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REMINDERS:

Bankruptcy Institute on September 12-13
MSBA Bankruptcy Section Meeting on Thursday, October 27, 2005

OCTOBER BANKRUPTCY SECTION MEETING DATE CHANGE

The date for the first MSBA Bankruptcy Section meeting is Thursday, October 27, 2005, at 6:00 p.m. at Kieran's. The meeting will consist of a social hour from 6:00 to 6:30, with the educational program to follow. There will not be a business meeting.

Educational Program:

Court Competition for Big Bankruptcy Cases (and the Prospects for Venue Reform)

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Trustee Lacks Sufficient Evidence to Prove Gross Misconduct Requirement for Equitable Subordination

In *Wells Fargo Home Mortgage, Inc. v. Michael S. Dietz* (D. Minn.), Case No. 04-3061, the District Court affirmed the Bankruptcy Court's holding regarding mortgage. In 2001, a married couple purchased a home with a mortgage financed by Wells Fargo Home Mortgage, Inc. (WFHM). Both spouses were listed on the deed as joint tenants to the property, but only the husband's attorney-in-fact signed the mortgage granted against the property in favor of WFHM. The Debtors filed a joint Chapter 7 case on December 20, 2002. The Chapter 7 Trustee commenced an adversary proceeding on two grounds: to avoid the mortgage held by WFHM pursuant to his "strong arm" powers under 11 U.S.C. § 544(a); and to have the mortgage equitably subordinated to the unsecured creditors' claims pursuant to 11 U.S.C. § 510(c).

Both parties moved for summary judgment. The Bankruptcy Court held that the mortgage did not attach to the wife's ownership interest in the property and that any claimed mortgage lien against her interest was unenforceable and therefore avoided. The Trustee's equitable subordination claim was dismissed. Both parties appealed to the District Court.

The District Court first affirmed the ruling of the Bankruptcy Court that WFHM's lien did not extend to the wife's interest in the homestead since the mortgage was executed by only one of the spouses who had an interest in the homestead. The Court based its analysis primarily on Minn. Stat. §§ 507.02 and 507.03. The Court concluded that, read together, the general rule of § 507.03 is superceded by the specific exception of § 507.02, which relates only to the inchoate marital rights of the non-signing spouse.

The second issue raised on appeal was whether WFHM's claim should be equitably subordinated to the claims of unsecured creditors. The court may, under principles of equitable subordination, subordinate all or part of an allowed claim or interest to another allowed claim or interest, or order that any lien securing such a subordinated claim be transferred to the estate under 11 U.S.C. § 510(c). Equitable subordination is appropriate if: the creditor engaged in some type of inequitable conduct; the creditor's misconduct resulted in injury to the creditors

of the bankrupt or conferred an unfair advantage on the claimant; and the result of equitable subordination of the claim is not inconsistent with the provisions of the Bankruptcy Code. The Court held that the Trustee lacked sufficient facts to support two of the three factors. The Trustee had not sufficiently proven a specific intent by WFHM to injure the debtors, nor that WFHM's actions were taken to gain an unfair advantage over other creditors. Equitable subordination requires that the one asserting it demonstrate that the misconduct occurred in relation to, or was directed at, the bankruptcy estate or the creditors. The Court found that WFHM's actions did not rise to the level of "gross misconduct" which would merit equitable subordination.

Debtor Has Sufficient Disposable Income to Pay Student Loan

In *Rose v. Educ. Credit Mgmt. Corp. (In re Rose)*, 324 B.R. 709 (8th Cir. B.A.P., May 31, 2005), the Bankruptcy Appellate Panel for the Eighth Circuit ("B.A.P.") reversed the Bankruptcy Court's determination that Plaintiff, Lily E. Rose ("Rose") was entitled to an "undue hardship" discharge of her student loan obligations to Educational Credit Management Corporation ("ECMC"). The Bankruptcy Code provides for discharge of student loans only if the debtor demonstrates by a preponderance of the evidence that repayment of the loans would impose an "undue hardship" on the debtor and his or her dependent(s). 11 U.S.C. § 523(a)(8); *see Andrews v. South Dakota Student Loan Assistance Corp. (In re Andrews)*, 661 F.2d 702, 704 (8th Cir. 1981). In the Eighth Circuit, undue hardship is determined by the "totality of the circumstances" test. *See Andrews*, 661 F.2d at 704. In articulating this test, the Eighth Circuit Court of Appeals has directed the bankruptcy courts in the Eighth Circuit to consider: "(1) the debtor's past, present, and reasonably reliable future financial resources; (2) calculation of the debtor's and his dependents' reasonable and necessary living expenses; and (3) any other relevant facts and circumstances surrounding that particular bankruptcy case." *See Andresen v. Nebraska Student Loan Program, Inc. (In re Andresen)*, 232 B.R. 127, 139 (B.A.P. 8th Cir. 1999); *Long v. Educ. Credit Mgmt. Corp. (In re Long)*, 322 F.3d 549, 554 (8th Cir. 2003).

In this case, Rose sought to discharge her student loans comprised of $41,453.44 owed to ECMC and $48,000 owed to Texas Guaranteed Student Loan Corporation. She claimed that, under 11 U.S.C. § 523(a)(8), requiring repayment of these obligations would be an undue hardship. The trial on this matter was conducted on November 4, 2003, and on October 22, 2004, the United States Bankruptcy Court for the District of Minnesota discharged Rose's student loans. *Rose v. Educ. Credit Mgmt. Corp. (In re Rose),* Unpublished Memorandum Decision, Oct. 22, 2004, (Adv. Pro. No. 03-3056) (Bankr. D. Minn. 2004).

ECMC appealed the Bankruptcy Court's determination that repayment of Rose's student loans would impose an undue hardship pursuant to 11 U.S.C. § 523(a)(8). The primary issue on appeal concerned Rose's expenses. The Bankruptcy Court found that Rose's income equaled her expenses (actual and imputed) leaving no funds available to pay ECMC.

ECMC argued that a proper calculation of Rose's expenses would result in Rose having surplus income sufficient to satisfy her student loan payments. As scheduled, Rose had surplus income over expenses of approximately $170 per month. However, the Bankruptcy Court, sua sponte added $170 of expenses--$150 for the future "expense of vehicle acquisition" and $20 for the "unavoidable consequences of the vagaries of everyday life." The Bankruptcy

Court also attributed the entire monthly apartment rent payment to Rose, despite the record demonstrating that Rose shared her apartment with a man named William Tomany ("Tomany") who was also a co-signer on the lease and whom Rose testified paid half of the rent.

The B.A.P. found that, "[a]s scheduled Rose had $171.81 per month in disposable income." Additionally, Rose's 21-year-old son who lived with her at the time of her bankruptcy filing had moved out, increasing her disposable income to $261.81 per month. The B.A.P. concluded, with Tomany paying half of the rent each month, Rose's disposable income increases another $350, for total disposable monthly income of $611.81.

The B.A.P. found that the Bankruptcy Court had erred in imputing future expenses that were only speculative, holding, "[t]here was, thus, no evidence before the court that would raise this speculation to the level of being reasonably reliable facts and circumstances. So, even though we are obligated to consider future factors, the debtor did not prove what those factors would be." As towards the rent expense, the Bankruptcy Court had held that Rose's future financial situation might worsen if Tomany chose to move out. The B.A.P. did not agree, finding even if Rose had to pay the full rent, "the evidence shows sufficient disposable income to not only pay on the loan, but to make the full payment."

Thus, the B.A.P. held, "[t]he bankruptcy court, therefore, erred in finding that failing to discharge this obligation would impose an undue hardship on Rose. We reverse, and hold that the student loan obligation to ECMC in the amount of $41,453.44 is nondischargeable."

Rooker-Feldman Doctrine Does Not Apply to Child Support Order

In re Mark Henry Foss, Mark Henry Foss v. Hall County Child Support Office, Case No. 05-6001, United States Bankruptcy Appellate Panel for the Eighth Circuit.

The State of Nebraska brought suit against the Debtor to establish paternity and seek reimbursement of medical expenses paid on behalf of Debtor's child. The District Court Child Support Referee entered Findings and Recommendations finding the Debtor to be the father and finding that the Debtor owed medical expenses to the State of Nebraska. Prior to the entry of an Order, the Debtor appealed the Findings and Recommendations. While the matter was pending in the District Court, the Debtor filed for Chapter 7 bankruptcy.

The Debtor brought an adversary proceeding raising the following issues: 1) that the State of Nebraska child support guidelines failed to take into consideration what was an economically appropriate award in violation of federal law and the United States Constitution; and 2) that debts owed to child support agencies were dischargeable in bankruptcy.

Hall County responded by filing a motion to dismiss on the grounds that the Debtor's claims were barred by the Rooker-Feldman Doctrine and that child support obligations were non-dischargeable in bankruptcy. The Bankruptcy Court dismissed the Debtor's adversary proceeding. The Debtor appealed and the Eighth Circuit B.A.P. affirmed.

Congress confers jurisdiction on district courts pursuant to 28 U.S.C. § 1334, which states in relevant part that "Except as provided in subsection (b) of this section, the district court shall have original and exclusive jurisdiction of all cases under title 11." However, district courts are authorized

to refer all civil proceedings arising under title 11, or arising in or related to cases under title 11 to the bankruptcy courts. In exchange, Congress provided bankruptcy courts the discretion to abstain from exercising the jurisdiction where either justice or comity required such abstention. Bankruptcy courts have established certain factors to help them evaluate whether abstention is appropriate under the circumstances of each individual case. Those factors are: (1) the effect on the efficient administration of the estate if a Court recommends abstention; (2) the extent to which state law issues predominate over bankruptcy issues; (3) the difficult nature of the applicable law; (4) the presence of a related proceeding commenced in state court or other non-bankruptcy court; (5) the jurisdictional basis, if any, other than 28 U.S.C. § 1334; (6) the degree of relatedness or remoteness of the proceeding to the main bankruptcy case; (7) the substance rather than form of an asserted core proceeding; (8) the feasibility of severing state law claims from the core bankruptcy matters; (9) the burden on the bankruptcy court; (10) forum shopping by parties; (11) the existence of the right to a jury trial; and (12) the presence of non-debtor parties in the proceedings.

The B.A.P. found that the Bankruptcy Court correctly applied those factors to the facts of this case in determining to dismiss the adversary proceeding, even though review was not barred by the Rooker-Feldman Doctrine as argued by Hall County. The Rooker-Feldman Doctrine is a jurisdictional rule that applies to final judgments or orders, and not to matters pending in state courts. Under the doctrine, lower federal courts are prohibited from reviewing state court decisions. In this case, the B.A.P. found that the Findings and Recommendations entered by the District Court Child Support Referee was not a final order and, thus, the Rooker-Feldman Doctrine would not have applied. The B.A.P. went on to state that abstention was still appropriate because the Debtor sought to challenge the constitutionality of the State of Nebraska's entire child support and medical care system, rather than seeking a determination as to the dischargeability of child support obligations. Issues related to paternity and child support are the exclusive province of state courts, and the Debtor's case was already pending in District Court. The B.A.P. also noted that the District Court had concurrent jurisdiction to determine the dischargeability of child support obligations under 11 U.S.C. § 523(a)(18) as established in *Grogan v. Garner,* 498 U.S. 279, 284 n.10 (1991).