was not, in name, a judgment for securities violations, though this interpretation would seem to require us to construe the meaning of "judgment" in § 523(a)(19)(B)'s language:

> (b) A [bankruptcy] discharge ... does not discharge an individual debtor from any debt—
>
> ...
>
> (19) that—
>
> ...
>
> (B) results, before, on, or after the date on which the petition was filed, from—
>
> (i) any *judgment*, order, consent order, or decree entered in any Federal or State judicial or administrative proceeding;
>
> (ii) any settlement agreement entered into by thedebtor; or
>
> (iii) any court or administrative order for anydamages, fine, penalty, citation, restitutionary payment, disgorgement payment, attorney fee, cost, or other payment owed by the debtor.

11 U.S.C. § 523(a)(19)(B) (emphasis added). That issue, of course, is not before us. So we have not had the benefit of briefing on it. And if we reached out and grabbed the issue, anyway, our analysis on that question would be mere dicta, since Lunsford's case, in fact, does involve a decision against him for securities fraud and therefore does not require us to resolve the question of whether the judgment must, on its face, find securities violations.

Plus, if the panel's alternative holding is implicitly based on the conclusion that the judgment must actually be

Footnotes

on a securities-violation cause of action (as opposed to unjust enrichment or other non-securities-violation causes of action), that would create significant potential for uneven application of § 523(a)(19)'s discharge preclusion —particularly when it comes to innocent third parties. Under those circumstances, whether an innocent debtor could discharge his debt would depend on the way in which the state or private party chose to prosecute its claim against the innocent debtor.

And if, contrary to its distinguishing of *Wilcox*, the panel intends for all judgments that ultimately result from securities violations—including judgments against entirely innocent investors—to be subject to § 523(a)(19)'s discharge preclusion, that interpretation appears to be at odds with "a central purpose" of the Bankruptcy Code to provide "a completely unencumbered new beginning to the honest but unfortunate debtor." *Grogan v. Garner*, 498 U.S. 279, 286–87, 111 S.Ct. 654, 112 L.Ed.2d 755 (1991) (citation and quotation marks omitted).

These matters raise some difficult questions, and we would, no doubt, benefit from advocacy on these issues by parties with an actual interest in them. We don't have that here. For these reasons, I concur in only our holding that the bankruptcy court correctly concluded that the arbitration award found that Lunsford violated securities laws, so § 523(a)(19)(A)'s preclusion applies to the debt at issue in this case. I would leave the issue addressed by the alternative holding to a case where it is better developed.

All Citations

848 F.3d 963, 63 Bankr.Ct.Dec. 201

* Honorable Ursula Ungaro, United States District Judge for the Southern District of Florida, sitting by designation. 1 Though the Oklahoma lower court ordered return of all profits without exception, the Oklahoma Supreme Court determined that innocent investors had to return profits only to the extent that they had received an unreasonable rate of return. *Wilcox*, 691 F.3d at 1173 n.3.

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2017 WL 694486
United States Court of Appeals, Eleventh Circuit.

Securities and Exchange Commission, Plaintiff–Appellee,
v. Wells Fargo Bank, N.A., Creditor, Interested Party–Appellant.

No. 16-10942
|
(February 22, 2017)

Synopsis

Background: Securities and Exchange Commission (SEC) brought action arising from collapse of Ponzi scheme. Following appointment of receiver to administer affairs, funds, and property of parties who perpetrated scheme, and establishment of claims administration process by which potential claimants could file proof of their claims against receivership, the United States District Court for the Middle District of Florida, No. 8:09–cv–00087–RAL– TBM, Richard A. Lazzara, J., 2016 WL 398026, granted receiver's motion seeking determination that nonparty secured creditor's failure to submit proofs of claim for loans secured by two properties extinguished its interests in those properties, and seeking release of proceeds from sale of property for which secured creditor did not file claim. Secured creditor appealed.

[Holding:] The Court of Appeals, Proctor, District Judge, sitting by designation, addressing an issue of first impression, held that a federal district court does not have the authority to extinguish a creditor's pre-existing state law security interest.

Reversed and remanded.

West Headnotes (7)

[1] Federal Courts
Remedial Matters

District court's order, in action by Securities and Exchange Commission (SEC) arising from collapse of Ponzi scheme, establishing claims administration process by which potential claimants could file proof of their claims against receivership that had been established to administer affairs, funds, and property of parties who perpetrated scheme, was not final, appealable order, in that it did not end the litigation on the merits and leave nothing for court to do but execute the judgment.

Cases that cite this headnote

[2] Equity
Grounds of jurisdiction in general

Receivers
Discretion of court

A district court has broad powers and widediscretion to determine relief in an equity receivership, and this discretion derives from the inherent powers granted an equity court to fashion relief.

Cases that cite this headnote

[3] Receivers
Presentation and filing of claims

Among a district court's broad powers to determine relief in an equity receivership is the power to establish proof of claim procedures and set an effective claims bar date.

Cases that cite this headnote

[4] Receivers
Discretion of court

Receivers
Liens on and Adverse Claims to Property

While a federal district court has wideranging authority to supervise a receivership, it does not have the authority to extinguish a creditor's pre-existing state law security interest.

Cases that cite this headnote

[5] Federal Courts
Mortgages, liens, bills, notes, security interests, and debt collection

Receivers

Liens on and Adverse Claims to Property

Security interests in property are determined by state law, and a receiver appointed by a federal court takes property subject to all liens, priorities, or privileges existing or accruing under the laws of the state.

Cases that cite this headnote

[6] **Bankruptcy**

Secured claims

In the bankruptcy context, a secured creditor's lien remains intact through the bankruptcy, regardless of whether the creditor files a proof of claim.

Cases that cite this headnote

[7] **Receivers**

Presentation and filing of claims

A federal district court cannot order a securedcreditor to either file a proof of claim and submit its claim for determination by the receivership court, or lose its secured statelaw property right that existed prior to the receivership.

Cases that cite this headnote

Appeal from the United States District Court for the Middle District of Florida, D.C. Docket No: 8:09–cv–00087–RAL–TBM

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Before JORDAN and JILL PRYOR, Circuit Judges, and PROCTOR,* District Judge.

PROCTOR, District Judge:

I. BACKGROUND

***1** Following the collapse of a Ponzi scheme, the district court appointed a receiver to administer the affairs, funds, and property of parties who perpetrated that failed scheme. The district court also established a claims administration process by which those who had claims to property administered by the equity receivership could file proofs of claim. In this appeal, we are called upon to decide whether in such a circumstance a district court may extinguish a non-party's preexisting rights to property under the administration of the equity receivership if that non-party fails to comply with the court's orders regarding filing of proofs of claim. We conclude a district court may not. And, we look to bankruptcy law to aid us in addressing this question of first impression.

On January 21, 2009, the SEC initiated an action (the "Nadel action") following the collapse of a Ponzi scheme perpetrated by Arthur Nadel. As a result, the district court appointed a Receiver over the Nadel action Defendants. The district court directed the Receiver to "administer and manage the business affairs, funds, assets, choses in action and any other property of the Defendants and Relief Defendants; marshal and safeguard all of the assets of the Defendants and Relief Defendants; and take whatever actions are necessary for the protection of the investors." Accordingly, the receivership exercised authority not only over claims from victimized investors, but also entities and businesses which were funded with, and properties purchased with, proceeds of Nadel's Ponzi scheme. While Wells Fargo is not a party in the Nadel action, it has secured interests in three properties which the Receiver took possession of pursuant to the district court's orders.

On April 21, 2010, the district court entered an order establishing a claims administration process by which potential claimants (both investors and creditors) could file proof of their claims against the receivership. As part of the claims administration process, the Receiver would mail a claims packet, which contained a Proof of Claim form, to investors and creditors whose property was implicated in the Ponzi scheme. Under authority of the district court order, the packet required that noninvestors (including non-party creditors such as Wells Fargo) provide to the Receiver any amount claimed due, together with supporting documents, by the claim bar date.[1] The district court's order required that all creditors submit their claims before the claim bar date, and did not distinguish between secured and unsecured creditors with respect to this requirement. The district court (1) established a deadline of September 2, 2010 for filing a Proof of Claim form and (2) barred any claims asserted after that date.

***2** Consistent with this process, the Receiver mailed a single claims packet to Wells Fargo at its Atlanta, Georgia address. After receiving this packet, Wells Fargo submitted a Proof of Claim as to its loan that secured one receivership property within the set claim bar date, but did not submit a Proof of Claim detailing its secured interest in the other two receivership properties.

II. PROCEDURAL HISTORY

On February 8, 2012, well after the September 2, 2010 claim bar date, Wells Fargo submitted a motion seeking a determination that the filing of Proofs of Claim was unnecessary to preserve its security interests in, and claims against, collateral in the Receiver's possession (including the two properties for which it failed to submit Proofs of Claim). Alternatively, Wells Fargo's motion sought leave to file belated claims pursuant to Rule 60(b) based on excusable neglect. The district court deferred ruling on the motion.

On December 7, 2015, the Receiver filed a motion seeking two forms of relief. First, the Receiver's motion sought a determination that Wells Fargo's failure to submit Proofs of Claim for the loans secured by two properties extinguished its interests in those properties. Second, the motion requested the release of the proceeds from the sale of one of the properties for which Wells Fargo did not file a Proof of Claim. Wells Fargo objected to the motion. Nevertheless, the district court granted the Receiver's motion, finding that Wells Fargo's security interests in the two properties were not preserved due to its failure to submit Proofs of Claim. The district court further held that Wells Fargo's Rule 60(b) request was untimely and insufficient. The district court specifically determined that Wells Fargo bore the burden to protect its rights pursuant to the framework set forth in the court's prior order. The district court reasoned that secured creditors such as Wells Fargo, despite their secured interest, were obliged to follow court orders in order to protect their rights to collateral in the receivership proceedings. Wells Fargo appeals the district court's order. After careful review, and with the benefit of oral argument, we agree with Wells Fargo, and reverse and remand this matter to the district court for further proceedings consistent with this opinion.

III. STANDARD OF REVIEW

The sole issue in this appeal is whether the district court correctly determined that Wells Fargo's failure to file certain proofs of claim in accordance with the district court's procedures extinguished Wells Fargo's secured interest in the receivership properties. This is a question of "pure law," which we review *de novo*. *See Young v. New Process Steel, LP*, 419 F.3d 1201, 1203 (11th Cir. 2005) (holding that "[w]e decide 'pure law' issues *de novo*, which is another way of saying that a ruling based on an error of law is an abuse of discretion.") (internal citations omitted).

IV. DISCUSSION

We first address the Receiver's argument that Wells Fargo's appeal is untimely. After finding that argument is without merit, we address whether Wells Fargo's security interests were properly terminated by the district court.

A. Wells Fargo's Appeal is Timely.

[1] As an initial matter, the Receiver argues that Wells Fargo untimely noticed its appeal, and accordingly is procedurally barred from bringing the appeal. Specifically, the Receiver contends that Wells Fargo's security interest in the two properties for which it did not file Proofs of Claim was extinguished at the point that it failed to submit those Proofs of Claim in compliance with the district court's order. Accordingly, the Receiver argues, Wells Fargo's "Motion for Determination" was effectively a motion for reconsideration, which was untimely, because it was filed more than a year after the entry of the relevant district court order. Similarly, then, the Receiver argues, Wells Fargo had until only September 21, 2010 to appeal the district court's order establishing the claims filing procedure. But the Receiver's argument is without merit. The district court's order establishing the claims filing procedure cannot be characterized as a "final trial court judgment that 'ends the litigation on the merits and leaves nothing for the court to do but execute the judgment.' "[2] *Fla. Wildlife Fed'n, Inc, v. Adm'r, U.S. EPA*, 737 F.3d 689, 692 (11th Cir. 2013) (quoting *Coopers & Lybrand v. Livesay*, 437 U.S. 463, 467, 98 S.Ct. 2454, 2457, 57 L.Ed.2d 351 (1978)). And, as the order was not final, it did not put Wells Fargo on notice that the district court would extinguish its secured interests by later order or that its security interests would be automatically terminated upon non-filing of a Proof of Claim. Accordingly, the first order from which Wells Fargo could take an appeal was the district court's February 2, 2016 order. Wells Fargo's appeal is timely. Fed. R. App. P. 4(a)(1)(A).

B. The District Court Erred When it Terminated Wells Fargo's Security Interest in the Properties at Issue.

***3 [2] [3] [4]** As we have observed, a "district court has broad powers and wide discretion to determine relief in an equity receivership." *SEC v. Elliott*, 953 F.2d 1560, 1566 (11th Cir. 1992). This discretion derives from the inherent powers granted an equity court to fashion relief. *Id.* (citing *SEC v. Safety Finance Service, Inc.*, 674 F.2d 368, 372 (5th Cir. 1982)). To be sure, among these broad powers is the power to establish proof of claim procedures and set an effective claims bar date. *See SEC v. Tipco, Inc.*, 554 F.2d 710, 711 (5th Cir. 1977). However, while a federal district court has wide-ranging authority to supervise a receivership, we hold it does not have the authority to extinguish a creditor's pre-existing state law security interest, as the district court purported to do here.

[5] It is axiomatic that security interests in property are determined by state law, *Butner v. United States*, 440 U.S. 48, 55, 99 S.Ct. 914, 918, 59 L.Ed.2d 136 (1979), and that "a receiver appointed by a federal court takes property subject to all liens, priorities, or privileges existing or accruing under the laws of the state," *Marshall v. New York*, 254 U.S. 380, 385, 41 S.Ct. 143, 145, 65 L.Ed. 315 (1920). But beyond these well-established rules, there is minimal authority with respect to a district court's authority, in the context of a receivership, to extinguish a secured creditor's preexisting state law security interest by operation of its own claims administration process. We note, however, that our Circuit's bankruptcy law has fielded and answered questions similar to those presented here and specifically addressed what limits are imposed upon a district court under similar circumstances.[3] We conclude bankruptcy law is both analogous and instructive here. After all, a primary purpose of both receivership and bankruptcy proceedings is to promote the efficient and orderly administration of estates for the benefit of creditors. *See, e.g., Elliott*, 953 F.2d at 1572–73 (analyzing bankruptcy law in the receivership context). Accordingly, we analyze the question before us through the lens of our bankruptcy decisions.

[6] In the bankruptcy context, a secured creditor's lien remains intact through the bankruptcy, regardless of whether the creditor files a proof of claim. *In re Bateman*, 331 F.3d 821, 827 (11th Cir. 2003) ("An unsecured creditor is required to file a proof [of] claim for its claim to be allowed, but filing is not mandatory for a secured creditor. In fact, a secured creditor need not do anything during the course of the bankruptcy proceeding because it will always be able to look to the underlying collateral to satisfy its lien.") (citations omitted); *In re Thomas*, 883 F.2d 991, 997 (11th Cir. 1989) (finding that a creditor's lien was not voided in bankruptcy proceeding, and a proof of claim must only be filed in a Chapter 13 proceeding to preserve a deficiency claim).[4]

***4 [7]** This reasoning is also consistent with treatises that have addressed the issue in the receivership context. For example, one such treatise states that:

> The appointment of a receiver does not invalidate liens existing at the time the receiver is appointed, although it may affect or change the remedy or remedies which the lienholder may use to enforce his lien. Generally speaking the person who has a specific lien on property is entitled by following proper procedure to pay himself out of the property and if it be insufficient, then to prove his claim for the deficiency. In the case of receivership such claim must come out of the proceeds of property not covered by the specific lien and such claim for deficiency must prorate with the

> unsecured creditors. Generally speaking no other creditor except the lienholder is entitled to any part of the proceeds of property covered by a lien until the lienor is first paid.

Ralph Ewing Clark, *A Treatise on the Law and Practice of Receivers*, § 646 (3d ed. 1959). A secured creditor certainly may file a proof of claim in a receivership action, in turn submitting itself to the jurisdiction of the receivership, and entitling itself to access of the general pool of receivership assets for any unsecured portion of its debt.[5] In fact, this may often be advisable where a secured creditor is undersecured or anticipates having a claim for deficiency beyond what may be paid out of the collateral. However, a federal district court cannot order a secured creditor to either file a proof of claim and submit its claim for determination by the receivership court, or lose its secured state-law property right that existed prior to the receivership.

V. CONCLUSION

For the reasons stated above, we reverse the district court's order granting the Receiver's Motion for Determination that Wells Fargo's Failure to Comply with this Court's Claims Administration Process Extinguished its Purported Interests in Receivership Properties, and for Release of Proceeds of Sale of Sarasota Property. Wells Fargo's security interests remain intact as to the two properties for which it did not file a Proof of Claim in the district court. This case is remanded for further proceedings consistent with this opinion.

REVERSED AND REMANDED.

All Citations

Footnotes

* Honorable R. David Proctor, United States District Judge for the Northern District of Alabama, sitting by designation.

1 The Claim Bar Date Notice explained that:

> If you were not an investor, but believe you are or may be a creditor of one o[r] more of the Receivership Entities, you must provide to the Receiver by the Claim Bar Date (1) the amount you contend you are owed from any Receivership Entity; (2) any amounts received from any Receivership Entity; and (3) legible copies of all documents on which you base your claim (i.e., all invoices for services or goods provided, loan documents, etc.) or, if any such documents are not available, a detailed explanation as to why such documents are not available.

The Claim Bar Date Notice further stated:

4. CONSEQUENCES OF FAILURE TO FILE A PROOF OF CLAIM BY THE BAR DATE

> ANY HOLDER OF A CLAIM OR POTENTIAL CLAIM THAT FAILS TO FILE A PROOF OF CLAIM (1) THAT FULLY COMPLIES WITH ALL REQUIREMENTS SET FORTH IN THIS NOTICE **AND** (2) BY THE CLAIM BAR DATE WILL BE FOREVER BARRED, ESTOPPED, AND ENJOINED FROM ASSERTING SUCH CLAIM AGAINST RECEIVERSHIP ENTITIES ... THEIR RESPECTIVE PROPERTY, THE RECEIVER, OR THE RECEIVERSHIP ESTATE, AND FROM PARTICIPATING IN ANY DISTRIBUTION FROM THIS RECEIVERSHIP.

2 Moreover, Wells Fargo clearly contests the abolition of its security interests in the properties at issue, not the creation of a claims procedure.

3 A number of other circuits have also looked to bankruptcy law to aid in addressing issues raised in the receivership context. *See e.g.*, *Marion v. TDI Inc.*, 591 F.3d 137, 148 (3d Cir. 2010) (analyzing bankruptcy law in a receivership context); *Fidelity Bank, Nat'l Ass'n v. M.M. Grp., Inc.*, 77 F.3d 880, 882 (6th Cir. 1996) (finding it “appropriate and helpful to refer to the rules governing appellate standing in bankruptcy proceedings” when no case law existed regarding the rules in a receivership action); *Unisys Fin. Corp. v. Resolution Trust Corp.*, 979 F.2d 609, 611 (7th Cir. 1992) (reasoning that bankruptcy law is “parallel” and “instructive” in the receivership context).

4 The Receiver argues that the cases cited by Wells Fargo “are a creature of, and unique to, the federal bankruptcy code itself.” Response Br. at 27. But that argument is simply off the mark. Secured creditors' liens ride through bankruptcy for reasons beyond 11 U.S.C. § 506(d). In fact, well before section 506(d) was added to the modern Bankruptcy Code, courts held that creditors' secured interests were preserved throughout bankruptcy. *Long v. Bullard*, 117 U.S. 617, 620–21, 6 S.Ct. 917, 29 L.Ed. 1004 (1886); *see also* *White v. FIA Card Servs., N.A.*, 494 B.R. 227, 230 (Bankr. W.D. Va. 2012) (“A longstanding pre-Code rule allowed secured creditors to choose not to participate in a debtor's bankruptcy proceeding and still retain valid, enforceable liens once the debtor was discharged from bankruptcy.”).

5 As the district court correctly noted, there is a distinction between a secured creditor's *in rem* rights to the collateral and its right to receive a distribution for the general pool of receivership assets. Nevertheless, the district court erred when it then determined that Wells Fargo's failure to file Proofs of Claim for two of its properties extinguished its *in rem* rights to the collateral as well as its right to receive a distribution from the pool of receivership assets.

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