Bankruptcy Bulletin

A Publication of the Minnesota State Bar Association Bankruptcy Section
SUMMER EDITION—2019

IN THIS ISSUE

A 401K or IRA Received Through Divorce Proceeding Without a QDRO is Not Exempt Under § 522(d)(12)

In *In re Lerbakken,* 590 B.R. 895 (B.A.P. 8th Cir. 2018), the B.A.P. affirmed the bankruptcy court's order disallowing the debtor's claimed exemptions in his ex-wife's 401K and IRA accounts. The B.A.P. explained that such accounts were not "retirement funds," as defined by the U.S. Supreme Court in *Clark v. Rameker.*

To clarify, the funds were not in Lerbakken's own 401k or IRA accounts. Rather, he was awarded a 50% interest in his ex-wife's retirement accounts during his pre-petition divorce proceeding. The debtor could have submitted a QDRO and rolled over any distribution(s) from his ex-wife's accounts into his own retirement accounts, but he failed to do so. As a result, he had a judicial order awarding half the value of the accounts to him, but he had not taken any action that caused the funds to be deposited into an account owned by him.

Under Section 522(d)(12), a debtor may claim an exemption for retirement funds "to the extent that those funds are in a fund or account that is exempt from taxation under section 401, 403, 408, 408A, 414, 457, or 501(a) of the Internal Revenue Code of 1986." Following the reasoning in *Clark,* the B.A.P. clarified that the exemption is limited to a debtor who creates an account of the type listed in Section 522, and contributes funds to it for the day of his or her own retirement.
Because the exemption is limited to funds set aside for one's own retirement, the debtor in *Clark* was not permitted to exempt an inherited IRA, and in this case, the debtor was not permitted to exempt funds in his ex-wife's 401K and IRA accounts. The B.A.P. further stated that the debtor's subjective intention to use the funds in the future upon his own retirement is not sufficient. If he wanted to qualify for an exemption under the Code, the funds must have been deposited into his own retirement account before the petition date.

https://my.mnbar.org/blogs/karl-johnson/2019/02/22/a-401k-or-ira-received-through-divorce-proceeding

Attorney's Administrative Expense For Allowed But Unpaid Fees is Subject to Chapter 13 Discharge

In *In re Jaworski*, BKY No. 13-43296-MER (Nov. 30, 2018), Judge Ridgway held that an attorney's administrative priority claim for allowed but unpaid fees does not survive a chapter 13 discharge. More than a year after the debtors filed their voluntary petition under chapter 13, the debtors' modified plan was confirmed with an estimate of $5,000 for attorney fees to be paid through the trustee.

More than a month after the debtors made their final payment, the trustee filed a motion to compel the attorney to submit an application for fees, stating that the trustee was holding $5,000 for attorney fees and a small amount of additional funds that had not yet been distributed to creditors. The trustee stated that the attorney's failure to submit a fee application delayed the trustee's ability to file (1) a final report to close the case and (2) a motion to modify the plan to allow the trustee to distribute funds on hand to other creditors.

After a hearing and additional delays, the attorney finally submitted his application for fees on the same day that the debtors received their discharge. The fee application showed total fees and expenses of $17,527.54, stated that the debtors had already paid the attorney $3,408, and requested $14,071.56 in net compensation. The trustee objected that (1) he had only $5,335.08 on hand after paying unsecured creditors, (2) $1,276 of the amount requested was for work performed outside the statute of limitations for fees, and (3) an order

allowing the full amount requested would allow the attorney to seek $8,784.06 from the debtors after their discharge.

The court rejected the attorney's arguments that this case reflected his common practice, that filing timely fee applications would cause his clients' cases to be dismissed, that including fees in the plans would require his clients to have unaffordable plan payments, and that the clients had entered into voluntary agreements to pay him post-discharge.

The court began its discussion by noting that 11 U.S.C. §§ 1322(a)(2), 507(a)(1), 303(a)(1), and 303(a)(2) collectively require that allowed attorney fees be both provided for in the plan and paid in full under the terms of the chapter 13 plan. Because a confirmed plan binds all parties and controls the relationship between the debtors and the attorney, a previously undisclosed voluntary agreement between the debtors and the attorney has no significance. Absent plan language providing otherwise, any attorney fees that remain unpaid are subject to discharge upon the debtors' completion of the plan. Ultimately, the court allowed fees and expenses limited to the amount of funds in the attorney's trust account and the funds the trustee had on hand because any amount beyond that was already discharged.

https://my.mnbar.org/blogs/karl-johnson/2019/02/25/attorneys-administrative-expense-for-allowed-but-u

District Court Affirms Order Modifying Automatic Stay to Allow Nonfiling Co-Debtor to Receive Statements and Negotiate a Cure and Remands for Bank to Comply

In *Suntrust Bank v. Hamlin, et al.*, 2019 WL 318394, the district court affirmed and remanded the bankruptcy court's order on Suntrust's motion for relief from the automatic stay under 11 U.S.C. §§ 362(d)(1) and 1301(c)(2).

Suntrust Bank, the appellant, moved for relief from the automatic stay in order to foreclose on a vehicle owned by a non-filing codebtor. Suntrust argued that it was entitled to relief because the loan was in arrears and the debtors' plan did not account for full repayment of the arrearage. Additionally, Suntrust argued that the value of the vehicle was less than the amount owed under the loan. The Bankruptcy Court held a telephonic hearing on the motion, wherein the non-filing codebtor indicated that the only reason she stopped making payments was because Suntrust terminated her online access to her account, which is how she historically made payments. Counsel for Suntrust confirmed that access to the online account had been terminated upon the debtors' filing for bankruptcy. Hamlin also explained at the hearing that she was willing to work with Suntrust to cure the arrears.

The bankruptcy court denied the motion and directed Suntrust to work with Hamlin on a schedule to repay the arrears. In the event the parties were unable to reach a resolution, the bankruptcy court explained that Suntrust could then renew its request for relief from the automatic stay. Suntrust then appealed the bankruptcy court's decision and purportedly did not reach out to the non-filing codebtor, arguing that such a communication would have been a violation of the automatic stay.

The district court cited three reasons to affirm and remand. First, the district court questioned whether it had jurisdiction because it was unclear whether the order was a final order. The district court explained that the record suggested the order merely deferred a ruling on the motion, pending the outcome of a negotiation, in which case the order would not have been final or appealable. Second, the district court found that the bankruptcy court did not abuse its discretion in modifying the stay to allow for a negotiation before it would ultimately grant Suntrust's request to move forward with foreclosure. The district court

noted that there was nothing in the record to suggest that the relief would never be granted, but instead that a negotiated resolution should be attempted first. Third, the district court rejected Suntrust's argument that negotiating with Hamlin would have been a violation of the stay when such negotiation was explicitly ordered by the bankruptcy court.

Ultimately, the district court remanded the matter to the bankruptcy court and directed Suntrust to comply with the bankruptcy court's order to first engage in a negotiation for the cure of the payment arrears with the non-filing codebtor.

https://my.mnbar.org/blogs/karl-johnson/2019/04/18/district-court-affirms-order-modifying-automatic-s

The BAP Holds that Fraudulent Transfer Judgment Against Transferee Cannot Be Enforced If Predicate Claim Against Transferor has been Satisfied

The Bankruptcy Appellate Panel vacated the bankruptcy court's order allowing a creditor's claim and remanded for entry of an order disallowing the claim because the creditor's state court judgment for fraudulent transfer was not enforceable after the transferor satisfied the predicate claim in the transferor's bankruptcy case and an unenforceable claim is not allowed under § 502(b)(1). *Lariat Companies, Inc. v. Wigley (In re Wigley)*, 593 B.R. 327 (B.A.P. 8th Cir. Nov. 9, 2018).

The creditor had two prepetition state court judgments, one against the debtor's spouse and his company for damages under a commercial lease and guaranty, and the second against the debtor for fraudulent transfers from the spouse to the debtor. In the spouse's chapter 11 case, the judgment on the guaranty was capped at $553,271 by operation of § 502(b)(6). Pursuant to the terms of his confirmed plan of reorganization, the spouse paid the full amount of the capped claim plus interest.

After the debtor filed her own petition under chapter 11, the creditor filed a proof of claim for the full amount of the fraudulent transfer judgment plus accrued interest. The bankruptcy court allowed the claim based on § 524(e), which states that "discharge of a debt of the debtor does not affect the liability of any other entity on, or the property of any other entity for, such debt," but capped the claim at $308,805 pursuant to § 502(b)(6) because the fraudulent transfer judgment, like the guaranty judgment, was ultimately based on the commercial lease.

On appeal, the BAP noted that the Minnesota Uniform Fraudulent Transfer Act (n/k/a the Minnesota Uniform Voidable Transactions act) does not create a new claim, but rather grants an alternate remedy for protecting preexisting creditor rights against the transferor. Noting that Minn. Stat. § 513.48(b)(1) limits a creditor's recovery to "the value of the asset transferred . . . or the amount necessary to satisfy the creditor's claim, whichever is less," the BAP held that the fraudulent transfer judgment is not enforceable if the predicate claim of the creditor (in this case, the guaranty judgment against the spouse) has been satisfied. Because the predicate claim was satisfied when the spouse paid the full allowed amount of the predicate claim, there was no enforceable claim against the debtor.

After the BAP issued its opinion, the creditor filed a motion for rehearing and alternative motion for stay of mandate. The BAP denied both motions. *Lariat Companies, Inc. v. Wigley (In re Wigley)*, 592 B.R. 339 (B.A.P. 8th Cir. Nov. 20, 2018).

https://my.mnbar.org/blogs/karl-johnson/2019/05/26/the-bap-holds-that-fraudulent-transfer-judgment-ag

BAP Holds that Bankruptcy Court Lacked Jurisdiction to Determine Validity of a Revocation of POA to Allow Creditor to Access Distributions from Spendthrift Trusts

In *AY McDonald Industries, Inc. v. McDonald (In re McDonald)*, 590 B.R. 506 (B.A.P. 8th Cir. 2018)The BAP vacated the bankruptcy court's order denying plaintiff's claims for injunctive relief and declaratory judgment and remanded with instructions to dismiss the same because the bankruptcy court lacked both "arising in" and "related to" jurisdiction.

The debtor entered into a prepetition restitution agreement with the plaintiff under which the debtor granted the plaintiff power of attorney to collect distributions the debtor had been receiving from two spendthrift trusts and use the funds toward the restitution. Under the restitution agreement, the plaintiff agreed to cease collection activities as long as the debtor was in compliance with the agreement.

On the same day he filed his voluntary petition under chapter 7, the debtor executed a revocation of the power of attorney. The plaintiff filed a complaint to commence an adversary proceeding under §§ 523(a)(4) and (a)(6) and also sought injunctive and declaratory relief asking the bankruptcy court to declare the power of attorney irrevocable and enjoin the debtor from attempting to revoke the power of attorney in the future. The bankruptcy court excepted the restitution claim from the debtor's discharge under § 523(a)(4), but denied injunctive and declaratory relief on a theory that the proper remedy was a release of the obligation to cease collection activities.

When the plaintiff appealed the denial of declaratory and injunctive relief, the BAP *sua sponte* examined the jurisdiction of both the bankruptcy court and the BAP. The claims relating to the power of attorney clearly did not arise under title 11 or in a case under title 11 because the claims were neither created nor determined under statutory provisions of title 11 and the claims would exist outside of the bankruptcy case.

The BAP restated that "related to" jurisdiction is determined using a "conceivable effect" test. Because the outcome of the claims for injunctive and declaratory relief could have no conceivable effect on the debtor or the bankruptcy estate and because the claims concerned distributions from spendthrift trusts, which are not property of the estate, the bankruptcy court lacked "related to" jurisdiction.

Finally, the BAP determined that because the bankruptcy court lacked subject matter jurisdiction, the BAP had no jurisdiction over the merits and was limited to correcting the lower court's error in even entertaining the claim. Therefore, the BAP vacated the denial and remanded with instructions to dismiss the claims.

https://my.mnbar.org/blogs/karl-johnson/2019/05/26/bap-holds-that-bankruptcy-court-lacked-jurisdictio

Unenforceable Lien Qualifies as "Judicial Lien" and Can Be Avoided Under § 522(f)

In *O'Sullivan v CRP Holdings, A-1, LLC*, 914 F.3d 1162 (8th Cir. 2019), the Eighth Circuit held that a creditor's docketed judgment created a judicial lien on the debtor's interest in his exempt homestead, even though it was not a lien under Missouri law and was not presently enforceable against the property; as such, the judicial lien could be avoided under 11 U.S.C. § 522(f). The debtor and his spouse owned their home in a tenancy by the entireties. Upon filing a petition for relief, the debtor claimed his interest in the home as exempt. Under Missouri law, docketing a judgment, which is against only one spouse, does not create a lien on property held in a tenancy by the entireties. Simply put, the creditor did not have a lien on

the exempt property under the definition of "lien"

The Eighth Circuit held that the Bankruptcy Code's definition of "judicial lien" is broader than the definition of "lien" under Missouri law. In affirming the Bankruptcy Appellate Panel, the Eighth Circuit held that federal law distinguished between "existent but presently unenforceable liens," which are still "judicial liens" under the Bankruptcy Code, and "nonexistent liens," which are not. The recording of the judgment created a cloud on the debtor's title and could potentially become a lien under Missouri law if the debtor's spouse died. That constituted a "charge against or interest in property," which is included in the Bankruptcy Code's definition of "judicial lien." The judicial lien impaired the debtor's exemption and therefore could be avoided under section 522(f).

https://my.mnbar.org/blogs/karl-johnson/2019/05/26/unenforceable-lien-qualifies-as-judicial-lien-and

Appeal of Order Overruling Trustee's Objection to Debtor's Second Amended Claim of Exemptions

In *Rucker v. Belew (In re Belew)*, 588 B.R. 875 (8th Cir. BAP 2018), the BAP held that bankruptcy courts lack authority to deny an exemption on a ground that is not specified in the Bankruptcy Code. The trustee objected to the debtor's claim of exemptions based upon bad faith. Specifically, the debtor failed to schedule various assets in his initial filing. The debtor failed to list a debit account, a possible equitable interest in his spouse's checking account, two unpublished, unedited fiction manuscripts, and a possible interest in cash held in a safe in the debtor's residence. The debtor amended his schedules and exempted all of those items. The trustee objected to the amended exemptions based upon the argument that the amended exemptions were in bad faith and prejudicial to the debtor's schedules. The bankruptcy court overruled the objection, relying on *Law v. Siegel*, 571 U.S. 415, 134 S.Ct. 1188, 188 L.Ed.2d 146 (2014), for the proposition that federal law provides no authority for bankruptcy courts to deny an exemption on a ground that is not specified in the bankruptcy code. In *Law,* Justice Scalia, in dicta, observed that federal law provides no authority for the bankruptcy courts to deny an exemption on the grounds not specified in the Code, e.g., based on debtor's fraudulent concealment of the asset claimed as exempt or the debtor's bad faith. On appeal, the BAP held that it and other courts have held that federal courts are bound by the Supreme Court's "considered dicta almost as firmly as by the Court's outright holdings." It observed that appellate courts should afford deference and respect to Supreme Court dicta. Because the dicta abrogated the Eighth Circuit precedent, the BAP affirmed the bankruptcy court.

https://my.mnbar.org/blogs/karl-johnson/2019/05/26/appeal-of-order-overruling-trustees-objection-to-d

The Eighth Circuit Affirmed the U.S. District Court's Dismissal of the Trustee's Second Amended Complaint for Failure to State a Claim

This case is a by-product of the various Thomas Petters cases. Thomas Petters, Inc. was a company involved in a multi-billion Ponzi scheme. Petters owned Polaroid Holding Corporation ("PHC") and Polaroid Consumer Electronics, LLC ("PCE"), which are successors in interest to Petters Consumer Brands, LLC ("Petters CB"). PettersCB paid Polaroid licensing fees from the sale of Polaroid branded consumer electronics to prominent retailers. Following the collapse of the Petters-related entities, some of the entities filed bankruptcy. The trustee in the Polaroid bankruptcy cases sued Opportunity Finance, LLC and DZ Bank AG Deutsche Zentral-Genossenschaftsbank seeking avoidance under

the Minnesota Uniform Fraudulent Transfer Act ("MUFTA") of over $250 million in loan payments. PettersCB made the payments to the defendants in 2003-2005 prior to Petters' acquisition of Polaroid. The defendants moved to dismiss and the bankruptcy court granted the motions, the U.S. District Court affirmed the dismissal. The Eighth Circuit affirmed.

The timing is critical to the dismissal. The trustee filed his complaint in December 2010 in reliance that the Ponzi-scheme presumption would satisfy the elements of MUFTA. The trustee filed an amended complaint on November 8, 2013. The defendants moved to dismiss the amended complaint. After lengthy arguments on March 3, 2014, the bankruptcy court took the matter under advisement. While the motions were under advisement, the Supreme Court of Minnesota issued its decision in *Finn v. Alliance Bank*, 860 N.W.2nd 638, 645-53 (Minn. 2015), holding that the Ponzi-scheme presumption did not satisfy the elements under MUFTA. After the Supreme Court decision, the trustee at a December 2015 omnibus hearing orally sought to, once again, amend the complaint on seven different grounds. The bankruptcy court at the omnibus hearing indicated that a decision was imminent and indicated that it would not entertain a motion to amend prior to issuing that decision.

Notably, prior to the Finn decision, some courts allowed a Ponzi scheme presumption to meet the proof requirements of fraudulent transfer claims by showing that a debtor operated a Ponzi scheme and transferred assets in furtherance of the scheme. *Finn*, 860 N.W.2d at 646. The Supreme Court held that the Ponzi scheme presumption does not apply to actual or constructive claims under MUFTA. Rather, a creditor must prove the elements of the fraudulent transfer with respect to each transfer. Ponzi scheme payments satisfying legitimate antecedent debts could not be avoided absent specific proof of actual intent to defraud or the statutory elements of constructive fraud.

A few weeks after the trustee sought to amend his complaint again, the bankruptcy court, in January 2016, issued its lengthy decision granting the motions to dismiss on two grounds. *In re Polaroid Corp.*, 543 B.R. 888 (Bankr. D. Minn. 2016). First, the bankruptcy court held that the trustee lacked statutory standing to assert claims under MUFTA because he failed to identify any creditor of PHC or PCE, to be successors-in-interest to PettersCB that would have an allowable claim against the debtors. *Id.* at 903; *see generally In re Marlar*, 267 F.3d 749, 753 (8th Cir. 2001). Second, applying the Minnesota Supreme Court's decision in Finn, the bankruptcy court held that the amended complaint failed to state a claim for actual or constructive fraudulent transfer under MUFTA. *Polaroid*, 543 B.R. at 911-14. The bankruptcy court further held that allowing the trustee to file a third amended complaint would be futile, as the pleading of facts that might demonstrate standing or state a claim would conflict with facts already pleaded. Id. at 903, 914. On appeal, the district court affirmed the bankruptcy court's decision to dismiss on both grounds and further held that the bankruptcy court did not abuse its discretion in denying leave to amend because the trustee unreasonably delayed in requesting leave to amend, defendants would be prejudiced, and any amendment would be futile. *Stoebner v. Opportunity Finance,* 562 B.R. 368 (D. Minn. 2016). The trustee appealed to the Eighth Circuit.

The Eighth Circuit affirmed the U.S. District Court and found it unnecessary to address standing arguments raised. The Eighth Circuit reiterated that the Ponzi presumption does not apply to actual or constructive fraudulent transfers adopting Finn. And, that the creditor (or trustee) must prove the elements with respect to each transfer. The trustee's complaint contained conclusory allegations,

tracking the statutory language; noting that "threadbare recitals of the elements, supported by mere conclusory statements" did not suffice and the court "is not bound to accept them as true." *Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009). The Eighth Circuit stated that the amended complaint was "bereft of facts demonstrating PettersCB's intent to defraud its own creditors through loan repayments." PettersCB financed legitimate business transactions with capital from the Opportunity Finance, repaying the loans through the proceeds of real life transactions. The Eighth Circuit also found that the trustee's failure to file a motion for leave to amend was necessary. The trustee's oral request at the omnibus hearing failed to meet the requirements under the rules.

https://my.mnbar.org/blogs/karl-johnson/2019/05/28/the-eighth-circuit-affirmed-the-us-district-courts

Loan is "Educational" Based on Intended Purpose Even if Not Used for Education, But Servicer Bears Burden to Show It Funded Student Loans

In *In re Page,* 592 B.R. 334 (B.A.P. 8th Cir. 2018), the debtor sought to discharge a student loan debt, but the Bankruptcy Court found in favor of her student loan servicer. On appeal, the B.A.P. closely examined both the language and legislative history of 11 U.S.C. §523(a)(8), reversed the Bankruptcy Court's order and remanded for additional findings.

First, to be excepted from discharge, the debt at issue must have been an "education loan" as such term is used in Section 523(a)(8). Debtor argued that many features of the debt were akin to an ordinary consumer loan and she had used the loan proceeds for non-educational expenses. The B.A.P. was unpersuaded by the Debtor's attempts to recharacterize the loan, citing the "purpose test" to determine that the Debtor's loan was indeed "educational." For example, where the loan is part of a financial aid package from a university, contains education-related terms, or where the borrower must be a student to qualify, the B.A.P. stated there can be no genuine issue of material fact about whether the loan is an "education loan" under Section 523(a)(8).

Second, to fall within the scope of 523(a)(8), the student loan servicer had the burden to prove that "TERI", a nonprofit entity, had "funded" the student loans in question. In this context, "funded" does not mean that the nonprofit provided the actual funds disbursed to the borrower. Rather, the B.A.P. adopted the "meaningful part" test, holding that a nonprofit entity must have played a "meaningful part in procurement of the loans at issue." Specifically, the B.A.P. explained that a nonprofit entity must have "committed financial resources to the loan program, or contributed something of value to make the program successful," or even given a guarantee of the loan. In the underlying case, the only relevant finding of fact was that TERI had provided a mailing address for loan applications submitted by regular mail or overnight delivery. It was unclear whether TERI received all of the applications in the student loan program used by the Debtor, or just a subset of applications. It was also unclear whether TERI actually handled the Debtor's application. Further, there was no evidence in the record about whether TERI merely forwarded applications to another party, or whether its employees were involved in more substantial activity such as reviewing and processing the applications. Because exceptions to discharge must be construed narrowly, the B.A.P. reversed and remanded for additional findings about whether the role of TERI in the debtor's case was sufficient to bring her loan within the scope of 523(a)(8)(i) and except her student loan debt from discharge.

https://my.mnbar.org/blogs/karl-johnson/2019/05/31/loan-is-educational-based-on-intended-purpose-even

Security Law Violation Exception from Discharge Limited to Debts Established by Enforcement Action

In *Conway v. Heyl (In re Heyl)*, 590 B.R. 898 (B.A.P. 8th. Cir. 2018), the BAP affirmed the bankruptcy court's order finding that the complaint did not state a claim for which relief is available under § 523(a)(19). A creditor brought an adversary complaint based on an investment loss that he alleged was caused by the debtor's false pretenses, false representations, and actual fraud. The debtor prevailed and the creditor then brought a second adversary proceeding, seeking to except the debt from the debtor's discharge under 11 U.S.C. § 523(a)(19) based on a consent order issued by a securities enforcement body of the state of Missouri. The debtor again prevailed and the creditor appealed to the BAP.

The BAP characterized the creditor's argument as asserting that the mere finding by a securities enforcement body of a securities law violation by the debtor automatically results in a debt owed to the creditor. The BAP rejected this argument as combining the two separate elements of a claim under § 523(a)(19)—a debt that is "for" a violation of securities law or fraud in connection with the sale of securities and a debt that "results from" a judgment, settlement or decree. The court reasoned that while the consent order may help the creditor satisfy the "for" element, the consent order simply did not "result" in a debt owed to the creditor.

https://my.mnbar.org/blogs/karl-johnson/2019/06/01/security-law-violation-exception-from-discharge-li

BAP Holds that Bankruptcy Court Lacked Jurisdiction to Determine Validity of a Revocation of POA to Allow Creditor to Access Distributions from Spendthrift Trusts

In *AY McDonald Industries, Inc. v. McDonald (In re McDonald)*, 590 B.R. 506 (B.A.P. 8th Cir. 2018)The BAP vacated the bankruptcy court's order denying plaintiff's claims for injunctive relief and declaratory judgment and remanded with instructions to dismiss the same because the bankruptcy court lacked both "arising in" and "related to" jurisdiction.

The debtor entered into a prepetition restitution agreement with the plaintiff under which the debtor granted the plaintiff power of attorney to collect distributions the debtor had been receiving from two spendthrift trusts and use the funds toward the restitution. Under the restitution agreement, the plaintiff agreed to cease collection activities as long as the debtor was in compliance with the agreement.

On the same day he filed his voluntary petition under chapter 7, the debtor executed a revocation of the power of attorney. The plaintiff filed a complaint to commence an adversary proceeding under §§ 523(a)(4) and (a)(6) and also sought injunctive and declaratory relief asking the bankruptcy court to declare the power of attorney irrevocable and enjoin the debtor from attempting to revoke the power of attorney in the future. The bankruptcy court excepted the restitution claim from the debtor's discharge under § 523(a)(4), but denied injunctive and declaratory relief on a theory that the proper remedy was a release of the obligation to cease collection activities.

When the plaintiff appealed the denial of declaratory and injunctive relief, the BAP *sua sponte* examined the jurisdiction of both the bankruptcy court and the BAP. The claims relating to the power of attorney clearly did not arise under title 11 or in a case under title 11 because the claims were neither created nor determined under statutory provisions of title 11 and the claims would exist outside of the bankruptcy case.

The BAP restated that "related to" jurisdiction is determined using a "conceivable effect" test.

Because the outcome of the claims for injunctive and declaratory relief could have no conceivable effect on the debtor or the bankruptcy estate and because the claims concerned distributions from spendthrift trusts, which are not property of the estate, the bankruptcy court lacked "related to" jurisdiction.

Finally, the BAP determined that because the bankruptcy court lacked subject matter jurisdiction, the BAP had no jurisdiction over the merits and was limited to correcting the lower court's error in even entertaining the claim. Therefore, the BAP vacated the denial and remanded with instructions to dismiss the claims.

https://my.mnbar.org/blogs/karl-johnson/2019/05/26/bap-holds-that-bankruptcy-court-lacked-jurisdictio

BAP Holds That Failure to Withdraw an Arrest Warrant that was Issued Pre-Petition is Not a Violation of the Automatic Stay

In Edwards v. City of Ferguson, 601 B.R. 660 (BAP 8th Cir. 2019), the BAP held that a city does not violate the automatic stay by not taking post-petition actions to rescind an arrest warrant and not issuing a compliance letter to assist in reinstatement of a debtor's driver's license.

The debtor was given a speeding ticket six years prior to filing her voluntary petition under chapter 13. After she failed to show up for the initial court date, an arrest warrant was issued. She then pleaded guilty to speeding, but never paid the fine. Non-payment of the fine eventually resulted in her driver's license not being renewed. About eight months before the petition date, the city re-issued the arrest warrant, but did not take any affirmative action to enforce the warrant or collect the fine. The day after filing the bankruptcy petition, the debtor's attorney notified the city of the filing and requested that the city release the arrest warrant and issue a compliance letter to reinstate the debtor's driver's license. In response, the city's counsel suggested that the debtor file a motion with the Ferguson Municipal court. Instead, the debtor filed a complaint to initiate an adversary proceeding alleging violation of the automatic stay of § 362(a) and unfair discrimination under § 525. The parties filed cross motions for summary judgment. The bankruptcy court granted the city's motion and denied the debtor's motion.

The debtor appealed only the ruling on the automatic stay, arguing that inaction by itself constitutes a violation of the automatic stay. The BAP noted that there are situations where inaction is a violation of the automatic stay, such as failure to stop wage garnishment that was initiated pre-petition. But, the BAP noted that the existence of an outstanding arrest warrant does not mean that the city will try to enforce it.

The BAP also held that nothing in the Bankruptcy Code compels the city to issue a compliance letter, especially when such a letter would be false because the debtor admits that she has not complied with the fine. Furthermore, the BAP noted that the debtor did not provide any evidence that the State of Missouri refused to issue her a driver's license based on the unpaid fine and, furthermore, the State of Missouri was not even a party to the adversary proceeding.

Finally, the debtor argued that the city's attorney's response to the debtor's post-petition request was somehow a violation of the automatic stay. The BAP held that a response to an inquiry is not an attempt to collect a debt and therefore not a violation of the automatic stay.

https://my.mnbar.org/blogs/karl-johnson/2019/07/22/bap-holds-that-failure-to-withdraw-an-arrest-warra

BAP Holds It Lacks Jurisdiction to Consider an Issue that was Withdrawn Prior to Judgment

The debtors' former business partner sued the debtors in state court alleging fraudulent misrepresentation and breach of fiduciary duty, among other claims. After striking the debtors' pleadings, the state court entered default judgment on liability and scheduled a hearing to determine damages. The debtors filed their voluntary petition before the hearing date and the plaintiffs timely filed a complaint seeking exception to discharge under §§ 523(a)(2), (4), and (6).

The plaintiffs filed a motion for partial summary judgment and argued that the state court default judgment precluded the debtor-defendants from re-litigating liability or the issue of dischargeability. After the hearing on this motion, the bankruptcy court stamped a copy of the motion "DENIED" and "WITHDRAWN" and entered it as an order. The parties then agreed that the sole issue to be decided was dischargeability under § 523(a)(4) "for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny[.]" The parties also agreed to submit the issue on stipulated exhibits, stipulated facts, and briefs without a trial. The plaintiffs' brief did not argue claim preclusion or even mention the state court judgment.

In the order granting summary judgment in favor of the debtor-defendants, the bankruptcy court included a section titled "PRELIMINARY MATTERS" that said the state court judgment "was only a default judgment" that did not establish any facts for the purposes of summary judgment.

On appeal, the plaintiffs argued that the bankruptcy court erred by not applying issue preclusion. The BAP held that regardless of the bankruptcy court's passing reference to the state court default judgment, issue preclusion was no longer before the bankruptcy court because the record showed that the issue had been withdrawn and was not reasserted when the parties submitted the case on stipulated facts and briefing. Because issue preclusion was abandoned, the BAP held it "afford[ed] no basis for the instant appeal." Therefore, the BAP affirmed summary judgment in favor of the debtors.

https://my.mnbar.org/blogs/karl-johnson/2019/07/22/bap-holds-it-lacks-jurisdiction-to-consider-an-iss

OTHER RECENT POSTS ON MSBA BANKRUPTCY SECTION WEBSITE:

Appeal of Order Granting Relief From Stay is Moot After Foreclosure Sale

https://my.mnbar.org/blogs/karl-johnson/2019/02/13/appeal-of-order-granting-relief-from-stay-is-moot

Former CEO Convicted of Defrauding Debtor Mamtek U.S., Inc. Must Turnover Proceeds from the Sale of his Personal Residence to Trustee

https://my.mnbar.org/blogs/karl-johnson/2019/02/22/former-ceo-convicted-of-defrauding-debtor-mamtek-u

NO CLEAR ERROR IN DECISION TO INDEFINITELY EXTEND DEADLINES FOR PAYMENT OF INSTALLMENTS OF FILING FEE

https://my.mnbar.org/blogs/karl-johnson/2019/02/24/no-clear-error-in-decision-to-indefinitely-extend

AN ORDER DENYING A MOTION WITHOUT PREJUDICE TO THE

FILING OF A COMPLAINT IS NOT A FINAL APPEALABLE ORDER

https://my.mnbar.org/blogs/karl-johnson/2019/02/24/an-order-denying-a-motion-without-prejudice-to-the

Eighth Circuit Affirms Sanctions for Violation of Discharge Injunction and Affirms Decision that Prior Bankruptcy Court Order and Related State Court Judgments had no Preclusive Effect

https://my.mnbar.org/blogs/karl-johnson/2019/03/01/eighth-circuit-affirms-sanctions-for-violation-of

Transactions and Loans Fully Disclosed in Company's Books are Not False Representations, Embezzlement, or Larceny

https://my.mnbar.org/blogs/karl-johnson/2019/04/24/transactions-and-loans-fully-disclosed-in-companys

BAP Affirms Denial of Discharge Under § 727 for Failure to Maintain Records

https://my.mnbar.org/blogs/karl-johnson/2019/05/26/bap-affirms-denial-of-discharge-under-727-for-fail

Standard for Revocation of Discharge Obtained by Fraud Must be Strictly and Narrowly Construed in Favor of Debtor and Debtor is not Required to Disclose Property Owned or Held by Corporation

https://my.mnbar.org/blogs/karl-johnson/2019/05/28/standard-for-revocation-of-discharge-obtained-by-f

Eighth Circuit Affirms Bankruptcy Court's Determination that a "Structure on Blocks" is Not Subject to the Antimodification Provision; Dissent Disagrees

https://my.mnbar.org/blogs/karl-johnson/2019/06/04/eighth-circuit-affirms-bankruptcy-courts-determina

District Court Adopts Bankruptcy Court's Report and Recommendation and Issues Arrest Warrants for Attorneys and their Client as a Civil Sanction; Vacated and Remanded Order Increasing Monetary Daily Sanction and Requiring Sanction to be Payable to Trustee

https://my.mnbar.org/blogs/karl-johnson/2019/07/08/district-court-adopts-bankruptcy-courts-report-and

Decline in Value of Cash Collateral Subordinates DIP Loan Lien Rights

https://my.mnbar.org/blogs/karl-johnson/2019/07/23/decline-in-value-of-cash-collateral-subordinates-d

Eighth Circuit: § 363(m) Bars a Collateral Attack on a Prior 363 Sale Order

https://my.mnbar.org/blogs/karl-johnson/2019/07/30/eighth-circuit-363m-bars-a-collateral-attack-on-a