A review of the opinions of the Supreme Court of the United States, the United States Court of Appeals for the Eighth Circuit, the United States Bankruptcy Appellate Panel for the Eighth Circuit, the United States District Courts for the District of Minnesota, and the United States Bankruptcy Courts for the District of Minnesota issued after those cases presented at the 2013 Bankruptcy Institute through generally, with some exceptions, August 2014, that affect the general practice of bankruptcy or closely related debt issues.

These materials should neither be relied on nor cited.

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JURISDICTION/APPEALS/PROCEDURE

1. Executive Benefits Ins. Agency v. Arkison, 134 S.Ct. 2165 (2014) (Thomas, J.).

WHEN CONFRONTED WITH A *STERN* CLAIM OUTSIDE THE SCOPE OF ITS CONSTITUTIONAL AUTHORITY, THE BANKRUPTCY COURT SHOULD TREAT THE CLAIM AS NON-CORE AND ISSUE PROPOSED FINDINGS AND CONCLUSIONS SUBJECT TO DE NOVO REVIEW BY THE DISTRICT COURT

An individual and his wife owned and operated two companies, one of which was an insurance agency. By early 2006, the agency had become insolvent, and on January 31, 2006, the company ceased operation. The next day, the individual used agency funds to incorporate a new insurance agency. The individual and others initiated a scheme to transfer assets from the original agency to the successor entity. The assets were deposited into an account held jointly by the other original company and the successor entity and ultimately credited to the successor entity at the end of the year. On June 1, 2006, the original insurance agency filed a voluntary Chapter 7 petition. The chapter 7 trustee filed an adversary proceeding in the bankruptcy court against the successor entity and others, asserting claims of fraudulent conveyance under 11 U.S.C. § 544 and state law. As relevant here, the complaint alleged that the individual used various methods to fraudulently convey the assets of the original agency to the successor entity, which answered the trustee's complaint and denied many of the trustee's allegations. After some disagreement as to whether the trustee's claims should continue in the bankruptcy court or the federal district court, the trustee filed a motion for summary judgment against the successor entity in the bankruptcy court, which granted summary judgment for the trustee on all claims, including the fraudulent conveyance claims. The successor entity appealed to the district court, which conducted a *de novo* review, affirmed the bankruptcy court, and entered judgment for the trustee. The successor entity then appealed to the Ninth Circuit. The circuit court found that the successor entity had impliedly consented to the bankruptcy court's jurisdiction. The court also observed that the bankruptcy court's judgment could instead be treated as proposed findings of fact and conclusions of law, subject to de novo review by the district court. The Supreme Court granted certiorari. The Court held "that when, under *Stern*'s reasoning, the Constitution does not permit a bankruptcy court to enter final judgment on a bankruptcy-related claim, the relevant statute nevertheless permits a bankruptcy court to issue proposed findings of fact and conclusions of law to be reviewed de novo by the district court. Because the District Court in this case conducted the de novo review that petitioner demands, we affirm the judgment of the Court of Appeals upholding the District Court's decision." The Court did not address the Ninth Circuit's "consent" analysis; the Court stated that it did not need to decide the issue of whether Article III permits a bankruptcy court, with the parties' consent, to enter final judgment on a Stern claim, "reserv[ing] that question for another day." The Court wasted no time in tackling the consent issue, having granted certiorari in *Wellness Intern. Network, Ltd. v. Sharif*, 727 F.3d 751 (7th Cir. 2013), *cert. granted*, 2014 WL 497634 (U.S. 2014). Note: This material is excerpted from the August 2014 issue of the Bankruptcy Current Awareness Alert newsletter, with permission. For more information about this publication please visit www.legalsolutions.thomsonreuters.com.

2. Law v. Siegel, 134 S.Ct. 1188 (2014) (Scalia, J.).

BANKRUPTCY COURT'S SURCHARGE OF A DEBTOR'S HOMESTEAD EXEMPTION EXCEEDS THE LIMITS OF BOTH THE COURT'S AUTHORITY UNDER § 105(a) AND ITS INHERENT POWERS

The Court held that the bankruptcy court exceeded the limits of its authority when it ordered that the $75,000, which was protected by debtor's homestead exemption, be made available to pay the trustee's attorney's fees. The Court began its analysis by noting that under 11 U.S.C. § 105(a), a bankruptcy court has statutory authority to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of" the Bankruptcy Code. And, as the Court had previously noted in *Marrama v. Citizens Bank of Massachusetts*, the bankruptcy court may also possess "inherent power. . . to sanction 'abusive litigation practices.'" "But in exercising those statutory and inherent powers, a bankruptcy court may not contravene specific statutory provisions," the Court said. Here, the Court found that the bankruptcy court's exemption surcharge contravened § 522, which (by reference to state law) entitled debtor to exempt $75,000 of equity in his home from the bankruptcy estate, via § 522(b)(3)(A), and which made that $75,000 "not liable for payment of any administrative expense," under § 522(k), including attorney's fees, entitled to administrative priority under 11 U.S.C. § 503(b)(2). Thus, the Court held, the "surcharge. . . exceeded the limits of both the court's authority under § 105(a) and its inherent powers." Note: This material is excerpted from the April 2014 issue of the Bankruptcy Current Awareness Alert newsletter, with permission. Copyright (c) 2014 Thomson Reuters/West. For more information about this publication please visit www.legalsolutions.thomsonreuters.com.

3. Buffets, Inc. v. Leischow, 732 F.3d 889 (8th Cir. 2013) (Colloton, J.).

DISTRICT COURT HAD "RELATED TO" JURISDICTION OVER STATE LAW CAUSE OF ACTION BECAUSE RESULTING JUDGMENT COULD CONCEIVABLY AFFECT BANKRUPTCY ESTATE

Buffets, Inc. appealed an order of the federal district court for the district of Minnesota that granted summary judgment in favor of defendants-appellees US Bank and BMO Harris Bank on the plaintiff's suit against the banks for violations of the Uniform Fiduciaries Act ("UFA"), Minn. Stat. § 520.01 *et. seq*. Plaintiff argued that the district court had no jurisdiction, or should have abstained, and that the court erred in granting the defendants' summary judgment motions.

The plaintiff had hired a third-party, LGI Energy Solutions, Inc. ("LGI"), to manage and to pay its utility bills. Plaintiff remitted funds to LGI's bank account; in turn, LGI used the funds to pay the plaintiff's utilities. Later, LGI ceased operating; and informed the plaintiff that there would be no distribution to unsecured creditors because BMO had a priority lien on its assets. The plaintiff claimed it remitted an estimated $3,471,238.54 to LGI's account, to be paid toward utility bills. Plaintiff sued LGI and BMO among others in state court. Later, LGI was forced into bankruptcy. BMO removed the case to district court on the basis of "related to" jurisdiction under § 1452(a), which referred the suit to the bankruptcy court. The bankruptcy court transferred the case back to district court. Prior to summary judgment, defendant Dean Leischow settled and plaintiff dropped its claims against defendant Data Solutions, LLC.

Observing that the funds at issue were placed in "personal, non-fiduciary accounts" containing commingled funds of LGI and other clients, and concluding that the plaintiff had not shown that the defendants were "aware of the fiduciary relationship between Buffets and LGI," the district court granted summary judgment in favor of the banks on the plaintiff's UFA claims.

On appeal, the Eighth Circuit ruled that the district court properly asserted jurisdiction. The district court asserted jurisdiction on the basis that the suit was related to a bankruptcy proceeding under 28 U.S.C. § 1334(b), and deemed that abstention was not required under 28 U.S.C. § 1334(c)(2). The district court asserted "related to" jurisdiction on the basis that if BMO won its indemnification claim against LGI, then the resulting judgment could conceivably affect LGI's bankruptcy. The Eighth Circuit reasoned that if a proceeding could tangentially or contingently effect a debtor's estate, then the suit is related to a bankruptcy case, and held that here, the district court properly asserted jurisdiction because if BMO could enforce its indemnification claim against LGI, then the claim could conceivably affect the estate. The Eighth Circuit ruled that the district court properly chose not to abstain from hearing the matter because the plaintiff failed to show, in a timely manner under local rules, that the suit could be timely adjudicated in state court. The Eighth Circuit also held that even if the court did not possess jurisdiction under § 1334(b) upon a determination that BMO could not enforce its indemnification claim under Minnesota law, the district court still had jurisdiction over the suit under the diversity of citizenship provision of 28 U.S.C. § 1332. The Eighth Circuit applied the rationales of *Caterpillar Inc. v. Lewis*, 519 U.S. 61 (1996) to this case. *Caterpillar* held that dismissal of a non-diverse party prior to judgment cures the defect in subject matter jurisdiction, and that the corresponding noncompliance with a removal statute does not readily prompt dismissal since after entry of judgment, "considerations of finality, efficiency, and economy become overwhelming." The court found jurisdiction proper here after noting that the parties had complete diversity of citizenship at the time that summary judgment was entered, and that "considerations of finality, efficiency, and economy" weighed against remand.

The court also dismissed the plaintiff's argument that the district court erred in dismissing its UFA claims under the Minnesota's UFA. Acknowledging that the UFA "provides principals limited protection against a bank's knowing or bad-faith processing of a specific transaction that breaches a fiduciary obligation," the Eighth Circuit reasoned that the UFA requires evidence of specific transactions made in violation of certain fiduciary obligations, and a showing that the bank was aware that the funds in dispute were subject to a fiduciary obligation. Here, the court determined that the plaintiff failed to identify specific transactions made in violation of certain fiduciary obligations, and that the plaintiff failed to show that "despite the commingled, non-fiduciary nature of LGI's accounts, the banks were so aware."

4. Lynd v. Ries (In re Genmar Holdings, Inc.), 549 Fed.Appx. 591 (8th Cir. 2013) (per curiam), *aff'g*, 490 B.R. 833 (B.A.P. 8th Cir. 2013) (Federman, J.).

ORDER DENYING MOTION TO RECONSIDER AFFIRMED

The Eighth Circuit agreed with the BAP's decision and could find no basis to set aside the bankruptcy court's order denying the motion to reconsider. For context, the summary of the BAP's decision, which was presented at last year's Institute, is reproduced here: A pro se creditor filed a claim and then an amended claim seeking "restitution" in the amount of $678,799.18; later he filed two identical motions "for Payment of Monies Due for Restitution," in which he demanded immediate payment of the claim. The jointly administered chapter 11 debtors objected to the motion on the basis that it was premature and on the basis that the claim, if allowed, would not entitle the creditor to immediate payment for "restitution." The bankruptcy court denied the creditor's motion and the creditor appealed to the Eighth Circuit BAP. Subsequently, the bankruptcy cases were converted to chapter 7 and joint administration was terminated. The BAP dismissed the creditor's appeal because the creditor failed to pay the filing fee. The creditor then appealed to the Eighth Circuit, which dismissed the appeal for procedural reasons. Just shy of one year from the issuance of the Eighth Circuit's formal mandate, the creditor filed with the bankruptcy court a "Motion for Reconsideration of Claim" under FED. R. BANKR. P. 3008, which the bankruptcy court denied as premature. The creditor again appealed to the BAP on due process and equal protection grounds, as well on as the merits of "the actual motion denial." The BAP ruled that both the motion in the bankruptcy court and the appeal were premature because the bankruptcy court never ruled on the allowance or disallowance of the creditor's claim. Note: This material is excerpted from the June 2013 issue of the Bankruptcy Current Awareness Alert newsletter, with permission. For more information about this publication please visit www.legalsolutions.thomsonreuters.com.

5. LorCon LLC # 1 v. Heyl (In re Heyl), 502 B.R. 337 (B.A.P. 8th Cir. 2013) (Nail, J.).

CREDITOR'S PRINCIPAL DID NOT HAVE STANDING TO APPEAL RULE 60 RULING

The bankruptcy court ruled in the debtor's favor in relation to an exception-to-discharge proceeding brought by a limited liability company and its principal. The LLC and its principal moved for relief from judgment under Fed. R. Bankr. P. 60, made applicable by Fed. R. Bankr. P. 9024, which the bankruptcy court denied. They then appealed to the BAP, but the LLC was later dismissed from the appeal, leaving the principal, proceeding on appeal pro se. The BAP affirmed, reasoning that the principal did not possess a financial stake in the bankruptcy court's order denying the Rule 60 motion; though he was a plaintiff in the adversary proceeding, the principal did not possess a pecuniary interest that was directly and adversely affected by that particular order. The BAP stated that whatever impact the bankruptcy court's Rule 60 order had, it was felt only by the LLC, which had been dismissed from the appeal. In other words, the Rule 60 motion did not request any relief that would affect the principal directly, and thus, in denying that motion, the bankruptcy court did not adversely and directly affect the principal. Additionally, the BAP held that even though the principal was a member of the LLC, the principal could not assert the LLC's interests on appeal.

6. In re Anderson, Civil No. 13-1366 (JRT) (D. Minn. Aug. 13, 2013) (Tunheim, J.).

FAILURE TO PAY APPEAL FEE IS BASIS FOR DISMISSAL OF APPEAL, AND DEBTOR FILING CLAIM AS CREDITOR IN OWN CASE IS BASIS FOR DISMISSAL OF CASE

The debtor sought to appeal an order of the bankruptcy court. The debtor failed to pay the full appeal fee of $298 pursuant to Fed. R. Bankr. P. 8001(a), § 1917, and § 1930 or file for *in forma pauperis* status. After the bankruptcy court brought this error to the debtor's attention, the debtor failed to remedy it. The appeal was then transmitted to the district court in the ordinary course.

The district court dismissed the appeal for violation of the rules of bankruptcy procedure. Furthermore, the court noted that it would have upheld the bankruptcy court's dismissal of the case anyway for lack of good faith and abuse of the bankruptcy process, particularly on account of the debtor filing a claim as a creditor in his own case against himself.

7. In re Nielsen, ---Fed.Appx. ---, 2014 WL 503174 (8th Cir. 2014) (per curiam).

APPEAL MAY BE TIMELY 150 DAYS AFTER ORDER ENTERED IF REQUIRED SEPARATE WRITTEN JUDGMENT NOT ISSUED

The bankruptcy court did not file a separate written judgment in an adversary proceeding as required by Fed. R. Bankr.P. 7058 and Fed.R.Civ.P. 58(a). On June 9, 2013, the debtor appealed the May 24, 2013 order in that proceeding. The BAP dismissed that appeal as untimely. The Eighth Circuit vacated and remanded. Under Fed.R.Civ.P. 58(c), in the absence of a required separate written judgment, the judgment is entered 150 days after entry of the order (October 21, 2013 in this case). Because the appeal must occur within 14 days after entry of the order, Fed. R. Bankr.P. 8002(a), the Eighth Circuit found the appeal to be timely.

8. In re Duke and King Acquisition Corp., 508 B.R. 107 (Bankr. D. Minn. 2014) (Kishel, J.).

RULE 12(b)(6) DISMISSAL MOTION EVALUATED WITHIN THE FOUR CORNERS OF THE COMPLAINT AND MUST STATE A CLAIM THAT IS PLAUSIBLE ON ITS FACE

On motion to dismiss under Rule 12(b)(6) for failure to state claim upon which relief can be granted, the bankruptcy court relied on the defining Supreme Court decisions in conducting the analysis of the complaint in its state of pre-discovery. "The content of the complaint is the only material to be considered in passing on whether [there is] a cognizable basis for suit against the movant-defendants, in alleged fact and applicable law. In evaluating that, the allegations in [the] complaint are to be assumed as true and all reasonable inferences of fact are to be directed in favor of [the] plaintiff, for the purposes of analysis on dismissal. … That deference is more qualified since the Supreme Court's recent issuance of two major opinions under Rule 12(b)(6). Now, "a complaint must contain sufficient factual matter, accepted as true, to 'state a claim to relief that is plausible on its face,' " if it is to pass muster in the face of a motion for dismissal. … To meet this standard, the facts pled must show more than just a "sheer possibility" of proving the claim on its merits. … To be plausible, fact-pleading must be enough to support a "reasonable inference that the defendant is liable for the [conduct] alleged." … The pleaded facts must "affirmatively and plausibly suggest that [the plaintiff] has the right [it] claims"; the pleading of "facts that are merely consistent with such a right" will not suffice, if they do not meet all the elements under law. … A "formulaic recitation of the elements of a cause of action," in conclusory legal terminology alone, will not suffice."

After a lengthy and thorough analysis of the pleadings for sufficiency under the applicable substantive legal theories of the numerous causes of action in the complaint, the court ruled that all of the claims against one group of defendants failed "at the pleading stage—some for want of a valid legal theory of recovery, the balance for an inexcusable failure to muster supporting facts to plead out a plausible basis on which he would satisfy essential elements under law." The court found no reason to provide the plaintiff an opportunity to amend the pleadings on the failed counts and claims "given the patent lack of merit, the deficient legal theories for some of them, and the adequate opportunity he had to develop factual support for the arguable theories." As to the other group of defendants, the court found some of the counts sufficiently pled, others survived the motion but required repleading, and the balance of claims dismissed.

9. Pettry v. Patriot Coal Corp. (In re Patriot Coal Corp.), 511 B.R. 563 (8th Cir. B.A.P. 2014) (Saladino, J.).

APPEALING AN ORDER DENYING A 60(b) MOTION APPEALS ONLY THAT ORDER AND ONLY THE MERITS OF THE COURT'S 60(b) DETERMINATION ARE REVIEWED

Bankruptcy court sustained chapter 11 debtor's omnibus objection and disallowed claims, and then denied claimants' motion for reconsideration under Rule 60(b)(4) (and § 502(j)). On appeal of the order denying reconsideration, the BAP affirmed under Rule 60(b)(4) for failure of the motion to raise any new issues or other grounds for reconsideration and because it simply restated the arguments already raised and rejected in the claim objection proceedings. The BAP noted that "appeal of the denial of a Rule 60(b) motion does not raise the underlying judgment for [the appellate court's] consideration and review but only presents the merits of the Rule 60(b) motion for [the appellate court's] consideration," which is reviewed for abuse of discretion.

10. Shaffer v. Bird (In re Bird), 513 B.R. 104 (8th Cir. B.A.P. 2014) (Nail, J.).

UNLESS NECESSARY TO AVOID A MISCARRIAGE OF JUSTICE, ISSUES RAISED FOR THE FIRST TIME ON APPEAL WILL NOT BE CONSIDERED

In § 523(a)(4) dischargeability adversary proceeding against debtor for breach of fiduciary duty while serving as chapter 11 trustee in three related chapter 11 cases, the bankruptcy court granted summary judgment in favor of judgment creditor. On appeal by the debtor, the BAP affirmed. The BAP found that the debtor had raised issues for the first time on appeal and that no exception to allow consideration of those issues as a basis for reversal (to avoid a miscarriage of justice) applied in the case. The BAP also noted that, in any event, the creditor had satisfied his burden to show that the record before the bankruptcy court did not contain a genuine issue of material fact, and that the debtor had failed to defeat the motion with more than "metaphysical doubt" with respect to the established record or with advancement of specific facts to create a genuine issue of material fact for trial such that he could present admissible evidence in his favor.

11. In re AFY, 734 F.3d 810 (8th Cir. 2013) (Riley, J.).

§363 MOOTS APPEAL OF SALE ORDER; FAILING TO OBJECT IN LOWER COURT FORECLOSES APPEAL; SHAREHOLDERS DO NOT HAVE STANDING TO APPEAL ON BEHALF OF CORPORATE DEBTOR

In February 2010, AFY and Sears Cattle Co. contracted to sell jointly owned property at auction. In March 2010, AFY filed for bankruptcy and a trustee was appointed. The trustee's motion to assume the purchase agreement for the sale was granted over the objection of the principals of the debtor (Robert and Korley Sears) and Sears Cattle Co. Moreover, the bankruptcy court granted the trustee's motion to compel Robert Sears and Sears Cattle Co. to close the sale. Following the sale of the property, Robert Sears and Sears Cattle appealed the sale order and order to compel. The district court dismissed the appeal on the grounds that it was moot under 11 U.S.C. § 363(m). The trustee then moved to convert the case. This motion was granted over the objections of Robert and Korley Sears. The Sears appealed and the district court dismissed the appeals for lack of jurisdiction. The Sears and Sears Cattle appealed both of the district court's earlier dismissals.

In affirming the district court, the 8th Circuit first addressed the appeal of the sale order. The court stated that § 363(m) moots the appeal of the sale order. Under 363(m), "[t]he reversal or modification on appeal of an authorization… [of a sale or lease under 363] does not affect the validity of a sale or lease under such authorization to an entity that purchased or leased such property in good faith, whether or not such entity knew of the pendency of the appeal, unless such authorization and such sale or lease were stayed pending appeal." On this issue, the appellants argued that because the bankruptcy court did not have jurisdiction to enter the sale order, the district court did not have jurisdiction to find the appeal moot. Moreover, appellants argued that the sale was not properly assigned, was not valid under Nebraska law, and was not in good faith. In rejecting these arguments, the 8th Circuit refused to allow an "end-run around § 363(m)" and found no compelling evidence of bad faith. Therefore, the district court correctly determined that the appeal was moot.

Next, the 8th Circuit addressed the appeal of the district court's determination that it lacked subject matter jurisdiction to decide whether the order to pay funds was valid. The district court found that it did not have subject matter jurisdiction for two reasons: first, Sears Cattle failed to appear by counsel and failed to object to the order in the bankruptcy court; and second, the Sears did not have standing because they were not aggrieved by the order. Regarding Sears Cattle, the appellate court agreed that Sears Cattle did not preserve their appeal because it did not object to the motion to pay funds. As for the Sears, the 8th Circuit relied on the shareholder standing rule, which "recognizes that corporations are entities separate from their shareholders in contradistinction with partnerships or other unincorporated associations." Because the Sears lack a direct interest in the litigation, they lack appellate standing to challenge the order to pay funds.

Finally, the 8th Circuit addressed the appeal of the conversion order. Again, the appellate court found that the Sears did not have standing to appeal the conversion order. The district court was affirmed.

12. <u>In re Smith</u>, 530 Fed.Appx. 616 (8th Cir. 2013) (per curiam).

ROOKER-FELDMAN DOCTRINE APPLIED TO DENY STAY VIOLATION OCCURRED UPON TAKING OF FUNDS FROM INMATE ACCOUNT

On January 20, 2009, The State of Missouri obtained a judgment against Zachary Smith, an inmate of the Missouri Department of Corrections, for the costs of his incarceration in the amount $87,830.13 and for costs through his final release. The judgment directed the inmate treasurer to forward to the State ninety percent of all deposits to Smith's account, excluding wages and bonuses earned while incarcerated.

In September 2010, Smith filed a chapter 7 bankruptcy petition and received a discharge in March 2011. In September 2012, the inmate treasurer directed forty-five dollars from Smith's account be taken and forwarded to the State. Smith filed a motion for contempt in the bankruptcy court, alleging that his creditors were violating the discharge order. The bankruptcy court denied the motion because Smith's future debts were not discharged and therefore the judgment was still valid as to future reimbursement.

The Bankruptcy Appellate Panel affirmed on appeal and Smith appealed that order, arguing that the state court judgment was void.

In affirming the bankruptcy court and the Bankruptcy Appellate Panel, the 8th Circuit Court applied the Rooker-Feldman doctrine. This doctrine prohibits lower federal courts from exercising appellate review of state-court judgments. Therefore, the court would not revisit the validity of the judgment from the state court proceedings. Furthermore, the appellate court agreed that any costs accrued post-petition were not discharged by Smith's bankruptcy. Therefore, the bankruptcy court and Bankruptcy Appellate Panel were affirmed.

13. Seaver v. Ritchie Special Credit Investments, Ltd. (In re Petters Capital, LLC), Adv. Pro. 10-04231-als (Bankr. D. Minn. Dec. 26, 2013) (Shodeen, J. sitting by designation).

COLLATERAL ESTOPPEL BARS MORE LITIGATION

On September 17, 2010, the Chapter 7 trustee filed this adversary proceeding against a group of entities, collectively known as the "Ritchie Defendants" and TLP Services, LLC. However, the Ritchie Defendants were already parties to pending and a separate adversary proceeding (in the Polaroid bankruptcy case) which included similar issues raised by the plaintiff in this adversary proceeding. Because of this parallel litigation, the trustee requested that this adversary be stayed pending the resolution of the first, parallel, adversary proceeding. This request was granted.

In April 2012, an order for partial summary judgment was entered in the parallel litigation avoiding a grant of security interests under the Trademark Security Agreement and disallowing the Ritchie Defendants' claim against the estate. After a status conference, the parties briefed whether the order in the parallel litigation had collateral estoppel effect in this adversary proceeding and which issues were subject to collateral estoppel.

In ruling that collateral estoppel applied to this adversary proceeding, the court recognized that five elements must be satisfied for collateral estoppel to apply: (1) the party sought to be precluded in the second suit must have been a party, or in privity with a party, to the original lawsuit; (2) the issue sought to be precluded must be the same as the issue involved in the prior action; (3) the issue sought to be precluded must have been actually litigated in the prior action; (4) the issue sought to be precluded must have been determined by a valid and final judgment; and (5) the determination in the prior action must have been essential to the prior judgment.

Regarding the first element, the court found that both the Ritchie Defendants and TLP Services, LLC, were subjected to the effects of collateral estoppel. The court stated that TLP, while not involved in the parallel litigation, was a wholly-owned subsidiary of Ritchie Capital, and its principal place of business was the same as that of Ritchie Capital. Moreover, a single individual had been taking action on behalf of the Ritchie Defendants and TLP. Therefore, TLP was found to be in privity with the Ritchie Defendants, subjecting TLP to the effects of collateral estoppel.

The court also found that the second element was met, stating that "eight counts contained in the… amended complaint in this adversary proceeding reference code sections that were included in seven of the counts in the complaint filed in the [parallel litigation]." Moreover, the facts in both complaints were "similar, if not identical."

Regarding the third element, the court applied estoppel to the trustee's count of actual fraud, but refused to apply the doctrine to the affirmative defenses of the Ritchie Defendants. As for the claims of actual fraud, the court noted that "[t]he docket in [the parallel case] reveals that the parties filed extensive and substantive pleadings and argued their respective positions… The elements of fraud arising under 11 U.S.C. section 548(a)(1)(A) have been fully litigated." In contrast, the affirmative defense under 11 U.S.C. section 548(c) "were not actually litigated" in the parallel case and therefore the court refused to apply the estoppel doctrine to this defense.

Regarding the fourth element, the court found that a final order had been issued in the parallel litigation. The court explained that "[t]he Eight Circuit follows a more relaxed view of the finality requirement." Favoring a more liberal approach, the judgment must simply be sufficiently firm to be accorded conclusive effect. Thus, while the parallel litigation only featured an order for partial summary judgment, this was sufficient to satisfy the requirement that a final order be issued in the parallel litigation.

Finally, the court also found the presence of the fifth element. Finding that the determination in the parallel litigation was essential to the judgment, the court found that extensive litigation in the parallel litigation addressed the same issues involved in the adversary proceeding. Therefore, collateral estoppel applied to the allegations of actual fraud. (The affirmative defenses in this case were not, however, barred.)

14. <u>Ritchie Capital Management, L.L.C. v. Opportunity Finance, L.L.C.</u>, 511 B.R. 603 (D. Minn. 2014) (Frank, J.).

ABSTENTION BY THE DISTRICT COURT, NOT REFERRAL TO THE BANKRUPTCY COURT, IS APPROPRIATE IN SPECIFIED CIRCUMSTANCES

Plaintiffs (the "Ritchie Plaintiffs") brought a motion to abstain and remand, seeking to have the federal district court abstain from exercising jurisdiction and to have the case remanded back to state court. The defendants (Opportunity Finance, L.L.C.; Sabes Family Foundation; Sabes Minnesota Limited Partnership; Robert W. Sabes; and Jon R. Sabes) sought referral to the bankruptcy court. The case originated in Minnesota state court, where the Ritchie Plaintiffs made claims that the defendants aided and abetted fraud, committed civil conspiracy, and received unjust enrichment.

In granting the motion to abstain, the court explained that under Section 1334(c)(2), district courts must abstain from exercising jurisdiction over certain state law claims if: "(1) a party to the proceeding files a timely motion to abstain; (2) the proceeding is based upon a state law claim or state law cause of action; (3) the proceeding is related (non-core) proceeding; (4) absent § 1334(b), the cause of action could not have been commenced in a federal court; (5) the proceeding is commenced in state court; and (6) the proceeding can be timely adjudicated in a state forum." The court also noted that the party seeking abstention has the burden of proof.

Finding that the six element test had been met, the court stated that there were no other bases for jurisdiction other than 1334, that the state court is fully competent to handle this matter, and that the claims are not core. As a result of the abstention, the court remanded the proceedings to state court pursuant to 28 U.S.C. § 1452(b).

15. Ritchie Capital Management, LLC v. Kelley, 2014 WL 2616988 (D. Minn. 2014) (Montgomery, J.).

A SETTLEMENT SHOULD BE FAIR AND EQUITABLE AND IN THE BEST INTEREST OF THE ESTATE; IT WILL NOT BE SET ASIDE BY THE DISTRICT COURT EXCEPT FOR PLAIN ERROR OR AN ABUSE OF DISCRETION

This case arose from the approval of a global settlement among VICIS Capital Master Fund and Douglas Kelley, as trustee and receiver for a number of Petters-owned entities. The settlement included a provision that VICIS would pay $7.5 million to resolve all claims that have been or could be brought against it by the trustee. The order approving the settlement authorized the trustee to allocate 85% of the settlement proceeds to the Petters Company, Inc. bankruptcy estate and the remaining 15% to the receivership estate. Following the approval, the Ritchie entities appealed the order, arguing that the bankruptcy court erred in approving the allocation to the receivership.

In denying the Ritchie entities' appeal, the court stated that a bankruptcy court's approval of a settlement will only be set aside for plain error or an abuse of discretion. The standard is "whether the settlement is fair and equitable and in the best interests of the estate."

The main argument of the Ritchie entities was that the allocation to the receivership was a gratuitous transfer because the PCI bankruptcy estate had no legal obligation to share the proceeds with the receivership. The court rejected this argument, stating that "VICIS paid $7.5 million to settle the Receiver's claims on behalf of the Receivership as well as the Trustee's claims on behalf of the Bankruptcy Estate." The court also noted "there was a rational basis for making the allocation based upon a formulaic comparison of the amounts transferred." Therefore, the bankruptcy court did not abuse its discretion and the appeal was denied.

AUTOMATIC STAY

16. In re Behrens, 501 B.R. 351 (B.A.P. 8th Cir. 2013) (Schermer, J.).

BANKRUPTCY COURT PROPERLY GRANTED § 362(d)(4) RELIEF FROM THE AUTOMATIC STAY IN THE ABSENCE OF A HEARING IN DEBTOR'S CASE BECAUSE DEBTOR'S FILING WAS PART OF A SCHEME TO HINDER OR DELAY CREDITORS

The Eighth Circuit BAP affirmed a bankruptcy court's order which granted a creditor relief from the automatic stay. Essentially, the debtor argued that the bankruptcy court abused its discretion by granting relief from the automatic stay without a hearing in his case. The bankruptcy court, however, did hold a hearing in his wife's separate bankruptcy case.

This case, which was the fourth out of five bankruptcies filed by either the debtor and/or his wife, was originally filed as a chapter 11, was subsequently dismissed, reinstated and then converted to chapter 7. The fifth case was his wife's chapter 7 case; it was dismissed after the court ordered relief from the automatic stay after a hearing in her case.

After the dismissal, but before reinstatement of the debtor's 2013 case, the creditor foreclosed and bought the property without knowledge of the wife's chapter 7 bankruptcy case, which had been filed just minutes before the foreclosure. The Sheriff did not record the deed before her bankruptcy filing or before the debtor's May 17, 2013 case reinstatement. On May 28, 2013, the bankruptcy court heard the motion of the wife to void the foreclosure as a violation of the automatic stay. The creditor opposed. Then, in both the wife's case and the debtor's case, the creditor filed a motion to terminate or annul the stay, validate the foreclosure, and allow recordation of the sheriff's deed. The debtor participated and presented argument at the hearing in his wife's case. The court held that the foreclosure sale was valid because the automatic stay in the wife's case was annulled under § 362(d)(4) because the court found that the debtor and wife "collectively engaged in serial bankruptcy filings in an effort to delay and hinder [the Creditor] from foreclosing its interest in the Property."

The BAP determined that the bankruptcy court properly applied § 362(d)(4) to the order for relief from the automatic stay in the debtor's case because the bankruptcy court's finding that the "Debtor's bankruptcy filing was part of a 'scheme' to hinder or delay creditors, and that such scheme was one involving multiple bankruptcy filings that affected the Property" was supported by the record. The BAP noted that the hearing in the wife's case concerned the same facts and issues, that the debtor participated in his wife's case, and that the wife submitted evidence at that hearing which supported both debtors' positions. The BAP pointed to instances in the record that supported the court's findings that the filings of the debtor and his wife were made to hinder or delay foreclosure. The BAP concluded that the bankruptcy court did not abuse its discretion and affirmed the bankruptcy court's decision.

17. <u>Behrens v. U.S. Bank, N.A. (In re Behrens)</u>, -- Fed. Appx. ----, 2014 WL 3953494 (8th Cir. 2014) (per curiam).

COURT OF APPEALS AFFIRMS BAP

Behrens appealed the order of the BAP. However, the court of appeals affirmed the BAP and denied the appeal. The summary for the BAP opinion is included in these materials. See below: <u>In re Behrens</u>, 501 B.R. 351 (B.A.P. 8th Cir. 2013) (Schermer, J.).

18. <u>In re Driggs</u>, BKY 13-42355 (Bankr. D. Minn. March 13, 2014) (Kishel, J.).

§ 362(c)(3)(A) TERMINATES THE AUTOMATIC STAY ONLY WITH RESPECT TO THE DEBTOR'S INTEREST IN THE PROPERTY, NOT AS TO THE ESTATE'S INTEREST IN THE PROPERTY

In an individual chapter 11 case, certain mortgage creditors requested orders from the bankruptcy court confirming the absence of the automatic stay, both as to the debtor, and as to the real property under 11 U.S.C. § 362(c)(3)(A). The creditors argued that because the debtor filed this subsequent chapter 11 case within one year of the dismissal of his previous chapter 11 case, then under § 362(c)(3)(A), the automatic stay terminated on the thirtieth day after the filing of this case. The debtor argued that § 362(c)(3)(A) terminates the automatic stay only as to property of the debtor but does not terminate the automatic stay as to property of the estate. The court held that § 362(c)(3)(A) terminates the automatic stay only "with respect to" the debtor's interest in the property, not as to the estate's interest in the property. Here, because the property was property of the estate because the debtor either did not claim an exemption, or was not allowed an exemption in the property, any interest that the debtor might have had in the property reposed in the estate. Therefore, the automatic stay had not terminated under § 362(c)(3)(A) as to the estate's interest in the property.

19. Behrens v. U.S.A. (In re Behrens), 505 B.R. 234 (B.A.P. 8th Cir. 2014) (Nail, J.).

DEBTOR FAILED TO STATE CLAIM FOR DAMAGES FOR ALLEGED VIOLATION OF AUTOMATIC STAY

The debtor commenced an adversary proceeding against the United States, essentially seeking to collaterally attack an earlier federal criminal judgment, which had resulted in a restitution claim, together with a corresponding lien, in favor of the SEC. The debtor contended that the government's criminal prosecution of him and its continued efforts to collect on the restitution judgment violated both an earlier federal district court order staying any further proceedings against him (subject to certain enumerated exceptions) and the automatic stay provided for by 11 U.S.C. § 362. The bankruptcy court dismissed debtor's complaint under Fed.R.Civ.P. 12(b) for the debtor's failure to state a claim. On appeal, the BAP held that the bankruptcy court properly dismissed the debtor's adversary complaint, since if the debtor wanted to challenge the criminal judgment, he would need to make that argument to the district court that entered the judgment. Moreover, the BAP said that any lien held by the government arose from the criminal judgment, pointing out that Congress has specifically given criminal judgments, including restitution awards and attendant liens, special protection from discharge in bankruptcy. Additionally, the debtor had not challenged the validity, priority, or extent of the government's lien on any grounds other than his contention that the government's criminal action violated the district court's stay of actions against him. Similarly, the debtor failed to specifically identify or quantify under § 362(k) any damages arising from the government's alleged violation of the automatic stay.

20. Chae v. Bennett (In re Bennett), 501 B.R. 93 (B.A.P. 8th Cir. 2013) (Schermer, J.).

BANKRUPTCY COURT PROPERLY DENIED STAY RELIEF TO A CREDITOR WHERE NO PURPOSE WOULD HAVE BEEN SERVED BY LIFTING THE STAY TO ALLOW THE CREDITOR TO CONTINUE TO PURSUE THE CLAIMS FOLLOWING THE ENTRY OF THE INDIVIDUAL CHAPTER 7 DEBTOR'S DISCHARGE

A creditor sought relief from the automatic stay to continue to litigate his malpractice, negligence, and fraud claims against the chapter 7 debtor in state court or, in alternative, for the bankruptcy court to abstain or remand. The bankruptcy court denied the motion and recited its findings of fact and conclusions of law on the record, stating that the creditor's malpractice and negligence actions were dischargeable debts in the debtor's chapter 7 case. The court also ruled that the creditor's fraud case would be dismissed if the creditor did not file an adversary proceeding by a date certain, which the creditor did not do, and thus the discharge that debtor had obtained discharged the fraud claim. The creditor had received notice of the deadline for filing an adversary proceeding regarding the fraud claim. Because there was nothing left for the creditor to litigate in state court, given that all of the alleged causes of action had been discharged, the bankruptcy court entered orders denying the creditor's requests for stay relief or for the bankruptcy court to abstain and remand. Here, the BAP found that the bankruptcy court had correctly noted that there were no remaining causes of action by the creditor, because all of the claims against debtor had been discharged. Additionally, there was nothing from which to abstain or to remand because the creditor had never removed the state court action to the bankruptcy court, i.e., no action was pending in the bankruptcy court in relation to the relief that the creditor had sought in the state court action. Accordingly, the Eighth Circuit BAP held that the bankruptcy court properly denied the creditor's request for relief from the automatic stay, and that there was no basis for an order of abstention and remand. Note: This material is excerpted from the January 2014 issue of the Bankruptcy Current Awareness Alert newsletter, with permission. Copyright (c) 2014 Thomson Reuters/West. For more information about this publication please visit www.legalsolutions.thomsonreuters.com.

21. Legendary Stone Arts, LLC v. Maness (In re Maness), 497 B.R. 326 (B.A.P. 8th Cir. 2013) (Saladino, J.).

CHECKING ON STATUS OF CRIMINAL PROSECUTION WAS NOT A STAY VIOLATION

An unpaid supplier for the chapter 7 debtor's general-contracting business brought an adversary proceeding seeking a determination from the bankruptcy court that the indebtedness due from the debtor's business, a corporation, was excepted from discharge under 11 U.S.C. § 523(a)(2)(A) and that the debtors were liable for such amounts under Missouri's lien fraud statute, Mo. Rev. Stat. § 429.014, which makes it a felony under certain circumstances for a defendant to receive payment on a construction project and fail to pay a supplier. Prior to the bankruptcy filing, the principals of the unpaid supplier contacted the prosecutor's office to relay facts of his dealings with the debtor; the principals brought a criminal complaint against the debtor two days before the petition date, which ultimately resulted in formal charges being brought against the debtor. Post-petition, the principals periodically contacted the investigators to check on the status of the criminal proceeding, although the issue of restitution was never mentioned. Subsequently, the debtor counterclaimed against the principals alleging a stay violation. The BAP affirmed the bankruptcy court's ruling that the principals had not violated the stay; there was no suggestion that the principals had ever contacted the debtor directly or indirectly, pre- or post-petition, to threaten that they would pursue criminal charges unless payment was made.

22. In re Borm, 508 B.R. 104 (B.A.P. 8th Cir. 2014) (Shermer, J.).

FOR PURPOSES OF RELIEF FROM STAY, CHAPTER 13 DEFAULT AND PAYMENT DELINQUENCIES OUTWEIGH THE EXISTENCE OF EQUITY IN SUBJECT PROPERTY

Under a confirmed chapter 13 plan, the debtors agreed to make monthly mortgage payments on their homestead to the creditor bank. After the debtors' failure to make payments under that plan resulted in a default of approximately $11,000, the creditor sought relief from the automatic stay. The bankruptcy court denied the creditor's motion because the debtors had made 9 of 15 payments in the prior year and because there was equity in the property. The creditors appealed, and the BAP reversed and remanded.

Reviewing the bankruptcy court's decision for an abuse of discretion, the BAP held that the undisputed facts met the requirements for a relief from stay imposed by § 362(d)(1). The noncompliance with the plan, failure to make 5 payments over the past year, and accrual of approximately $11,000 in late payments supported this finding. Furthermore, the BAP noted that the number of repayments missed outweighed the consideration of equity in the property.

EXEMPTIONS

23. Clark v. Rameker, 134 S.Ct. 2242 (2014) (Sotomayor, J.).

FUNDS HELD IN AN INHERITED INDIVIDUAL RETIREMENT ACCOUNT ARE NOT "RETIREMENT FUNDS" WITHIN THE MEANING OF § 522(B)(3)(C)

An individual had owned, at the time of her death, an individual retirement account worth about $300,000. Since her daughter was the designated beneficiary of the IRA, the daughter inherited the IRA upon her mother's death. When the daughter and her spouse filed for chapter 7 bankruptcy, they sought to exclude the $300,000 in the inherited IRA from the bankruptcy estate using the "retirement funds" exemption under 11 U.S.C. § 522(b)(3)(C). The chapter 7 trustee objected to the claimed exemption. The bankruptcy court held that since the inherited IRA did not represent "retirement funds" in the hands of debtor, so the inherited IRA was not exempt under § 522(b)(3)(C) and (d)(12). The court concluded that funds are "retirement funds" only when held for the owner's retirement, unlike an inherited IRA, which must be distributed earlier under the Internal Revenue Code. On appeal, the district court reversed, adopting the approach of the Eighth Circuit BAP in *In re Nessa,* where the BAP held that IRA funds which the debtor had inherited from the debtor's parent remained, in form and substance, "retirement funds" after the funds were transferred to the inherited account, even though they were not the debtor's own retirement funds. After the district court issued its decision, the Fifth Circuit in *In re Chilton* adopted the approach taken by the district court and the Eighth Circuit BAP, observing that § 522(b)(3)(C) and (d)(12) do not require that the "retirement funds" must be the debtor's retirement funds, only that they were someone's retirement funds. The Seventh Circuit disagreed with the Fifth Circuit and the Eighth Circuit BAP. The Supreme Court granted certiorari, and affirmed the Seventh Circuit, holding that funds held in inherited IRAs are not "retirement funds" within the meaning of § 522(b)(3)(C), and reasoning that the "text and purpose of the Bankruptcy Code make clear that funds held in inherited IRAs are not 'retirement funds' within the meaning of § 522(b)(3)(C)'s bankruptcy exemption. The Court explained that "three legal characteristics of inherited IRAs lead us to conclude that funds held in such accounts are not objectively set aside for the purpose of retirement. First, the holder of an inherited IRA may never invest additional money in the account. . . Second, holders of inherited IRAs are required to withdraw money from such accounts, no matter how many years they may be from retirement. Under the Tax Code, the beneficiary of an inherited IRA must either withdraw all of the funds in the IRA within five years after the year of the owner's death or take minimum annual distributions every year. . . Here, for example, petitioners elected to take yearly distributions from the inherited IRA; as a result, the account decreased in value from roughly $450,000 to less than $300,000 within 10 years. That the tax rules governing inherited IRAs routinely lead to their diminution over time, regardless of their holders' proximity to retirement, is hardly a feature one would expect of an account set aside for retirement. Finally, the holder of an inherited IRA may withdraw the entire balance of the account at any time—and for any purpose—without penalty. . . Funds held in inherited IRAs accordingly constitute 'a pot of money that can be freely used for current consumption,'not funds objectively set aside for one's retirement." Note: This material is excerpted from the August 2014 issue of the Bankruptcy Current Awareness Alert newsletter, with permission. For more information about this publication please visit www.legalsolutions.thomsonreuters.com.

24. In re Miller, 500 B.R. 578 (B.A.P. 8th Cir. 2013) (Federman, J.).

IRA PURCHASED WITH ROLLOVER FUNDS FROM ANOTHER IRA HELD EXEMPT UNDER § 522(b)(3)(C)

The chapter 7 trustee appealed an order of the bankruptcy court for the district of Minnesota that overruled the trustee's objection to the debtor's claimed exemption in an IRA. The bankruptcy court determined that the IRA was exempt under 11 U.S.C. § 522(b)(3)(C) because it qualified as a tax-exempt individual retirement annuity under 26 U.S.C § 408(b). The debtor had purchased the IRA prepetition with a one-time payment of funds through a direct rollover from a tax-qualified IRA. The underlying documents provided that "[n]o additional Purchase Payments are permitted after the Contract Issue Date," and that it was a "Single Payment Immediate Annuity Contract," which consequently did not allow for additional annual premiums. The debtor claimed the IRA as exempt under 11 U.S.C. § 522(b)(3)(C). On *de novo* review, the trustee argued that the IRA did not meet the requirements for an individual retirement annuity under §§ 408(b)(2)(A) and (B) of the Internal Revenue Code. Those sections required that the IRA be paid with flexible, annual premiums; because the IRA at issue here was purchased with a single, fixed payment, it was not tax-exempt, and therefore not exempt under § 522(b)(3)(C).

The issue was whether the IRA remained tax-exempt in light of the requirements of §§ 408(b)(2)(A) and (B). The parties agreed that §§ 408(b)(2)(A) and (B) should be read together—subsection (2)(A) requires that premiums are not to be fixed, and subsection (2)(B) provides that the annual premium cannot exceed a certain annual dollar amount under § 219(b)(1)(A) of the Internal Revenue Code. Section 219(b)(1)(A) limits annual contributions being made from pre-tax income. The BAP determined that even if you qualify the IRA's purchase payment as a premium, § 219(b)(1)(A)'s limit on the annual premium did not apply to this IRA, because the funds were a rollover. The BAP also determined that the debtor's purchase price was not 'fixed' because the purchase price of the IRA was any amount that the debtor chose to roll over. Thus, the BAP interpreted §§ 408(b)(2)(A) and (B) to mean that "*if there are annual premiums*, they may not exceed the limitations of § 219(b)(1)(A)," but not "that annual premiums are required." As such, and in affirming the bankruptcy court, the BAP determined that rollover individual retirement annuities remain tax-exempt even when the IRA does not require annual contributions.

25. In re Johnson, 509 B.R. 213 (B.A.P. 8th Cir. 2014) (Federman, J.), rev'g, In re Johnson, BKY Case No. 13-41370-MER (Bankr. D. Minn. Sept. 11, 2013) (Ridgway, J.).

PROPERTY TAX REFUND NOT EXEMPT UNDER MINN. STAT. § 550.37, SUBD. 14, AS "GOVERNMENT ASSISTANCE BASED ON NEED"

The chapter 7 trustee appealed an order of the bankruptcy court that overruled the trustee's objection to the debtor's claimed exemption in a state property tax refund. Debtor, an 88-year-old widow, owned a home valued at $200,000 with about $150,000 in equity. Her regular source of income was social security. She derived supplemental income from renting a bedroom, but that ceased shortly after the filing. She attempted to exempt $1,946.00 property tax refund under Minn. Stat. § 550.37, subd. 14, as "government assistance based on need." The trustee objected, arguing that the property tax refund did not fit explicitly or implicitly within the category of "government assistance based on need." The bankruptcy court, relying in part on In re Tomczyk, 295 B.R. 894, 896 (Bankr. D. Minn. 2003), overruled the objection. It held that the property tax refund was eligible for exemption under Minn. Stat. § 550.37, subd. 14, as "government assistance based on need."

The BAP observed that exemption statutes are to "be construed liberally in favor of the debtor and in light of the purposes of the exemption," but that Minn. Stat. § 645.17, provides that "the legislature does not intend a result that is absurd, impossible of execution, or unreasonable." The BAP looked to its recent holding in Hardy v. Fink (In re Hardy), 503 B.R. 722 (8th Cir. B.A.P. 2013), that a debtor could not exempt a portion of her federal income tax refund attributable to the child tax credit as "public assistance benefits" under the Missouri statute providing for such exemption because after looking at the plain and ordinary dictionary meanings of the term "public assistance," ["government aid to needy, aged, or disabled persons and to dependent children," "government aid to the poor, disabled, or aged or to dependent children, as financial assistance or food stamps," or "government benefits provided to the needy, usually in the form of cash or vouchers"], the child tax credit did not fit within the plain and ordinary meaning of "public assistance" since the credit was available to married individuals with incomes up to $110,00 and unmarried individuals with incomes up to $75,000—persons who "cannot be said to be needy." Noting that the heading of § 550.37, subd. 14, is titled "Public Assistance," the BAP reasoned that "like the dictionary definition of public assistance, the Minnesota statute expressly requires that the government assistance here be 'based on need' in order to be exempt." The BAP further noted that here, the property tax refund represented an overpayment of taxes, and that had the debtor initially paid the exact amount of taxes, the Debtor would not have been entitled to exempt the cash remaining. The BAP also noted that if property tax refunds qualified as "government assistance based on need" then they would be exempt for six months from collection by creditors, which would lead to an absurd and unreasonable result—one that was unintended by the Minnesota legislature.

26. Paul v. Allred (In re Paul), 739 F.3d 1132 (8th Cir. 2014) (Riley, J.).

A DEBTOR COULD NOT CLAIM A HOMESTEAD EXEMPTION FOR A HOUSE IN WHICH THE DEBTOR HAD NOT LIVED FOR YEARS AND TO WHICH THE DEBTOR HAD NO INTENT OF RETURNING

Debtor in this case filed a voluntary petition for chapter 7 relief in an "opt-out" state. Among his assets, debtor listed real property in which he claimed a homestead exemption under applicable state law. In the petition, debtor listed his new wife's house as his address. At the § 341 meeting of creditors, the debtor testified that, in 1997 or 1998, he purchased the property in question. Debtor lived at the property for a period of time, but had moved out fourteen or fifteen years ago. Since that time, debtor had rented out the property. As of the § 341 meeting, debtor had no intention of residing at the property. Not long after the meeting of creditors, the trustee objected to the debtor's claim of homestead exemption in the property. In entering judgment in favor of the trustee, the bankruptcy court reasoned that the state homestead exemption was inapplicable to debtor, since he had no "present intent to return to" the property and where he and his family had "made their home elsewhere and had no intent to move." The BAP affirmed. The Eighth Circuit also affirmed, observing that, in "large part, [debtor's] propositions appear to suffer from the misconception that ownership of a house automatically entails a 'right' to its characterization as a homestead." "On the contrary," the court said, since "[t]he homestead right consists of the 'right of occupancy' and 'when the need for protection for the family ceases, then there is no longer any reason for the homestead. The homestead exemption is therefore temporary and exists only so long as the conditions prevail under which it was allowed by the homestead law.'" Note: This material is excerpted from the March 2014 issue of the Bankruptcy Current Awareness Alert newsletter, with permission. For more information about this publication please visit www.legalsolutions.thomsonreuters.com.

27. Goben v. Corydon State Bank (In re Goben), 499 B.R. 326 (B.A.P. 8th Cir. 2013) (Schermer, J.).

STATE VEHICLE EXEMPTION NOT ALLOWED WHERE THE DEBTOR HAS NO EQUITY

The bank held a lien on the chapter 7 debtor's vehicle. After the debtor claimed an exemption in the vehicle under Iowa Code § 627.6, the bank objected. The BAP affirmed the bankruptcy court's determination that, because the amount owed the bank exceeded the vehicle's value, the debtor had no equity in vehicle that the debtor could claim as exempt under the Iowa statute. The BAP also agreed with the bankruptcy court's statement that "11 U.S.C. § 522(f) is not available to Debtor to avoid this type of lien."

28. In re Hardy, 503 B.R. 722 (B.A.P. 8th Cir. 2013) (Nail, J.).

REFUNDABLE CHILD TAX CREDIT IS NOT A PUBLIC ASSISTANCE BENEFIT

The chapter 13 debtor claimed that the refundable portion of the "Child Tax Credit" from a federal tax refund did not constitute part of the bankruptcy estate because it was a "public assistance benefit" under MO.REV.STAT. § 513.430.1(10). The statute does not define "public assistance benefit." The trustee objected to this exemption, and the bankruptcy court sustained. The debtor than appealed, and the BAP affirmed.

The BAP found that under § 513.430.1(10)(a), the refundable portion of the Child Tax Credit could not be considered a public assistance benefit and could not be claimed as an exemption. The court determined that the dictionary definitions of the phrase did not support the debtor's argument. It found that the high income threshold for the tax credit and prior case law demonstrated that the legislature did not intend to restrict the tax credit to low income families or needy individuals. The court further noted that taxpayers with very low incomes were not eligible for such a credit, suggesting that the credit could not be interpreted as applying to low-income families. Thus, because the debtor did not provide evidence indicating that the credit was available only to needy individuals, the BAP affirmed the bankruptcy court's decision.

AVOIDANCE & OTHER TRUSTEE POWERS

29. Cox v. Momar Inc. (In re Affiliated Foods Southwest Inc.), 750 F.3d 714 (8th Cir. 2014) (Loken, J.).

EIGHTH CIRCUIT UTILIZES TWO YEAR LOOK-BACK PERIOD FOR § 547(c)(2)'s ORDINARY-COURSE-OF-BUSINESS EXCEPTION

The chapter 7 trustee commenced an adversary proceeding against a defendant corporation to recover as avoidable preferences two payments that the defendant had received from debtor, during the 90 days prior to debtor's filing of a voluntary chapter 11 petition, which was later converted to chapter 7. The debtor was a wholesale food cooperative and the defendant was a supplier of cleaning and sanitation products. Although the defendant conceded that the payments were preferential transfers within the meaning of 11 U.S.C. § 547(b), it asserted affirmative defenses to preference liability, including the exception for transfers made in the ordinary course of business per § 547(c)(2). The trustee conceded that one of the two transfers was not an avoidable preference and the parties each moved for summary judgment on the defendant's claim that the second transfer, which was a payment of $31,470.50 made on April 26, 2009, to satisfy an invoice from the defendant dated March 31, 2009, fell within the ordinary course of business exception in § 547(c)(2). The district court ruled in favor of the defendant and the Eighth Circuit affirmed. The court commented that this was the first case where it had to address the amended version of § 547(c)(2). The trustee argued that the district court committed clear error because the 26-day delay in making the challenged payment was inconsistent with the ordinary business dealings between the parties, because debtor had made three payments to the defendant in the one-year period preceding the preference period with a mean days-to-pay of 44 days. But the defendant argued that in the two years before the preference period, debtor had made seven payments to the defendant on the average of 35.43 days after invoice, with payment times ranging from 13 to 49 days, which the defendant argued would put the challenged payment's 26-day period within the ordinary course of business between the defendant and the debtor. The court noted that the one-year look-back period advanced by the trustee included only three transfers outside the preference period, all of which occurred when debtor was suffering financially and did not include any transfers when debtor was financially healthy. "In these circumstances, a two year look-back capturing all nine transactions is a far better benchmark," the court ruled. Note: This material is excerpted from the May 2014 issue of the Bankruptcy Current Awareness Alert newsletter, with permission. Copyright (c) 2014 Thomson Reuters/West. For more information about this publication please visit www.legalsolutions.thomsonreuters.com.

30. Stoebner v. San Diego Gas & Electric Co. (In re LGI Energy Solutions, Inc.), 746 F.3d 350 (8th Cir. 2014) (Loken, J.).

EIGHTH CIRCUIT HOLDS, AS A MATTER OF FIRST IMPRESSION, THAT IN THREE-PARTY RELATIONSHIPS WHERE THE DEBTOR'S PREFERENTIAL TRANSFER TO A THIRD PARTY BENEFITS THE DEBTOR'S PRIMARY CREDITOR, NEW VALUE (EITHER CONTEMPORANEOUS OR SUBSEQUENT) CAN COME FROM THE PRIMARY CREDITOR, EVEN IF THE THIRD PARTY IS A CREDITOR IN ITS OWN RIGHT AND IS THE ONLY

DEFENDANT AGAINST WHOM THE DEBTOR HAS ASSERTED A CLAIM OF PREFERENCE LIABILITY

The debtor performed bill payment services for its clients, which were large utility customers such as two national restaurant chains, for the operation of their restaurants. During the preference period, debtor made transfers totaling $75,053.85 to one utility and transfers totaling $183,512.74 to another utility to pay outstanding invoices for utility services provided to the restaurants. After these transfers, but during the preference periods of the involuntary chapter 7 petitions, the utilities continued to provide services to the two chains and sent new invoices to the debtor and also continued to send invoice spreadsheets to the two chains, which then sent checks totaling approximately $297,000 to the debtor for the payment of the invoices. The chapter 7 trustee sued to recover the payments as avoidable preferences under 11 U.S.C.A. § 547(b); the utilities asserted the subsequent new value defense of § 547(c)(4). Through separate decisions, the bankruptcy court permitted the defense in part, allowing each utility to offset payments received by the debtor from the utility customers—the two restaurant chains—for utility services provided after a preference payment. On appeal, the cases were consolidated in the BAP, which reversed the bankruptcy court, in part, and allowed each utility a larger offset for all the payments by the two restaurant chains made after a preference payment, including payments for services provided before the preference payment. In applying this standard, the BAP reduced the first utility's preference exposure from $31,242.63 to zero, and the second utility's preference exposure from $131,267.63 to $25,625.75. The trustee appealed, raising a § 547(c)(4) issue of first impression. The second utility cross-appealed to the Eighth Circuit, arguing that the BAP had made a clerical error in calculating the second utility's preference exposure, which the trustee did not contest. The Eighth Circuit affirmed the BAP, and reduced the preference liability of the second utility as requested in the cross appeal. The Eighth Circuit held that, "in three-party relationships where the debtor's preferential transfer to a third party benefits the debtor's primary creditor, new value (either contemporaneous or subsequent) can come from the primary creditor, even if the third party is a creditor in its own right and is the only defendant against whom the debtor has asserted a claim of preference liability." The court added that, "[a]s § 547(b) makes avoidable a transfer 'for the benefit of a creditor,' it both serves the purposes of § 547 and honors the statute's text to construe 'such creditor' in the § 547(c)(4) exception as including a creditor who benefitted from the preferential transfer and subsequently replenished the bankruptcy estate with new value." Note: This material is excerpted from the May 2014 issue of the Bankruptcy Current Awareness Alert newsletter, with permission. Copyright (c) 2014 Thomson Reuters/West. For more information about this publication please visit www.legalsolutions.thomsonreuters.com.

31. Shelton v. CitiMortgage, Inc. (In re Shelton), 735 F.3d 747 (8th Cir. 2013) (Melloy, J.).

A CREDITOR'S LIEN IS NOT EXTINGUISHED BY THE CREDITOR'S FAILURE TO TIMELY FILE A CLAIM AGAINST THE ESTATE

The claims bar date in the debtors' chapter 13 case was January 25, 2011, but the secured creditor, which held a lien on debtors' primary residence, filed a claim for $210,596.66 on August 22, 2011. One week later, the debtors objected to the claim, urging disallowance of the claim because it was untimely filed. Debtors did not, however, challenge the substantive validity of the claim or otherwise object to the validity of the underlying debt, or the creditor's lien. Before a scheduled hearing on the timeliness objection, the parties agreed to the entry of an order disallowing the claim, but the bankruptcy court's order did not specify the basis for disallowance of the claim. After the claim was disallowed, the debtors commenced an adversary proceeding, seeking to avoid the creditor's lien under 11 U.S.C. § 506(d). Once again, however, debtors did not challenge the substantive validity of the lien or the debt. The creditor moved to dismiss, which the bankruptcy court granted, relying on the longstanding principle under *Dewsnup v. Timm*, that valid liens pass through bankruptcy unaffected. The bankruptcy court also found support for its conclusion based on authority from the only two circuit courts to have addressed the issue, both of which concluded that the plain language of § 506(d) did not void liens where an associated claim was disallowed solely on the basis of the claim's untimeliness. Finally, the bankruptcy court observed that the Eighth Circuit had held, in *In re Be-Mac Transport Co., Inc.*, albeit in another context, that "a lien survived bankruptcy notwithstanding § 506(d) where the bankruptcy court had rejected a claim as untimely but where there had been no finding of invalidity regarding the underlying debt or claim." The Eighth Circuit held that, "[r]egardless of whether. . . *Be-Mac Transport* can be distinguished from the present facts, we agree with the well-reasoned judgments from the Fourth and Seventh Circuits." Note: This material is excerpted from the December 2013 issue of the Bankruptcy Current Awareness Alert newsletter, with permission. Copyright (c) 2013 Thomson Reuters/West. For more information about this publication please visit www.legalsolutions.thomsonreuters.com.

32. Pierce v. Collection Associates, Inc. (In re Pierce), 504 B.R. 506 (B.A.P. 8th Cir. 2013) (Kressel, J.).

STATUTORY DEFENSE UNDER § 547(c)(8) TO PREFERENCE LIABILITY APPLIED WHERE AGGREGATE VALUE OF TRANSFERS WAS LESS THAN $600

The chapter 13 debtors commenced an adversary proceeding to avoid six transfers totaling $858.98, as alleged preferences, made pursuant to a pre-petition wage garnishment. The bankruptcy court ruled in favor of the garnishee. The parties agreed that all elements of 11 U.S.C. § 547(b) prima facie case were met regarding the transfers of the garnished wages, but the parties disagreed regarding the application of the defense contained in § 547(c)(8), which provides that "a trustee may not avoid under this section a transfer—(8) if, in a case filed by an individual debtor whose debts are primarily consumer debts, the aggregate value of all property that constitutes or is affected by such transfer is less than $600." The bankruptcy court ruled that the transfers were not avoidable. The BAP agreed with the debtors that at one time all six wage garnishments constituted preferences, but that by the time the debtors had commenced their preference action, the garnishee had already returned $296.20 to them. As the debtors recognized, the only remedy available to them was avoidance of the wages still in possession of the garnishee; that amount was $562.78, i.e., an amount less than $600. Thus, the BAP ruled that § 547(c)(8) applied.

33. McCarthy v. Brevik Law (In re McCarthy), 501 B.R. 89 (B.A.P. 8th Cir. 2013) (Schermer, J.).

DEBTOR HAD STANDING TO BRING A STRONG-ARM AVOIDANCE PROCEEDING TO AVOID THE FIXING OF STATUTORY ATTORNEY'S LIEN ON THE DEBTOR'S HOMESTEAD PROPERTY

The debtor's former divorce attorney objected to confirmation of his chapter 13 plan. The debtor then commenced an adversary proceeding, seeking to avoid the fixing of an attorney's lien held by the attorney against the debtor's homestead. The complaint stated that it was "filed pursuant to [Bankruptcy Code] §§ 522(h), and 545(2), and Federal Rule of Bankruptcy Procedure 7001, to avoid a statutory attorney's lien against Debtor's homestead on the grounds that such liens are unenforceable against debtors' [sic] homesteads [sic] in Minnesota absent a specific written waiver of homestead exemption." The BAP surmised that a debtor has standing to bring an avoidance action under § 522(h) when: "(1) the debtor's transfer of property was involuntary; (2) the debtor did not conceal the property; (3) the trustee did not attempt to avoid the transfer; (4) the debtor seeks to exercise an avoidance power enumerated under § 522(h); and (5) the transferred property could have been exempted if the trustee had avoided the transfer under the provisions of § 522(g)." Accordingly, the BAP held that the debtor's § 545(2) action met each requirement of the five-part test. Note: This material is excerpted from the December 2013 issue of the Bankruptcy Current Awareness Alert newsletter, with permission. Copyright (c) 2013 Thomson Reuters/West. For more information about this publication please visit www.legalsolutions.thomsonreuters.com.

34. Finn v. Alliance Bank, 838 N.W.2d 585 (Minn. Ct. App. 2013) (Willis, J.), review granted, (Minn. Nov. 12, 2013).

MINNESOTA SUPREME COURT TO DECIDE WHETHER TO ADOPT OR APPLY THE "PONZI SCHEME PRESUMPTION" [REVIEW GRANTED]

The issues in this case are complex and a careful reading of the opinion itself is required. Moreover, the decision is being reviewed by the Minnesota Supreme Court. The receiver of entities that fraudulently sold loan participations through an alleged Ponzi scheme brought claw back actions under the Minnesota Uniform Fraudulent Transfer Act (MUFTA) against banks and other financial institutions seeking to recover profits received by the banks and financial institutions. The district court dismissed some of the claims and granted summary judgment in favor of the banks and financial institutions on other claims. The Minnesota Court of Appeals ruled that constructive-fraud claims brought under the MUFTA are governed by the six-year statute of limitations for actions based on liability created by statute, which did not contain a "discovery" provision, where the alleged constructively fraudulent transfers were not actionable at common law or under the original fraudulent-transfer statute. By contrast, actual-fraud claims under the MUFTA are governed by the six-year statute of limitations for actions for relief upon the ground of fraud, which do contain a "discovery" provision, rather than statute of limitations for actions upon a liability created by statute. This is so, the court ruled, since the MUFTA merely codified actual-fraud claims that already existed at common law. The appellate court also ruled that application of the "Ponzi-scheme presumption" was consistent with the legislative intent of the MUFTA with respect to presumptions of fraudulent intent and lack of sufficient assets to pay debts; however, application of the presumption regarding lack of reasonably equivalent value was inconsistent with the legislative intent of MUFTA. The outcome of this decision is partially at odds with *In re Petters Co., Inc*., 494 B.R. 413 (Bankr. D. Minn. 2013) (Kishel, J.).

35. In re Genmar Holdings, Inc., 496 B.R. 532 (B.A.P. 8th Cir. 2013) (Nail, J.).

INTENTIONAL TWO WEEKS REQUIRED BETWEEN EXCHANGE EVENTS IS NOT A CONTEMPORANOUS EXCHANGE, AND ARBITRATION IS NOT NECESSARILY ORDINARY COURSE OF BUSINESS

After filing for arbitration, the purchaser of a defective boat entered into a settlement agreement with a subsidiary of the chapter 7 debtor. The debtor, not its subsidiary, then paid $65,000 to the purchaser's attorneys no more than 90 days before it filed for bankruptcy. In exchange, the subsidiary would acquire a lien waiver and title to the boat. The trustee filed an adversary proceeding against the purchaser's attorneys to recoup that alleged preferential transfer under § 547 and § 550. Because the purchaser's attorneys informed the trustee of their role as a conduit for the settlement payment after the complaint filing deadline, the trustee filed, and the bankruptcy court granted, a motion to amend his adversary complaint to include the purchaser. The purchaser and his attorneys subsequently filed answers and counterclaims alleging fraud. All parties then moved for summary judgment. The bankruptcy court granted the trustee's preferential transfer claim against the purchaser but not the purchaser's attorneys. Additionally, the court ruled against the purchaser and his attorneys on the fraud counterclaim. On appeal, the purchaser challenged the amendment of the adversary complaint and the judgment on the preferential transfer claim. The BAP affirmed.

The BAP first addressed the appellant's argument that the trustee's mistake in identifying the proper party before the filing deadline should preclude the trustee from amending his complaint. Rule 15(c)(1)(C)(ii) only addresses whether the defendant [purchaser], not the plaintiff [trustee] "knew or should have known that it would have been named as a defendant but for an error." Thus, the BAP found no abuse of discretion in the grant of the trustee's motion to amend.

Next, the BAP determined that the appellant's argument that the settlement agreement represented a contemporaneous exchange lacked merit. A trustee may not avoid a preferential transfer under § 547(b) if it satisfies the requirements of §547(c). Under § 547(c)(1), the court must determine whether the debtor and creditor intended a transfer to be a contemporaneous exchange. The BAP found that the settlement agreement between the purchaser and a subsidiary of the debtor provided evidence of intent only between those two parties and not of the debtor. Furthermore, applying the plain meaning rule to interpret the meaning of "contemporaneous" as "occurring. . . during the same time," the BAP found that the settlement agreement's provision that the exchange occur at least two weeks apart did not constitute a contemporaneous exchange.

Finally, the appellant asserted, and the BAP rejected, that the transfer satisfied the requirement under § 547(c)(2) in that it was "in payment of a debt incurred in the ordinary course of business and. . . was, subjectively, in the ordinary course of business between the parties." The purchaser did not provide evidence that the sales contract contained an arbitration clause, and the debtor was not a party to that contract or the arbitration proceeding. The presence of an arbitration clause also did not demonstrate that arbitration proceedings occurred in the debtor's ordinary course of business. Additionally, the purchaser did not provide evidence that the payment owed to him arose in his ordinary course of business. Thus, the settlement payment did not satisfy the requirements under § 547(c)(2).

36. In re Hecker, 496 B.R. 541 (B.A.P. 8th Cir. 2013) (Federman, J.).

THE "PERSON AGGRIEVED DOCTRINE" LIMITS APPELLATE STANDING TO PERSONS WITH A FINANCIAL STAKE IN THE ORDER BEING APPEALED

Chapter 7 trustee sought to avoid, as a preference or unauthorized postpetition transfer, liens obtained by judgment creditors prepetition but registered postpetition on property owned by debtor. The bankruptcy court granted summary judgment in favor of the defendants. The BAP ruled that the postpetition registration was an avoidable transfer, but remanded for determination of an appropriate remedy. On remand, the bankruptcy court ruled that the trustee should recover nothing from the judgment creditors, and that the mortgagee holding second and third mortgages failed to protect its lien position by redeeming and was not entitled to an order voiding the lien registrations. On appeal, the BAP held that the mortgagee holding second and third mortgages lacked standing to appeal, because if it was aggrieved, it was not as a result of the registrations or the bankruptcy court's ruling on remand:

"Ordinarily, a party to a lawsuit has no standing to appeal an order unless he can show some basis for arguing that the challenged action causes him a cognizable injury, i.e., that he is 'aggrieved' by the order. To appeal from an order of the bankruptcy court, appellants must have been directly and adversely affected pecuniarily by the order. This principle, also known as the 'person aggrieved' doctrine, limits standing to persons with a financial stake in the bankruptcy court's order. The 'person aggrieved' standard, which is more stringent than the constitutional test for standing, serves the acute need to limit collateral appeals in the bankruptcy context. A debtor has standing to appeal if the bankruptcy court order 'diminishes the person's property, increases the person's burdens, or impairs the person's rights."

With respect to the trustee's remedy, the BAP reiterated that the trustee is entitled to a judgment, either by return of the property transferred or the value of such property, to restore the estate to its prior financial condition, but noted that the present issue was not whether the transfer was avoidable under § 549 but what remedy was available under § 550. The BAP agreed with the bankruptcy court that immediately prior to the registration of the judgment liens, the trustee held a right of redemption and that, had the trustee redeemed, he would have owned the property subject to those liens and recovered no value to the estate. "For that reason, the right of redemption simply had no value to the Trustee. That is why, sensibly, he did not exercise it in the first place, and why he does not want it back now as the remedy for avoiding the transfer. But that is also why the estate suffered no damages from registration of the judgments." The BAP rejected the trustee's attempt to "piggyback" onto the judgment creditors' valuable rights of redemption, and affirmed the bankruptcy court's judgment that the trustee recover nothing.

37. In re Petters Co., Inc., 499 B.R. 342 (Bankr. D. Minn. 2013) (Kishel, J.).

PLEADING THAT PAYMENTS WERE MADE IN FURTHERANCE OF A PONZI SCHEME IS SUFFICIENT FOR FRAUD PLEADING; CONSTRUCTIVE FRAUD CANNOT BE USED TO RECOVER PAYMENTS ON PRINCIPAL OF LOAN; INSIDER STATUS SATISFIED BY PLEADING THAT PERSON HAD ACCESS TO PERSON IN CONTROL OF THE DEBTOR AND INFLUENCE OVER DECISIONMAKING

In the third of three memorandum opinions, the court addressed a final set of issues common to the adversaries initiated by the bankruptcy trustee. In the cases addressed by this opinion, the defendants had engaged in transactions with the debtors that were documented as loans and the trustee sought to recover transfers made on these loans as actual or constructive fraud. The court addressed the defendants' various arguments supporting their motions to dismiss under Rule 12(b).

The first issue addressed by the court was the defendants' assertion that a transfers documented as a loan and subsequent payments on that loan could not qualify as fraudulent transfers. The legal theory being that "[a] preference is not a fraudulent conveyance." In rejecting this argument, the court highlighted that "[t]he complaints at bar allege a massive, multi-year Ponzi scheme that involved many dozens of lender-investors and tens of thousands of transfers on transactions… treated as loans." In a factual situation of this nature, the entire existence of the Ponzi scheme requires a fraud on all parties that does not end until the scheme collapses. Therefore, to satisfy the pleading standard for fraud, the intent element is met by asserting: "the existence of the scheme; the funding of the subject transfer by the engine of the scheme…; and the service of the subject transfer in furtherance of the scheme." If these facts are asserted in the complaint, then avoidance theories based on actual fraud may go forward. The court stated: "[i]t matters not whether the transferee… received its due in payment on the contract that was regular on its face, or even one fully-enforceable under state law." If the payment was made in furtherance of a Ponzi scheme, the transfer is subject to a fraudulent transfer action based on actual or constructive fraud.

The next issue addressed by the court was whether the trustee could make a prima facie case regarding these transfers considering that the trustee could not argue that the debtor received less than reasonably equivalent value because the payments reduced the debt dollar-for-dollar; foreclosing any argument that the transfers were constructively fraudulent. Responding to the defendants' theory, the court agreed that there was equivalent value as to payments made on the principal. However, as to payments made on interest, the court stated, "as to… interest paid out from other parties' infusions, nothing is identifiable to real generation of income from past infusions, and nothing is retained or received." Therefore, the trustee cannot maintain a fraudulent conveyance action under a theory of constructive fraud as to repayment on the principal of a loan, but may do so as to payments in excess of the principal, whether denominated as profit, interest, or otherwise. For similar reasons, the court also rejected the defendants' value defense under 11 U.S.C. § 548(c).

Next, the court addressed the adequacy of pleadings as to the insider status of certain employees of the debtors. The court first noted that both MUFTA and the Bankruptcy Code contain lists of contractual relationships that would qualify an employee as an "insider." In these instances, pleading that an employee held the position of a formal-officer would suffice, even if that employee did not have actual control. However, in the absence of such a relationship, a finding of "actual control," would suffice to show that a non-officer was an insider. Two major considerations are used in this analysis: the closeness of the relationship between the debtor and the defendant; and the place of the transfers in a transaction that was conducted at arms-length, or not. In re Richmond, 429 B.R. 263, 297 (Bankr. E.D. Ark. 2010). Because this is a fact-intensive analysis, sufficient pleadings vary on a case-by-case basis. In this case, the court explained that "the [t]rustee must plead that a defendant had a status with, or access to, persons in control of a [d]ebtor, with a corresponding close relationship and opportunity to influence the decision-making for the [d]ebtor's activities, and coupled with specific allegations that the transfers to the defendant were not at arms length."

The final issue addressed by the court was whether claims for unjust enrichment and other equitable remedies were actionable if based upon the same facts as the fraudulent transfer claims. In dismissing the trustee's claims under equitable theories, the court stated that "due to the existence of fraudulent transfer remedies… all of [the trustee's] unjust enrichment claims against all defendants must be dismissed. When an adequate remedy at law exists, equitable theories are not available.

38. Ritchie Capital Management, L.L.C. v. Stoebner, 2014 WL 1386724 (D. Minn. 2014) (Nelson, J.), denying appeal of, In re Polaroid Corp., 472 B.R. 22 (Bankr. D. Minn. 2012) (Kishel, J.).

GRANT OF SUMMARY JUDGMENT TO TRUSTEE UPHELD ON APPEAL WHERE PONZI SCHEME PRESUMPTION UNREBUTTED; FAILURE TO DISCLOSE EXPERT WAS HARMLESS

In an adversary proceeding against the Ritchie Entities, the trustee sought to avoid certain liens that Polaroid had granted to the Ritchie Entities pursuant to a September 2008 Trademark Security Agreement and a disallowance of claims based on that agreement. The trustee sought relief under 11 U.S.C. § 548, claiming both actual and constructive fraud, and filed a motion for summary judgment on the issue of actual fraud. Applying the Ponzi scheme presumption, the bankruptcy court found that the Ritchie defendants had failed to rebut the presumption and granted the motion for summary judgment. In the alternative, the bankruptcy court also found fraudulent intent by applying the badges of fraud analysis. The Ritchie defendants appealed.

On appeal, the Ritchie defendants made three arguments. First, that the Ponzi scheme presumption was inapplicable to Polaroid because it was not part of Tom Petter's Ponzi scheme. Second, that the finding of fraud under the badges of fraud analysis misconstrued the law and ignored evidence. And finally, that the bankruptcy court abused its discretion in ruling that the trustee's failure to disclose an expert was harmless.

Regarding disclosure of the expert, on appeal the district court found that the bankruptcy court's ruling was not clearly erroneous. The district court agreed that the trustee failed to strictly adhere to the disclosure requirements under Fed. R. Civ. P. 26(a)(2). However, the district court also noted that the witness was not unexpected and that the Ritchie defendants had ample opportunity to examine the facts and opinions of the witness. Moreover, the witness essentially corroborated other witnesses' testimony regarding whether Polaroid received any of the proceeds from the Ritchie Entities' loans. Therefore, the bankruptcy court was affirmed.

The district court also agreed with the bankruptcy court as to the application of the Ponzi presumption. The district court stated, "[t]here can be no dispute that Tom Petters operated a massive Ponzi scheme. Through his control of Polaroid, he looted Polaroid's assets in order to appease the Ritchie Entities, whose loan money had gone not to Polaroid, but to pay off other investors." In response to the argument that Polaroid was not part of the Ponzi scheme, the court noted that Tom Petters was Polaroid's sole board member, Petters transferred Polaroid's security interests by "fiat," and that Petters "did not simply influence Polaroid–he controlled the transfer completely." Therefore, the Ritchie defendants appeal was denied as to this issue and the court refused to address the alternative finding that the badges of fraud established actual fraud under 11 U.S.C. § 548(a).

Although the parties did not address the issue of the disallowance of claims, the district court addressed it briefly, agreeing with the bankruptcy court that there is no evidence that the Ritchie defendants lent money to Polaroid. The court stated that to the extent that the Ritchie defendants appealed the bankruptcy court's ruling regarding the disallowance of claims, the appeal is denied.

39. Kelley v. Feneis (In re Petters Co., Inc.), ADV 10-4268 (Bankr. D. Minn. April 3, 2014) (Kishel, J.).

AVOIDABILITY OF TRANSFERS MADE BY DEBTORS BEFORE THE SIX-YEAR PERIOD NOT BARRED PER SE; PROPERY SOUGHT UNDER §542 MUST BE PROPERTY OF THE DEBTOR WHEN THE DEBTOR FILED FOR BANKRUPTCY

While many of the Petters adversaries share similar issues, this case reviewed a unique issue: whether relief for turnover is barred if plaintiff's counts for avoidance are time barred. While the court recognized that the issue was moot because the plaintiff had already dismissed the count by the time the opinion was issued, it also pointed out that the defendant's argument regarding the time bar had no merit. The court stated that "the avoidability of transfers made by the Debtors before the beginning of the six-year base limitations period was not barred per se."

However, the court also recognized that the demand for turnover was confused. The plaintiff was seeking turnover under 11 U.S.C § 542(a), which is used when a third party holds an asset that was the property of the debtor when the debtor filed for bankruptcy. In this case, the plaintiff pled that defendant had come into possession of the property before bankruptcy. The court stated, "[the property] does not become property of the estate until the transfer is avoided… Under the pleaded transactional facts, there was nothing in the Defendant's possession to turn over pursuant to § 542 when the Plaintiff sued him." The plaintiff voluntarily dismissed the count and the motion to dismiss was denied.

40. Kelley v. High Plains Investment, LLC (In re Petters Co., Inc.), ADV 10-4250 (Bankr. D. Minn. April 4, 2014) (Kishel, J.).

COMPLAINT ALLEGING ACTUAL FRAUD REQUIRES FRAUD ALLEGATION TO BE DIRECTED AT TRANSFEROR

This Petters avoidance action featured the defendant's argument that the plaintiff's complaint should be dismissed on the ground that the plaintiff did not adequately plead that the defendant knew of the possibility of fraud in conjunction with the transaction between Petters Company, Inc. (PCI) and the defendant when the defendant only engaged in one "note transaction."

As an initial observation, the court noted that the defendant came from a misguided position, in that the defendant argued that the plaintiff alleged actual fraud on the part of the defendant. Rather, the allegation of fraud was directed at the debtor-transferor. This is what was required for a showing of actual fraud and dismissal under Rule 12(b)(6) was not appropriate. The court also recognized that the plaintiff's allegations of the defendant's complicity in the debtor's fraud merely went to rebutting an affirmative defense of good faith. However, regardless of whether the plaintiff rebutted such a defense, the plaintiff was not required to do so in the complaint. The motion to dismiss was denied and the issue of good faith was allowed to proceed in the litigation.

41. Kelly v. Cunningham (In re Petters Co., Inc.), ADV 10-4442 (Bankr. D. Minn. April 4, 2014) (Kishel, J.).

A COMPLAINT MUST BE SPECIFIC ENOUGH FOR EACH DEFENDANT TO KNOW THE BASIS OF THE SUIT AGAINST IT AND THE AMOUNT SOUGHT

In this case, the question presented was "whether the plaintiff's complaint should be dismissed on the ground that the plaintiff had not pled specific facts on which the liability of each named defendant as to a specific transfer by a debtor could be established."

Agreeing with the defendants' position, the court stated, "[f]rom the face of this pleading, no particular defendant could determine the transactional basis of the suit against it, or the amount for which it was being sued." The court also noted that the complaint raised far too many possible theories for liability as to any particular defendant. "Where a number of defendants are sued in common on a fraud-based cause of action pleaded without allocation of participation, causality, or fault among them, the pleading does not meet the particularity standards of Rule 9(b)."

The court concluded by stating "the Plaintiff has pleaded the trunk of a claim for avoidance… However, the Plaintiff has not pled out the branches of that tree, to reach to any particular defendant." While the court refused to dismiss the case in its entirety, the court ordered the plaintiff to file a second amended complaint, identifying each payment he seeks to avoid, the application of the payments, the tracing of rolled-over notes, and linking these events to specific dates.

42. Manty v. Bougie (In re Bougie), 510 B.R. 606 (Bankr. D. Minn. 2014) (Sandberg, J.).

EQUITABLE TOLLING APPLIES AS LONG AS TRUSTEE RELIED ON THE SCHEDULES; TRUSTEE ALLOWED TO SELL PROPERTY OF THE ESTATE OVER THE OBJECTION OF CO-OWNERS

In August 2007, Shaun Bougie (the debtor), Camissa Abbot, and Jayme Bougie executed a mortgage in favor of Mortgage Electronic Registration Systems, Inc., encumbering their single-family residence. However, the mortgage was not recorded at that time. Two months later, Shaun Bougie filed his chapter 7 petition, but failed to disclose his interest in the home or the mortgage. The trustee never knew that the property existed during the pendency of the case, which was closed in February 2008.

Nearly a year later, the mortgage was recorded and assigned to Flagstar Bank. Two judgment liens also attached to the property in December 2008 and July 2009, held by Asset Acceptance and LVNV Funding, LLC, respectively. Camissa Abbot filed for bankruptcy and received a discharge in July 2009 and Jayme Bougie filed for bankruptcy and received a discharge in November 2012. In February 2013, Flagstar Bank filed an application to reopen Shaun Bougie's bankruptcy case to move for relief from the automatic stay. The application was granted that same month.

The trustee then filed this adversary proceeding, seeking authority to avoid the mortgage lien, authority to sell the property (including the interests of Camissa Abbot and Jayme Bougie), and a determination that the judgments of Asset Acceptance and LVNV Funding only attach to the one-third interest of Camissa Abbot. Only Flagstar responded. The trustee then filed a motion for summary judgment.

As for the avoidance action, the only outstanding issue was whether the trustee's action was time barred by 11 U.S.C. § 549. Under 11 U.S.C. § 549, a party must take action to avoid a post-petition transfer prior to either two years after the transfer sought to be avoided or the close of the bankruptcy case, whichever occurs earlier. In this case, the tolling period appeared to have ran, but the trustee argued that it was extended under the doctrine of equitable tolling, which tolls the limitation period when a party takes positive steps to conceal a fraud or when a fraud goes undiscovered without any action to conceal it.

Flagstar countered by arguing that it did not take any steps to conceal a fraud. However, the court found that for equitable tolling to apply, the trustee only needs to make a showing of due diligence, which it did by relying on the schedules. Therefore, the action was not barred by the statute of limitations and the transfer of the lien was avoided.

Regarding the authority to sell the property, the court recognized that the trustee must demonstrate four elements under 11 U.S.C. 363(h): (1) the partition of the property was impracticable; (2) the sale of the estate's undivided interest would realize significantly less than sale of the property free of the co-owners' interests; (3) the benefit to the estate of a sale outweighs the detriment to the co-owners; and (4) the property is not used in the production of electric energy or natural gas. Finding that the four elements had been met, the court approved the sale of the property.

DISCHARGE & DISCHARGEABILITY

43. In re Fields, 510 B.R. 227 (B.A.P. 8th Cir. 2014) (Schermer, J.), aff'g, Community Finance Group, Inc. v. Fields (In re Fields), ADV 10-5019 (Bankr. D. Minn. Nov. 7, 2013) (Kishel, J.) and Community Finance Group, Inc. v. Fields (In re Fields), 449 B.R. 387 (Bankr. D. Minn. 2011) (Kishel, J.).

THE BANKRUPTCY COURT DID NOT CLEARLY ERR IN FINDING THAT THE DEBTOR MADE A MISREPRESENTATION AND THAT THE CREDITOR JUSTIFIABLY RELIED ON THE MISREPRESENTATION

The debtor appealed an order of the bankruptcy court excepting a debt from discharge under 11 U.S.C. § 523(a)(2)(A). Previously, the debtor-defendant, as CEO and chief manager of a real estate development company, had obtained loan proceeds from a finance company and used those proceeds to pay interest on another loan. Later, the loan went into default. Subsequently, the debtor filed bankruptcy, and the creditor, a finance company, filed a complaint under § 523(a)(2)(A) and (B). The bankruptcy court determined that the debt was nondischargeable under § 523(a)(2)(A). On appeal, the debtor challenged the bankruptcy court's factual findings regarding the misrepresentation and justifiable reliance elements of a § 523(a)(2)(A) claim.
On review, the BAP determined that the bankruptcy court did not clearly err in finding that the debtor made a misrepresentation. The BAP pointed to Fed. R. Bankr. P. 8013 stating that it will not "second guess" a trial court's assessment of the credibility of witnesses. Because the bankruptcy court thoroughly explained how it assessed the credibility of the witnesses, and because the court's decision was supported by the record, the BAP determined that the bankruptcy court did not clearly err in finding that the debtor made the misrepresentation.

The BAP also determined that the court correctly found that the creditor justifiably relied on the debtor's misrepresentation. The court found that the creditor primarily relied on the debtor's misrepresentation after determining that the creditor's justifiable reliance was not rebutted by the record.

44. Sailor Music v. Walker (In re Walker), 514 B.R. 585 (B.A.P. 8th Cir. 2014) (Kressel, J.).

JUDGMENT DEBT ARISING OUT OF COPYRIGHT INFRINGEMENT ACTION HELD NONDISCHARGEABLE BECAUSE DEBTOR'S CONDUCT WAS WILLFUL AND MALICIOUS

The debtor appealed the decision of the bankruptcy court that a judgment debt against the debtor for copyright infringement was nondischargeable under 11 U.S.C. § 523(a)(6). The debtor argued that the bankruptcy court erred in determining that he acted willfully and maliciously.

The debtor was a managing member of a saloon; under his control, the saloon played music and held music performances—some of which constituted copyrighted material. ASCAP—a performing rights organization—had a nonexclusive right to license the public performance of the copyrighted material. After discovering that the saloon was holding public performances of the copyrighted material without a license, ASCAP sent a letter by return receipt informing the debtor about the copyright violations and offering him a settlement. The debtor signed the receipt confirming delivery. The debtor testified that he had no recollection of reading the letter; as a result, he did not accept settlement.

Later, various parties (collectively the appellee) sued the debtor and the saloon in federal district court for copyright infringement. The court issued a default judgment for liability against the debtor for willful failure to comply with discovery. Subsequently, the court entered a final, joint and several judgment of $41,231.90 against the debtor and the saloon for copyright infringement.

Later, the debtor filed for chapter 7 bankruptcy. The judgment creditor filed a complaint against the debtor, alleging that the debt was nondischargeable under 11 U.S.C. § 523(a)(6). Because "the debtor had willfully failed to obtain an ASCAP license and maliciously disregarded the rights of ASCAP's members and Federal copyright law," the bankruptcy court held that the debt was nondischargeable.

The BAP affirmed the bankruptcy court's determination that the judgment debt was nondischargeable under § 526(a)(6) because the debtor's conduct was willful and malicious. The BAP determined that the bankruptcy court was not clearly erroneous in its finding that the debtor "intentionally ignored" the letters and numerous contact attempts from ASCAP. The BAP also determined that the debtor's conduct was willful because he intentionally infringed the appellee's legal rights and as a result intended the injury. The BAP agreed with the bankruptcy court's finding that the debtor's conduct was malicious because he intended to harm the appellee when he knew the appellee was entitled to compensation though he avoided getting a license.

45. In re Tyler, 2014 WL 1329559 (Bankr. D. Minn. Mar. 28, 2014) (Constantine, J.).

CREDITOR FAILED TO SHOW THAT A FIDUCIARY RELATIONSHIP EXISTED OR THAT THE DEBTORS COMMITTED FRAUD OR DEFALCATION

The bankruptcy court granted summary judgment in favor of the defendant-debtors in a nondischargeability action under 11 U.S.C. § 523(a)(4) brought by the creditor. The plaintiff-creditor failed to show that a fiduciary relationship existed and failed to show that the defendants committed fraud or defalcation. The defendants' construction company did not fully pay the plaintiff for sold materials. Customer proceeds were placed into a general account, and the defendants' expenses and wages were paid from these proceeds. The defendants did not keep separate accounts for construction projects.

The plaintiff sued the defendants to except its debt from discharge under § 523(a)(4), fraud or defalcation while acting in a fiduciary capacity. The plaintiff argued that Colorado Statute § 38–22–127 and Minnesota Statute § 514.02 created the requisite fiduciary capacity. The defendants argued that no such fiduciary capacity was created, and that even if it were, there was no requisite fraud or defalcation.

The court determined that neither the Minnesota statute nor the Colorado statute created the fiduciary capacity required by § 523(a)(4). The court observed that "fiduciary" in § 523(a)(4) referred to trustees of express trusts. It also stated that because Minn. Stat. § 514.02 provided that a violation of that statute would not create a fiduciary relationship, then it did not create the express trust required under 11 U.S.C. § 523. The court then stated that in order for a statutory trust to satisfy the fiduciary capacity requirement of § 523(a)(4), the statutory trust must: (1) include a definable *res* and (2) impose "trust-like" duties; and that the debtor "must have been a trustee before the wrong and without reference thereto."

The court determined that even if a fiduciary capacity did exist for purposes of § 523(a)(4), there was no cognizable "fraud or defalcation." The plaintiff argued that fraud or defalcation existed under state law because the defendant did not pay to the plaintiff the funds of the trust created under Minnesota or Colorado law; however, the bankruptcy court disagreed, stating that a *per se* violation is not cognizable as fraud or defalcation under Supreme Court precedent. Relying on the rule that to except a debt from discharge on the basis of fraud, the fraud must be "positive fraud, or fraud in fact, involving moral turpitude or intentional wrong . . . and not implied fraud, or fraud in law, which may exist without the imputation of bad faith or immorality," the court found that no fact in the record satisfied this fraud requirement. Defalcation under § 523(a)(4) includes a scienter requirement of "intentional wrong . . . [including] not only conduct that the fiduciary knows is improper but also reckless conduct . . . ." Because there was no fact in the record to establish the existence of fraud or defalcation, summary judgment in favor of the defendant was proper.

46. Malmberg Dev. Co. v. Puro (In re Puro), ADV 09-3069 (Bankr. D. Minn. Dec. 16, 2013) (Kishel, J.).

DEBTOR'S DISCHARGE DENIED UNDER § 727(a)

In this case, a judgment creditor, a real estate company, objected to the debtor's discharge under 11 U.S.C. §§ 727(a)(2), (a)(3), (a)(4), and (a)(5). The debtor was a former real estate agent of the creditor. After trial, Chief Judge Kishel denied the debtor's discharge under §§ 727(a)(3), 727(a)(4)(A), and 727(a)(5), but not under § 727(a)(2)(A).

The court found that the evidence did not support the denial of discharge under § 727(a)(2)(A)—transfers of property of the debtor made with the intent to hinder, delay, or defraud—because there was insufficient proof that the debtor possessed any undivided, vested interest in either the real estate or the vehicle. The court found that the money transfers to the debtor's son were made to support his college and living expenses; therefore, they lacked the requisite intent to hinder, delay, or defraud creditors.

The court denied the debtor's discharge under § 727(a)(3) for failure to keep or preserve records after finding that the debtor failed to reasonably explain and justify her lack of records regarding two separate real estate transactions and the disposition of a large amount of cash withdrawn from an account.

The court denied the debtor's discharge under § 727(a)(4)(A) for knowingly or fraudulently making a false oath in connection with a bankruptcy case after finding that the debtor made false oaths in her bankruptcy case concerning the transfer of her wedding rings, the payments to her son for his college and living expenses, the status of a joint bank account, and the delivery of records to the trustee for a personal bank account, and the statements made in connection with a real estate transaction.

The debtor's discharge was also denied under § 727(a)(5) for failure to satisfactorily explain a loss of assets after finding that the debtor failed to satisfactorily explain the disposition of cash withdrawals from her bank account.

47. Conway v. National Collegiate Trust (In re Conway), 559 F. App'x 610 (8th Cir. 2014) (per curiam).

EXCEPTING ALL OF DEBTOR'S STUDENT LOANS FROM DISCHARGE WOULD IMPOSE AN "UNDUE HARDSHIP" UNDER 11 U.S.C. § 523(A)(8), BUT CASE REMANDED FOR A SEPARATE "UNDUE HARDSHIP" DISCHARGE ANALYSIS OF EACH LOAN

The Eighth Circuit affirmed the judgment of the Eighth Circuit BAP that reversed the bankruptcy court's finding that the debtor had reasonably reliable future financial means to pay all her student loan debt to a certain creditor. The BAP found that excepting all fifteen of the student loan debts from discharge imposed an "undue hardship" upon the debtor under 11 U.S.C. § 523(a)(8). The BAP, however, remanded the case back to the bankruptcy court for an undue hardship analysis for each student loan. The Eighth Circuit also determined that the BAP did not abuse its discretion in reaching the merits of the bankruptcy court's decision, despite certain immaterial deficiencies in the record on appeal.

48. Heide v. Juve (In re Juve), --- F.3d ----, 2014 WL 3746878 (8th Cir. 2014) (Smith, J.).

CREDITOR JUSTIFIABLY RELIED ON A DEBTOR'S REPRESENTATIONS FOR PURPOSES OF § 523(a)(2)(A)

First, the circuit court found that the debtor, who had owned a used car dealership with a third-party, had made representations to the creditor, his long-time friend, who provided financing to the debtor, e.g., that the creditor's investment was "safe" and that he had obtained a life insurance policy with the creditor as beneficiary (when the debtor had not done so). The debtor had also represented to the creditor that all of the cars on the lot belonged to the creditor, when in fact debtor had been encumbering the vehicles. Second, the circuit court found that the debtor had known that some of his representations were false and that the representations had been made with the purpose to deceive the creditor, yet the debtor nevertheless continued to represent to the creditor that the creditor owned all the vehicles on the lot and that the creditor's investment was "safe." Third, the circuit court found that the creditor had "justifiably relied" on the debtor's representations. Here, debtor had taken advantage of the creditor's friendship and misused the trust associated with that friendship, concealing the misrepresentation of the security of the creditor's investment by making periodic interest payments, and knowing that he was squandering the creditor's property. And when the creditor began to have concerns about the security of the loan and asked for additional security, the debtor assured the creditor by lying and covered up his misdeeds from the dealership's co-owner. The circuit found that the bankruptcy court had not clearly erred in finding that the creditor had justifiably relied on the debtor's representations. The court also found that the bankruptcy court correctly applied the law to the facts—as brought out after a full trial on the merits. Note: This material is excerpted from the September 2014 issue of the Bankruptcy Current Awareness Alert newsletter, with permission. Copyright (c) 2014 Thomson Reuters/West. For more information about this publication please visit www.legalsolutions.thomsonreuters.com.

49. Johnson v. Johnson, 542 Fed.Appx. 536 (8th Cir. 2013) (per curiam).

BANKRUPTCY COURT PROPERLY REVOKED THE DEBTORS' DISCHARGE AS HAVING BEEN OBTAINED THROUGH FRAUD

Post-discharge, the creditors her commenced an adversary proceeding against the debtors, alleging that they had engaged in fraud and had failed to report to the trustee their continued interest in certain lake property. After a trial, the bankruptcy court found that debtors' purported sale of the lake property to the parents had several badges of fraud. It concluded that the transaction was actually a loan from the parents and that the debtors had maintained an ownership interest in the lake property. The bankruptcy court also found that the debtors had engaged in the transaction with the intent to hinder, delay, or defraud creditors, and revoked the debtors' discharge. The issue before the circuit court was whether the bankruptcy court properly revoked the debtors' discharge under 11 U.S.C.A. § 727(d)(1) ("such discharge was obtained through the fraud of the debtor"). In this case, the bankruptcy court determined that, had the debtors' fraud been known, they would have been denied a discharge under § 727(a)(2)(A) and § 727(a)(4)(A). The debtors appeared to argue that the bankruptcy court had erred in finding that either a contract for deed or equitable mortgage existed, because the same proof could not be used to establish both. The debtors also argued that the creditors had failed to produce evidence of an equitable mortgage. The circuit court concluded that the transaction had "all the hallmarks of an equitable mortgage" and that the record was "replete with evidence to establish the fraudulent nature of the transaction and to establish an equitable mortgage." Here, as an alternative ground for revocation of the debtors' discharge under § 727(d)(1), the bankruptcy court determined that the debtors' could have originally been denied a discharge under § 727(a)(4)(A) for having fraudulently failed to disclose valuable assets. "Although the sham lake property transaction alone would have been sufficient to revoke discharge, we see no clear error in the bankruptcy court's additional finding of fraud," the circuit court held. Note: This material is excerpted from the December 2013 issue of the Bankruptcy Current Awareness Alert newsletter, with permission. Copyright (c) 2013 Thomson Reuters/West. For more information about this publication please visit www.legalsolutions.thomsonreuters.com.

50. Goldstein v. Diamond (In re Diamond), 509 B.R. 219 (B.A.P. 8th Cir. 2014) (Kressel, J.).

REOPENING A BANKRUPTCY CASE IS NOT A PREREQUISITE TO COMMENCING AN EXCEPTION-TO-DISCHARGE ACTION

The bankruptcy court issued an order stating that absent a motion to reopen the case, the court would not permit a dischargeability complaint to be filed, and ruling that new requests for relief are not properly before the court until the case is reopened. The court directed the clerk to return the complaint and the brief to the creditor, who then timely appealed to the Eight Circuit BAP. The court began its analysis by noting that, ordinarily, once a bankruptcy estate is fully administered and the trustee has been discharged, the case is closed, but under 11 U.S.C.A. § 350(b), a "case may be reopened in the court in which such case was closed to administer assets, to accord relief to the debtor, or for other cause." The BAP added that there "is a fair amount of case law deciding when a case may be reopened. There is little case law, however, on whether a case must be reopened for the purpose of filing a dischargeability complaint." The BAP concluded "that opening a case to initiate a dischargeability proceeding is little more than a managerial act and has no immediate impact on the substance of the underlying bankruptcy case. Reopening a case allows the court file to be resurrected from the court's records and also allows the clerk to orderly administer the case. While important, the convenience of the clerk is not a proper reason for refusing to docket a complaint. The filing of an adversary proceeding creates an entirely new docket, anyway. For these reasons, we hold that reopening a case is not a prerequisite to filing a dischargeability complaint." Note: This material is excerpted from the June 2014 issue of the Bankruptcy Current Awareness Alert newsletter, with permission. Copyright (c) 2014 Thomson Reuters/West. For more information about this publication please visit www.legalsolutions.thomsonreuters.com.

51. <u>Pennington-Thurman v. Bank of America N.A. (In re Pennington-Thurman),</u> 499 B.R. 329 (B.A.P. 8th Cir. 2013) (Shodeen, J.), *judgment aff'd,* 559 Fed.Appx. 600 (8th Cir. 2014) (per curiam).

THE BANKRUPTCY COURT HAS THE DISCRETION TO DENY A DEBTOR'S MOTION TO REOPEN THE BANKRUPTCY CASE TO BRING AN ADVERSARY PROCEEDING WHERE THE PROPOSED CAUSE OF ACTION LACKS MERIT

Once the debtor's bankruptcy case was fully administered, it was closed. Subsequently, the bank commenced foreclosure proceedings against the debtor's home and she filed a motion to reopen the bankruptcy case in order for her to commence an adversary proceeding against the bank for violation of the discharge injunction (§ 524(a)). The debtor's motion stated that the bank had sent her 41 notices, two transfers of service provider, nine "recent inquiries," and had placed six notices on the debtor's front door. The debtor also asserted that each of these documents, coupled with their combined effect, constituted attempts to collect a discharged debt. The bank argued that the notices were not attempts to collect a debt against debtor, personally, but were instead related to enforcement of its mortgage against the real estate, which would not be subject to the discharge injunction. The bankruptcy court denied the motion, holding that the notices were not attempts to collect a debt as a personal liability of the debtor and thus did not violate the discharge injunction. In sum, the BAP held that, because the bankruptcy court had correctly concluded that the debtor's asserted claims lacked merit, it could find no abuse of discretion in the its denial of the debtor's motion to reopen the bankruptcy case. [In an unpublished opinion, the Eighth Circuit affirmed.] Note: This material is excerpted from the December 2013 issue of the Bankruptcy Current Awareness Alert newsletter, with permission. Copyright (c) 2013 Thomson Reuters/West. For more information about this publication please visit www.legalsolutions.thomsonreuters.com.

52. Bank of America, N.A. v. Armstrong (In re Armstrong), 498 B.R. 229 (B.A.P. 8th Cir. 2013) (Federman, J.).

DEBTOR'S DIVERSION OF INSURANCE CHECKS WAS EMBEZZLEMENT

The chapter 7 debtor owned a limited liability company, which, in turn, owned a strip mall that was partially destroyed by fire. The BAP affirmed the bankruptcy court's determination that the debtor had misappropriated the "property of another," for purposes of embezzlement under 11 U.S.C. § 523(a)(4). The BAP pointed out that "the only difference between a nondischargeable debt for embezzlement and a nondischargeable debt for larceny under § 523(a)(4) is whether the initial possession of the property was lawful." Notwithstanding that the loan documents required him to do so, the debtor failed to list the mortgage holder as a loss payee on the mall's insurance policy. When the debtor received three insurance checks made jointly payable to himself "d/b/a" the LLC and the mortgage holder, he endorsed the checks and deposited them into the LLC's account, and diverted the majority of the funds to his personal use. Regardless of whether the LLC had an ownership interest in the insurance proceeds to the exclusion of the mortgage holder, nothing in the record suggested that the debtor had any ownership interest in the mall or the proceeds from the insurance policy. And because the undisputed circumstantial evidence showed that the debtor acted with fraudulent intent, the BAP was satisfied that the debtor had embezzled the funds within the meaning of § 523(a)(4).

53. In re Conway, 495 B.R. 416 (B.A.P. 8th Cir. 2013) (Saladino, J.).

UNDER TOTALITY OF THE CIRCUMSTANCES TEST FOR UNDUE HARDSHIP STUDENT LOAN DISCHARGEABILITY CASES, ANALYSIS MUST BE MADE FOR EACH STUDENT LOAN, NOT ALL OUTSTANDING LOANS COMBINED TOGETHER

The debtor brought an adversary proceeding against the creditor in a reopened chapter 7 case to discharge 15 student loans totaling $118,579.66. On appeal, the debtor asserted that the bankruptcy court erred in determining under § 523(a)(8) that the aggregate loan repayment amount did not constitute "undue hardship." The parties disagreed as to whether the debtor's future income allowed for loan repayment without hardship. The BAP reversed and remanded.

The BAP applied the totality-of-the-circumstances test to determine the existence of undue hardship. Under this test, courts consider (1) "past, present, and reasonably reliable future financial resources," (2) "reasonable and necessary living expenses," and (3) "'any other relevant facts and circumstances'" of the debtor. The court found that the debtor's past earnings and unsuccessful attempts to find a job with a higher salary demonstrated that the debtor did not have the resources to repay the entire loan amount. Furthermore, the court found that the debtor's living expenses were reasonable and necessary and that other financial resources did not further enable the debtor to repay the loans. However, the BAP determined that, pursuant to §523(a)(8), the bankruptcy court must conduct an undue hardship analysis for each of the 15 loans separately because repayment of some of those loans may not constitute undue hardship. Consequently, it reversed the bankruptcy court's ruling and remanded for that analysis.

PLANS, DISMISSAL & CONVERSION

54. In re Strickland, 504 B.R. 542 (Bankr. D. Minn. 2014) (Ridgway, J.).

INCOME NEED ONLY BE ‘DERIVED’ DURING THE RELEVANT SIX-MONTH PERIOD TO BE INCLUDED IN CURRENT MONTHLY INCOME AND MONTHLY EXPENSES MUST BE DEBTOR’S ACTUAL MONTHLY EXPENSES IN EFFECT ON THE DATE OF THE ORDER FOR RELIEF

The U.S. Trustee (“UST”) moved to dismiss the debtors’ chapter 7 case based on the presumption of abuse under § 707(b)(2). When calculating their current monthly income (“CMI”) for purposes of the means test, the debtors excluded income received outside of the six-month period preceding their bankruptcy filing. The UST argued that income should have been included in their current monthly income because it was “derived” during the relevant six-month period. The debtors argued that the income must be “received” by the debtors during the relevant six-month period in order to be included within the definition of CMI. Adopting the analysis of In re Robrock, 430 B.R. 197, 204 (Bankr. D. Minn. 2010), the court held that income need only be ‘derived’ during the relevant six-month period to be included in CMI even though the income would be ‘received’ outside of that six-month period.

The UST also objected to the allowance of a debtors’ monthly wage garnishment expense. Observing that § 707(b)(2)(A)(ii)(I) requires that monthly expenses be a debtor’s actual monthly expenses in effect on the date of the order for relief, and noting that § 362 imposes an automatic stay on wage garnishments, the court held that the debtors could not include wage garnishments as a monthly expense because the wage garnishment ceased to be in effect as an actual monthly expense on the date of the order of relief.

55. In re Melander, 506 B.R. 855 (Bankr. D. Minn. 2014) (Ridgway, J.).

EXEMPTIONS OBJECTION OVERRULED, BUT PLAN CONFIRMATION DENIED BECAUSE THE PLAN DID NOT COMMIT ALL OF THE DEBTORS’ PROJECTED DISPOSABLE INCOME AND BECAUSE THE PLAN WAS NOT CONDUCIVE TO THE SPIRIT OF CHAPTER 13

TCF Bank (“TCF”) objected to the debtors’ claimed exemptions in certain property and objected to confirmation of the debtors’ chapter 13 plan. TCF claimed that the debtors significantly undervalued their property, that their plan was proposed in bad faith, that the plan failed to meet the best interest of creditors test, and that it did not apply all of the debtors’ disposable income to their unsecured creditors.

The court overruled TCF’s objection to exempt property on the basis that TCF failed to carry its burden under Fed. R. Bankr. P. 4003(c) in refuting the debtors’ valuations of each item, but it sustained TCF’s objection to the extent that the debtors’ exemptions exceeded the amounts set forth in 11 U.S.C. § 522(d)(5).

TCF objected to the plan based upon the debtors’ failure to contribute all of Mr. Strickland’s Social Security income into the plan. It also challenged certain expenses and deductions of the debtors. TCF argued that if the debtor voluntarily contributed a portion of his Social Security income, then the debtor must commit all Social Security income. The court held that “unless there is some other indicia of bad faith . . . TCF must accept the portion of [the debtor's] Social Security income that he is willing to contribute voluntarily." As to TCF's dispute as to the debtors' $216.00 monthly contribution to a voluntary retirement account, the court adopted the rationales of those courts holding that the retirement contributions were excluded from disposable income and allowed the expense. Regarding the expense of $440.00 for long-term care, the court did not allow it because the debtors failed to give specific reasons as to why the expense was necessary and because the expense was not the type of allowable expense listed under 11 U.S.C. § 707(b)(2)(A)(ii)(I) or § 707(b)(2)(A)(ii)(II). In sum, the court denied confirmation of the plan because the plan did not commit all of the debtors' projected disposable income and that the proposed plan was not conducive to the spirit of chapter 13.

56. In re Kelley, 536 Fed. App'x 675 (8th Cir. 2013) (per curiam).

EIGHTH CIRCUIT AGREED WITH BAP DECISION THAT AFFIRMED BANKRUPTCY COURT ORDER

Finding no basis to overturn the bankruptcy court's order, the Eighth Circuit agreed with the Eighth Circuit BAP decision that affirmed a bankruptcy court's order that directed the debtors to convey certain real property to the bank pursuant to their confirmed plan.

57. Copeland v. Fink (In re Copeland), 742 F.3d 811 (8th Cir. 2014) (Smith, J.).

DEBTORS' PROPOSED SPECIAL TREATMENT OF TAX ARREARAGES IN THEIR CHAPTER 13 PLAN UNFAIRLY DISCRIMINATED AGAINST OTHER UNSECURED CREDITORS

The amended chapter 13 plan proposed by the debtors provided a distribution of about 97% to the taxing authorities, leaving nothing for the general unsecured creditors. The bankruptcy court denied confirmation. The debtors amended their plan a second time to remove the provisions regarding special-classification, which the trustee estimated would then provide a distribution of approximately 78% to all general unsecured creditors. The debtors then objected to their own plan because it did not provide for priority treatment of their tax debts. Although the bankruptcy court overruled the debtors' objections to their second amended plan, it did not enter a confirmation order. Two months later, the debtors again amended their plan and renewed their objection to the lack of priority treatment for the tax authorities. Noting that the priority issue had already been decided, the court overruled the objection and entered an order confirming the plan. The BAP affirmed and an appeal to the Eighth Circuit followed. The circuit court noted that its test for unfair discrimination has four parts: "(1) whether the discrimination has a reasonable basis; (2) whether the debtor can carry out a plan without the discrimination; (3) whether the discrimination is proposed in good faith; and (4) whether the degree of discrimination is directly related to the basis or rationale for the discrimination." In reviewing the debtors' proposed chapter 13 plan, the circuit court agreed with the bankruptcy court that the plan was unfairly discriminatory. Note: This material is excerpted from the March 2014 issue of the Bankruptcy Current Awareness Alert newsletter, with permission. For more information about this publication please visit www.legalsolutions.thomsonreuters.com.

58. Schlehuber v. Fremont National Bank & Trust Co. (In re Schlehuber), 558 Fed.Appx. 715 (8th Cir. 2014) (per curiam), *aff'g*, 489 B.R. 570 (B.A.P. 8th Cir. 2013) (Schermer, J.).

BANKRUPTCY COURT DID NOT ABUSE ITS DISCRETION IN CONVERTING THE CHAPTER 7 DEBTOR'S CASE TO ONE UNDER CHAPTER 11 VIA § 706(b)

The BAP's decision was reported at last year's Institute. Here, the debtor filed a voluntary chapter 7 bankruptcy petition; one of his creditors moved under 11 U.S.C. § 706(b) to convert the petition to one under chapter 11. The bankruptcy court granted the motion, and the BAP affirmed. The debtor then appealed to the Eighth Circuit, arguing that the bankruptcy court applied an improper legal standard, and abused its discretion, in granting the motion to convert. The debtor also renewed his constitutional challenge to certain bankruptcy statutes. The court declined to address the constitutional challenges, finding that the debtor had abandoned them in his appeal to the BAP. As to the remainder of the debtor's appeal, the court noted that it reviews a conversion order under § 706(b) under an abuse of discretion standard. The court could find no basis to conclude that the bankruptcy court had applied an improper legal standard or abused its discretion in granting the motion to convert.

59. In re Slater, Case No. 12-33389-KAC (Bankr. D. Minn. Jan. 8, 2014) (Constantine, J.), *appeal dismissed*, No. 14-cv-729 ADM (D. Minn. April 9, 2014) (Montgomery, J.).

DEBTOR'S PURPORTED CONVERSION FROM CHAPTER 11 TO CHAPTER 13 INEFFECTIVE

This matter came before the court on a creditor's motion to dismiss the debtor's "Chapter 13" case based upon the debtor's ineligibility to be in a case under chapter 13. The motion was also supported by the chapter 13 trustee, based upon the asserted ineligibility of the debtor to be in a case under chapter 13. The debtor commenced the case under chapter 11 on June 4, 2012. On January 2, 2013, the debtor filed a document entitled "Conversion of Chapter 11 Case to Chapter 13 Case." The conversion notice was signed by the debtor and his then-counsel and provided, inter alia, that the conversion by the debtor to chapter 13 "is allowed" and that "the debtor . . . converts this case to a Chapter 13 case . . . ." The court docket thereafter indicated that the case was under chapter 13. Notably, however, there was no application or motion seeking an order from the court to convert the case; further, there was no order doing so. The bankruptcy court ruled that the "question presented by the motion is the debtor's eligibility to be a debtor under chapter 13. . . . The question presented is not addressed as the court determines that the case was never converted to a case under chapter 13; the debtor is currently a debtor under chapter 11. Accordingly there is no chapter 13 case to be dismissed, for lack of eligibility or otherwise." The court reasoned that conversion of a case under chapter 11 to one under chapter 13 is governed by 11 U.S.C. § 1112(d) and requires court action. Thus, the debtor's purported conversion was ineffective, the motion was denied, and the debtor remained in chapter 11. The court also ordered that the docket be corrected. [An appeal by the debtor was later dismissed.]

60. In re Hernandez, 496 B.R. 553 (B.A.P. 8th Cir. 2013) (Kressel, J.).

CHILD SUPPORT PAYMENTS AUTOMATICALLY WITHHELD FROM INCOME EARNED ON ACCOUNT OF EMPLOYMENT UNDER A DEAD PERSON'S STOLEN SOCIAL SECURITY NUMBER STILL CONSTITUTES PRIORITY DOMESTIC SUPPORT

The debtor received child support payments for her two children via income withholding of the father until he died in 2005. From 2007 to 2008, one of the debtor's children remained in out-of-home foster care through the Nebraska DHHS. DHHS spent approximately $65-$68 per day for the care of that child. From 2008 to 2011, child support payments resumed, presumably because someone stole the decedent father's identity and was employed using his stolen social security number and thereby causing the child support payments to be withheld again. Those payments were paid to the debtor by DHHS. In 2012, the debtor filed a chapter 13 case. DHHS sought payment for 50% of the amount paid to the debtor from 2008 to 2011 as a priority domestic support obligation representing the amount it should have retained while funding the support of one of the children. The bankruptcy court agreed with DHHS's position and classified the child support payments made to the debtor as a priority domestic support obligation under § 101(14A). The debtor appealed this decision, and the BAP affirmed.

On appeal, the only element of § 101(14A)(B) contested by the parties was whether the debt was "in the nature of support of a child of the debtor." The debtor argued that the court should not consider payments derived from the income of an individual who committed identity theft as satisfying § 101(14A)(B). Because DHHS only requested 50% of the amount paid to the debtor between 2008 and 2011, however, the BAP inferred that the DHHS only sought the funds for the purposes of paying for the care of the debtor's child.

61. In re Paulson, 524 Fed.Appx. 306 (8th Cir. 2013) (per curiam).

REPEATED FAILURE TO FILE A CONFIRMABLE PLAN IS BASIS FOR DISMISSAL

The BAP affirmed the bankruptcy court's dismissal of the debtor's chapter 13 case and denial of the debtor's motion for reconsideration. The debtor appealed the BAP's decision. The 8th Circuit affirmed the BAP and held that pursuant to § 1307(c)(1), repeated failure to file a confirmable plan constitutes "unreasonable delay. . . that is prejudicial to creditors" and is grounds for dismissal.

62. In re Jordahl, --- B.R. ---, 2014 WL 4250504 (Bankr. D. Minn. 2014) (Sanberg, J.).

PLAN MAY CURE AND MAINTAIN DIRECT PAYMENTS ON LONG-TERM DEBT, BUT MAY NOT UNFAIRLY DISCRIMINATE AGAINST OTHER UNSECURED CREDITORS

Chapter 13 debtors proposed a 60-month plan with payments of $155 for 51 months and $430 for the final nine months, totaling $11,775. Unsecured claims total $151,948 and the unsecured creditors would receive $9,211.50 over the life of the plan, or 6%. The plan separately classified student loan debt of $49,045 with the usual monthly payments of $424 to be made directly to the lenders, for a total of $25,440 paid on the student loans during the plan, or a total dividend to the unsecured student loan class of creditors of 52%. The chapter 13 trustee objected to the debtors' plan arguing that it unfairly discriminated against the debtors' unsecured creditors in violation of § 1322(b)(1), and because it provided for payments of post-petition interest on nondischargeable debt without providing full payment of all allowed claims, in violation of § 1322(b)(10).

The bankruptcy court acknowledged "a split among courts as to whether the classification of an unsecured debt under § 1322(b)(5) is subject to the unfair discrimination test found in § 1322(b)(1). … The majority of courts have held that section 1322(b)(5) and section 1322(b)(1) must be read in conjunction with each other, requiring any treatment of long-term debt under § 1322(b)(5) to satisfy the unfair discrimination analysis under § 1322(b)(1). … These courts have focused on the plain language of the statute by examining the close placement of subsections (b)(1) and (b)(5) and subsection (b)(5)'s specific exclusion of subsection (b)(2), indicating Congress's intent for the two subsections to be read in conjunction with each other. … The minority of courts have found that subsection (b)(5) acts independently from subsection (b)(1) and excepts long-term debt payments from the unfair discrimination analysis. The minority approach reasons that subsection (b)(5) is more specific than the general subsection (b)(1) and the failure to treat the subsections as independent from each other would render subsection (b)(5) meaningless."

The court concluded that "[t]he reasoning of the courts adopting the majority approach is sound. Nothing in § 1322(b)(5) excludes the application of § 1322(b)(1). Rather, subsection (b)(5) has specific language excluding subsection (b)(2). If Congress wanted § 1322(b)(1) to also not apply to classifications under § 1322(b)(5), it would have said so. Further, reading the two provisions in conjunction with each other furthers the bankruptcy code's goal of balancing the rights of creditors to equal treatment with the rights of debtors to a fresh start." The court adopted the majority approach and ruled that the debtors could use § 1322(b)(5) to cure and maintain direct payments on long-term debt, but that they could not unfairly discriminate against other unsecured creditors under § 1322(b)(1).

The court set forth the test under § 1322(b)(1): "In the Eighth Circuit, a proposed separate classification of an unsecured claim is not unfair discrimination if: (1) the discrimination has a reasonable basis; (2) the debtor cannot carry out a plan without the discrimination; (3) the discrimination is proposed in good faith; and (4) the degree of discrimination is directly related to the basis or rationale for the discrimination." Applying the § 1322(b)(1) analysis to the facts of the case, the court found that the debtors failed to provide sufficient evidence to prove that the discrimination found in their plan was fair, and denied confirmation.

LIEN STRIPPING

63. <u>Minnesota Housing Finance Agency v. Schmidt (In re Schmidt)</u>, --- F.3d ----, 2014 WL 4243251 (8th Cir. 2014) (Colloton, J.).

EIGHTH CIRCUIT JOINS ITS SISTER CIRCUITS IN HOLDING THAT A BANKRUPTCY COURT MAY STRIP OFF A VALUELESS LIEN IN A CHAPTER 13 CASE

The debtors filed a modified chapter 13 plan that treated the agency as an unsecured creditor and required the agency's mortgage lien to be removed from the home upon the debtors' bankruptcy discharge. The bankruptcy court, relying on the Eighth Circuit BAP's decision in *In re Fisette*, ruled in favor of the debtors. The court granted the debtors' motion to value, and confirmed their modified plan on the ground that a bankruptcy debtor may strip off a lien on the debtor's primary residence if there is no equity in the residence to support the lien. The agency appealed both rulings to the district court, which recognized that the "single legal issue presented by [the agency's] appeals is whether a Chapter 13 debtor can strip off a lien on the debtor's principal residence if no equity exists to support the lien." As the district court explained, the resolution of this issue turned on the interplay between . . . § 506(a)(1) and the clause in . . . § 1322(b)(2) that forbids a court from modifying the rights of certain creditors who have a security interest in real property that is the debtor's principal residence. The court agreed with other circuits that when considering the rights of creditors who hold homestead liens, "the dividing line drawn by §

1322(b)(2) runs between the lienholder whose security interest in the homestead property has some 'value,' see § 506(a), and the lienholder whose security interest is valueless." The agency relied on *Nobelman's* conclusion that the antimodification provision of § 1322(b)(2) protects against modification of any "claim secured . . . by" a debtor's principal residence, not merely a "secured claim," contending that § 1322(b)(2)'s antimodification provision applies to all claims "secured only by a secured interest in . . . the debtor's principal residence," regardless as to whether the claim is a secured claim under § 506(a)(1). The Eighth Circuit stated that the agency read "too much into *Nobelman's* discussion on this point. Because the creditor's claim in *Nobelman* was partially secured, the Court was not concerned with whether § 1322(b)(2)'s antimodification provision applies regardless of a claim's status under § 506(a)(1). The question in Nobelman was whether § 1322(b)(2) permits bifurcating a partially secured claim and stripping the lien from the unsecured portion of that claim. *Nobelman* thus made clear that if a creditor's claim is at least partially secured, none of the creditor's rights may be modified. If, however, the creditor's claim is wholly unsecured, then the reasoning of *Nobelman* does not preclude modifying the creditor's rights under § 1322(b)(2)." Note: This material is excerpted from the October 2014 issue of the Bankruptcy Current Awareness Alert newsletter, with permission. For more information about this publication please visit www.legalsolutions.thomsonreuters.com.

BANKRUPTCY TRUSTEES/PROPERTY OF THE ESTATE

64. <u>In re Tri-State Financial, LLC</u>, 512 B.R. 209 (B.A.P. 8th Cir. 2014) (Nail, J.).

EIGHTH CIRCUIT BAP REVERSED THE BANKRUPTCY COURT AND REMANDED FOR ADDITIONAL CONSIDERATION OF CERTAIN ESTOPPEL ARGUMENTS

The Eighth Circuit BAP reversed the bankruptcy court and remanded for additional consideration of certain estoppel arguments brought up in post-trial briefing but which were not addressed by the bankruptcy court. The BAP deemed premature issues brought up on appeal.

65. <u>Peoples v. Radloff (In re Peoples)</u>, --- F.3d ----, 2014 WL 4085840 (8th Cir. 2014) (Colloton, J.).

A CHAPTER 7 DEBTOR LACKS STANDING TO APPEAL AN ORDER APPROVING A SETTLEMENT WHERE THE DEBTOR LACKS A PECUNIARY INTEREST IN THE BANKRUPTCY COURT'S ORDER

In this case, the court observed that the amount of the settlement approved by the bankruptcy court was $20,000 and that three creditors had timely filed claims against the debtor's bankruptcy estate in an aggregate amount of approximately $23,000. "Even without accounting for administrative expenses-such as the trustee's attorneys' and accountants' fees-and the lien against the settlement funds asserted by [the debtor's] state-court counsel, the amount owed to [the debtor's] creditors exceeds the amount of the settlement. Because no surplus funds exist to distribute to [the debtor], she lacks a pecuniary interest in the bankruptcy court's order. Although the rules of procedure provided for notice to [debtor] and an opportunity for her to object in the bankruptcy court to the settlement agreement itself . . . , she is not a person aggrieved by the bankruptcy court's order, so she lacks standing to appeal either the order approving the settlement or the order denying her motion to reconsider," the circuit court ruled. Note: This material is excerpted from the October 2014 issue of the Bankruptcy Current Awareness Alert newsletter, with permission. For more information about this publication please visit www.legalsolutions.thomsonreuters.com.

66. Bank of England v. Webb (In re Webb), 742 F.3d 824 (8th Cir. 2014) (Murphy, J.).

BANKRUPTCY COURT DID NOT CLEARLY ERR IN DETERMINING THAT THE CHAPTER 7 DEBTORS' "JOINT VENTURE" WAS NOT A SEPARATE LEGAL ENTITY AND THE PROPERTY LISTED ON THE DEBTORS' SCHEDULES IN THE NAME OF THE JOINT VENTURE WAS PROPERTY OF THE DEBTORS' BANKRUPTCY ESTATE AND SUBJECT TO SALE BY THE TRUSTEE

The debtors executed a joint venture agreement in January 2003 to operate a rice farming business under the name of their joint venture. The agreement provided that each of them would have a 50% interest in the business, but that "[n]othing herein shall be construed to create a partnership of any kind." During the operation of the business, the debtors borrowed funds from a bank, and from the U.S. Department of Agriculture Commodity Credit Corporation; many of the loan agreements were executed in the name of the joint venture. Approximately nine years later, the debtors filed for relief under chapter 7, listing in their schedules an ownership interest (in the name of their joint venture) in an estimated 105,000 bushels of rice grain stored in grain bins, an estimated 117,000 bushels of rice grain located at another storage facility, and certain vehicles, rolling stock, and farm equipment. The following month, the bank filed a motion for relief from the automatic stay, arguing that it had a perfected security interest in the rice and equipment arising out of nine unpaid loans it had made to the joint venture. The bankruptcy court scheduled a hearing on the bank's motion, but in the meantime, the chapter 7 trustee filed a complaint seeking an order authorizing the trustee to sell all of the debtors' remaining rice grain free and clear. The bankruptcy court ruled that the joint venture was not a general partnership or other separate legal entity. As such, the rice grain and equipment listed on their schedules in the name of the joint venture was owned by the debtors individually, and therefore were part of their bankruptcy estate. The court entered an order permanently enjoining the bank from taking control of the assets. The court also ordered the trustee to sell the contested rice grain and to hold the proceeds from the sale in an estate account pending a determination of the parties' rights. The bank appealed to the district court, which affirmed. After its own review of the evidence, the Eighth Circuit concluded that the bankruptcy court did not clearly err in concluding that the debtors had not intended to create a separate entity. Note: This material is excerpted from the April 2014 issue of the Bankruptcy Current Awareness Alert newsletter, with permission. For more information about this publication please visit www.legalsolutions.thomsonreuters.com.

67. In re Racing Services, Inc., 744 F.3d 543 (8^{th} Cir. 2014) (Melloy, J.).

HOPSCOTCHING ONE PROVISION TO REACH OTHERS WILL NOT RESULT IN SUSTAINABLE CONTRACT INTERPRETATION IF IT REQUIRES AN UNNATURAL CONSTRUCTION WHEN ACTUAL MEANINGS OTHERWISE MAKE SENSE

Defendant was an employee and founder of the debtor, and its sole stockholder. Pursuant to a split-dollar/collateral-assignment agreement, the defendant owned a cash-value whole-life insurance policy that the debtor purchased on behalf of the defendant. The trustee sought a determination that cash surrender value of life insurance policy was an asset of the bankruptcy estate. The bankruptcy court granted summary judgment in favor of trustee. The BAP affirmed. On appeal, the Court of Appeals applied North Dakota law of contract interpretation and concluded that "the plain language of the Split–Dollar Agreement limits [the debtor's] rights in a manner that is dispositive in this case and that [the defendant], rather than the Trustee, holds the superior claim to the policy's cash value proceeds. In reaching this conclusion, we find it unnecessary to look beyond the written agreement to determine the parties' intent."

The construction turned on whether or not to extend application of a phrase in one provision of the contract to subsequent provisions: Paragraph 8 provided, "If the agreement … is terminated, the [debtor] shall transfer its interest in the Policy to the [defendant] in exchange for an amount equal to the [debtor's] interest...." The Court held that "Standing alone and read in isolation, Paragraph 8 arguably could be subject to two possible interpretations." It could be read as imposing no actual duty to transfer funds and as granting no actual right to force a transfer, or, it could be read as using the word "shall" to apply to both parties and create reciprocal rights and duties enforceable by either party.

Relying on rules of interpretation and the plain language of the agreement, the BAP concluded that applying the one provision to the other provisions would not make sense and would require "that the drafters intended an unnatural construction in which the introductory language of Paragraph 2 hopscotched Paragraphs 3–7 to reach Paragraph 8." Because one of the possible interpretations avoids that problem, the Court adopted that construction: "the word 'shall' in Paragraph 8 applies only to Racing Services and not to Bala. Only this interpretation accords actual meaning to the limiting, introductory language of Paragraph 2 and cabins the grant of rights to Paragraph 2. We therefore conclude that Paragraph 8 is not a source of rights for Racing Services, but rather, that it imposes upon Racing Services a duty that arises at Bala's option."

Chief Judge Riley filed a brief concurring opinion supporting the reversal in which he noted that the plain language of "the collateral assignment agreement gave Racing Services limited rights in the "cash surrender proceeds" of the policy only "upon surrender of the policy by the Assignor [Bala]," and that "[b]ecause that condition was not satisfied on the unusual facts of this case under North Dakota law, the bankruptcy estate never obtained rights to the policy proceeds, and Bala has the superior claim to the liquidated cash value of her policy."

68. Rent-A-Center East, Inc. v. Leonard (In re Web2B Payment Solutions, Inc.), --- B.R. ---, 2014 WL 3576805 (D. Minn. 2014) (Doty, J.).

UNDER MN LAW NO EXPRESS, RESULTING OR CONSTRUCTIVE TRUST IN CASE OF DEBTOR PROCESSING CHECKS FOR PAYDAY LOAN AND CHECK CASHING CLIENT

Plaintiff (RAC), a business primarily engaged in renting furniture and appliances, established a financial services division offering check-cashing and payday loan services. RAC entered into an agreement with Web2B (the debtor), pursuant to which Web2B processed checks received from clients. Web2B agreed to establish an account at North American Banking Company (NABC), through which it would "accept electronic credit and debit entries for" RAC. A few years later, Web2B filed chapter 11, and NABC turned over funds held by NABC in various Web2B accounts to the chapter 11 trustee. RAC demanded most of the funds, and filed an adversary proceeding seeking a declaratory judgment that the funds were RAC's, and that an express or resulting trust existed or that imposition of a constructive trust was warranted. On cross motions for summary judgment, the bankruptcy court granted the trustee's motion.

On appeal by RAC, the district court affirmed, holding that, under applicable Minnesota law, no express trust resulted because the agreement itself contemplated commingling of proceeds such that there was no segregation of a trust res; that no resulting trust existed because there was express agreement to commingling and because the facts presented no evidence of intent to create a trust; and that none of the requirements under Minnesota law necessary to warrant imposition of a constructive trust were met either (to prevent unjust enrichment, or where legal title was obtained through fraud, duress, crime, etc., or by the improper advantage of a confidential or fiduciary relationship). The court also rejected RAC's conversion argument because checks to RAC were endorsed to Web2B which became the holder in due course. Finally, the court rejected RAC's unjust enrichment claim because an alleged breach of contract is not sufficient to satisfy the inequity requirement of unjust enrichment.

SANCTIONS AND BANKRUPTCY PREPARERS

69. Alexander v. Hedback (In re Stephens), 559 Fed.Appx. 588 (8th Cir. 2014) (per curiam).

EIGHTH CIRCUIT AFFIRMS SANCTIONS FOR FRIVOLOUS CLAIMS

Over the past 15 years, a son and his parents (the debtors) made numerous frivolous claims to ownership and a homestead exemption in real property in St. Paul, Minnesota. In 2011, the bankruptcy trustees evicted them and tried to sell the property. The bankruptcy court authorized the sale free and clear of any encumbrances. The son filed a lis pendens, delaying the sale. The trustees moved for $25,000.00 in damages, plus attorney's fees, and expenses. The bankruptcy court scheduled a hearing and ordered discovery, but both the son and his attorney refused to cooperate. The bankruptcy court imposed sanctions, including: (1) a default judgment of $25,000.00 for damages, against the son and his attorney, jointly and severally; (2) $10,184.70 in attorney's fees and expenses against the son and his attorney, jointly and severally; and (3) $10,000.00 against the attorney individually. The son appealed to the district court, which affirmed. The son then appealed to the Eighth Circuit, attacking the bankruptcy court's jurisdiction and sanctions. The court affirmed on all issues, agreeing with the findings and conclusions of both the district court and the bankruptcy court.

70. In re Fischer, 501 B.R. 346 (B.A.P. 8th Cir. 2013) (Kressel, J.).

CONTEMPT REQUIRES VIOLATION OF UNAMBIGUOUS OPERATIVE COMMANDS AND NEGLIGENCE IS NOT RELEVANT TO THE DETERMINATION

Prepetition, the chapter 12 debtors received a loan from a bank to finance operations on their farm, and the bank received a perfected security interest in the debtors' livestock, crops, and farm products. After failing to make payments for real estate taxes under a confirmed plan, the debtors entered into a stipulation with the bank to provide for payment of the delinquent taxes. In that stipulation, the debtors agreed to sell their cattle, and the bank agreed to "subsequently" release its interest in the debtors' cattle and crops. The bankruptcy court then entered an order approving the stipulation. In accordance with the stipulation, the debtors completed the sale and made the bank aware of the sale. The debtors then sought a new loan for their farming operations but were denied because the bank had not yet released its liens. After notice by the debtors of its failure to release the liens, the bank did so three months after originally learning of the sale. The debtors then filed a motion asserting that the bank was in contempt by violating the court's order. They argued that the bank violated the order by not releasing the liens in a timely manner. The bankruptcy court denied the motion because the order and stipulation did not specify a time frame for release of the liens. It further found that the timing of the release could have constituted negligence but that negligence did not constitute contempt. The debtors appealed, and the BAP affirmed.

The BAP held that the bank could not be found in civil contempt, which required the debtor to prove that the bank "violated a specific order of which he or she was aware." This order must be unambiguous and contain operative commands to permit a finding of contempt. Furthermore, negligence should not be considered when determining contempt. In the instant case, the BAP found that the text of the order approving the stipulation did not contain operative commands but abstract legal conclusions. Additionally, the court distinguished this case from cases where an order contained clear and unambiguous language regarding enforceability of a stipulation. Even if this language had been present, however, the use of the term "subsequent" in the stipulation was not sufficiently clear to allow for enforceability. Thus, the court could not find contempt.

71. In re Young, 507 B.R. 286 (B.A.P. 8th Cir. 2014) (Schermer, J.).

SANCTIONS IMPOSED PURSUANT TO § 105 REQUIRE NOTICE AND OPPORTUNITY

Bankruptcy court issued OSC against attorney for Rule 9011 sanctions, found violations as well as misrepresentations made during OSC hearing, and imposed sanctions (including sixth month suspension) pursuant to 9011 and § 105. The BAP held that: 1) the bankruptcy court's orders were final and appealable because the sanctions were imposed after chapter 13 plan confirmation, after conclusion of an adversary proceeding; because the debtor obtained his discharge and the final report had been filed shortly after the appeal was filed; and because the court imposed non-monetary or monetary but non-compensatory sanctions payable to the clerk of court; and 2) the bankruptcy court acted within its discretion when it found violations of Rule 9011(b) and imposed sanctions because notice and opportunity to respond was adequate; the OSC set forth "clear and easy to comprehend bases upon which” violations could be found and for which sanctions could be imposed; and the sanctions order “explained which conduct was improper and why sanctions were imposed … [a]nd the court's reasons for imposing sanctions under three of the four areas mentioned in the OSC showed that [the] conduct in the case was not reasonable under the circumstances.” But, the BAP concluded that the sanctions (imposed under § 105 authority) for conduct during the OCS hearing were ordered without adequate notice and opportunity and the sanctions were reversed and remanded on that point for further proceedings with the necessary notice and opportunity.

72. In re King, 744 F.3d 565 (8th Cir. 2014) (Bye, J.).

POST-PETITION LOAN AGREEMENT THAT INCLUDES PRE-PETITION DEBT IS A REAFFIRMATION AND REQUIRES BANKRUPTCY COURT APPROVAL

The debtor and creditor entered into several pre-petition loan agreements. The debtor did not list the creditor or the pre-petition debt owed to that creditor in the chapter 13 filing or the chapter 7 conversion documentation; however, the debtor informed the creditor of this omission. Post-conversion, the parties entered into a new loan agreement (loan A), which allegedly reaffirmed a portion of the pre-conversion debt. Under § 524(c), though, a bankruptcy court must approve the reaffirmation and incorporation of pre-discharge debt into new post-discharge debt. The parties entered into additional new loan agreements post-discharge. Later, finding the loan A agreement unenforceable pursuant to § 524(c), the court granted the debtor’s motion to reopen the bankruptcy case, add the creditor, and discharge the debt under loan A. The creditor’s attorney subsequently filed a state court action to recover the debt under loan A and the additional new post-discharge agreements. The debtor then filed to reopen the bankruptcy case for an adversary proceeding, and the bankruptcy court granted that motion which levied sanctions against the creditor’s attorney and dismissed the pending state court action. Subsequently, the attorney and creditor filed for reconsideration of the state court action dismissal. Given conflicting live witness testimony about the nature of loan A funds (pre- or post-discharge), the court found that some unproven amount of those funds was post-discharge. However, due to a lack of proof of the amount of pre- versus post-discharge funds, the court upheld the sanctions and dismissed the part of the state court action involving loan A. The attorney and creditor filed, and the bankruptcy court denied, a second motion for rehearing or relief pursuant to Rule 60(b). The BAP affirmed both the first and second motions, and the Eighth Circuit affirmed.

The Eighth Circuit first found that the bankruptcy court did not err in finding that a portion of loan A debt was pre-conversion based on the debtor’s testimony. Even though the debtor and creditor provided inconsistent statements regarding that debt, the Eighth Circuit determined that the creditor did not provide objective credible evidence that would allow the reversal of the bankruptcy court’s credibility findings. Next, the Eighth Circuit upheld sanctions against the attorney, clarifying that those sanctions arose from the attorney’s attempt to recoup the pre-conversion debt under loan A only in state court. It also denied the creditor the ability to collect any post-conversion debt under loan A given the lack of evidence of the amount of such debt presented to the bankruptcy court. Furthermore, the Eighth Circuit upheld the dismissal of the 60(b) motion. The attorney and creditor raised new legal arguments in the second motion, and the court could not reverse the 60(b) motion denial because no exceptional circumstances prevented the parties from raising the new legal arguments in their first motion.

73. Jonak v. McDermott, 511 B.R. 586 (D. Minn. 2014) (Nelson, J.).

BANKRUPTCY PETITION PREPARERS MAY PROVIDE ONLY TYPING SERVICES

UST brought adversary proceeding under § 101, §110, §§ 526 -528, and applicable Minnesota law alleging an individual defendant and his entities engaged in unauthorized practice of law. The district court affirmed the bankruptcy court's injunction against defendants, the petition-preparer and his wholly owned entities. "So what does § 110 tacitly permit? The answer in a nutshell is 'not much.' … Rather, § 110 proscribes virtually all conduct falling into the category of guidance or advice, effectively restricting 'petition preparers' to rendering only 'scrivening/typing' services. … The case law makes it 'abundantly clear that providing anything more than typing services is prohibited under § 110.'" The court, after a thorough analysis of the applicable provisions, found the injunction sufficiently clear in scope and supported by law.

MISCELLANEOUS

74. Citizens State Bank Norwood Young America v. Brown, 849 N.W.2d 55 (Minn. 2014) (Wright, J.).

MINNESOTA'S UNIFORM FRAUDULENT TRANSFER ACT APPLIES TO FRAUDULENT TRANSFERS MADE PURSUANT TO AN UNCONTESTED MARITAL DISSOLUTION DECREE

The Minnesota Supreme Court, considered the issue of whether Minnesota's Uniform Fraudulent Transfer Act ("MUFTA") applied to fraudulent transfers made pursuant to an uncontested marital dissolution decree.

Earlier, on June 29, 2010, Citizens State Bank obtained a default judgment against the debtor to enforce personal guarantees the debtor had made for certain commercial loans. During the pendency of that lawsuit, debtor filed for divorce, entered into a voluntary marital termination agreement. The marital dissolution decree was entered on October 13, 2010. Pursuant to the divorce decree, the debtor transferred an investment account worth about $1.2 million and a ½ interest in a partnership. To levy upon the transferred assets, the bank sued under MUFTA, Minn. Stat. §§ 513.41--.51 (2012), alleging that the debtor fraudulently transferred the assets. At summary judgment, the debtor alleged that the transfers were not fraudulent since they were made pursuant to a marital dissolution decree. The state district court, observing that the transfers were made pursuant to an uncontested marital dissolution decree, held that the transfers were fraudulent, and the court of appeals affirmed.

On review, the Minnesota Supreme Court looked at the meaning of "transfer" as defined by Minn. Stat. § 513.41(12) as "every mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with an asset." The Court determined that "because a transfer made pursuant to an uncontested marital dissolution decree is a mode of 'disposing of or parting with' assets, it falls within the statutory definition of 'transfer.'" The Court also compared other states' interpretations of the Uniform Fraudulent Transfer Act, and observed that in many states, the versions of the Uniform Fraudulent

Transfer Act applied to transfers made under marriage settlement agreements. The Court also noted that MUFTA provided an exemption for transfers made to charities or religious organizations, but did not provide a similar exemption for transfers made under marriage settlement agreements. Construing enumerated exemptions to mean the exclusion of others, the Court did not exempt those transfers made under a marriage settlement agreement from MUFTA's definition of "transfer." Accordingly, the Court held that "a transfer made pursuant to an uncontested marital dissolution decree may be set aside as fraudulent under MUFTA."

The Court also addressed whether summary judgment in the bank's favor was appropriate by analyzing the seven badges of fraud under the MUFTA:

1. The ex-spouse was an "insider" because, even though they were not married at the time of the transfers, they continued to live together, and they continued to have a close relationship with each other.
2. The debtor had transferred substantially all of his non-exempt assets.
3. The debtor did not receive reasonably equivalent value in exchange for the transferred assets. He received about $421,000 and assumed approximately $270,000 in joint obligations, while she received about $1.5 million in assets.
4. The debtor was insolvent at or around the time of the transfers because he had a negative net worth after they were made.
5. The debtor had been sued or threatened with a lawsuit around the time of the transfers because the divorce decree was entered shortly after the bank commenced suit.
6. Under Minn. Stat. § 513.44(b)(10), the Court found that the transfers "occurred shortly before or shortly after a substantial debt was incurred" by using the date that default judgment was entered against the debtor.
7. The debtor "retained possession or control of the property after the transfer" because his name continued to appear on a transferred account for several months after the divorce.

Summary judgment was proper because "the presence of several badges of fraud . . . creates an inference of fraud that requires clear evidence of a legitimate purpose to rebut." The debtor and his ex-spouse failed to rebut such inference.

The Court then considered whether the district court erred by allowing the bank to levy certain assets. As to the ex-spouse's savings account, it determined that the district court erred in permitting to levy execution on this account because it was not a fraudulent transfer since the account was in the ex-spouse's name both prior to the divorce and after it. As to all other assets, the levy execution was proper because those assets were fraudulent transfers to be voided.

75. In re Phillips, 500 B.R. 570 (B.A.P. 8th Cir. 2013) (Saladino, J.).

BANKRUPTCY COURT PROPERLY APPLIED COLLATERAL ESTOPPEL DOCTRINE

The BAP affirmed an order of the bankruptcy court of Minnesota that awarded judgments against the debtor for intentional conversion, litigation costs, and finding them to be nondischargeable under § 523(a)(6). The main issue was whether the bankruptcy court properly invoked the doctrine of collateral estoppel.

Certain creditors sued the debtor and other defendant-entities for conversion in state court. After he filed bankruptcy, the state court stayed litigation against the debtor, but not as against the other defendant-entities. The state court found that defendant-entities Hi-Tech Floors and South Properties were owned and controlled by the debtor either directly or through his wife's ownership. The state court also found that because of the debtor's actions, Hi-Tech Floors converted plaintiffs' assets so as to be liable for conversion in the amount of $173,852.00. The state court also found South Properties liable for conversion of rents and deposits in the amount of $30,003.54, and Hi-Tech Floors and South Properties jointly liable for conversion of rents and deposits in the amount of $52,800.00.

In the bankruptcy proceeding, the bankruptcy court found the debtor liable for intentional conversion of property in the amounts of $173,852.00 and $82,803.54. It also assessed litigation costs of $5,738.30 against the debtor. On appeal, the debtor argued that the bankruptcy court erred in giving collateral estoppel effect to state court findings. The debtor argued: 1) that collateral estoppel should not apply because the state court judgment was post-petition; 2) that collateral estoppel should not apply since the debtor was merely a witness and not a party to the state court litigation; 3) that the state court findings regarding ownership of assets could not be given collateral estoppel effect because he did not have the opportunity to litigate ownership; and 4) that the state court's order could not be given collateral effect since it would violate the automatic stay.

The BAP addressed, in turn, each of the debtor's arguments and found each to be without merit, and upheld the bankruptcy court's application of collateral estoppel to be proper.

76. <u>In re American Resource & Energy, LLC</u>, 513 B.R. 371 (Bankr. D. Minn. 2014) (Kishel, J.).

PETITIONERS' CLAIMS WERE SUBJECT TO "BONA FIDE DISPUTE," DISQUALIFYING THEM TO FILE THE INVOLUNTARY PETITION

On cross-motions for summary judgment in an involuntary chapter 7 case, the bankruptcy court ruled that none of the three petitioners qualified as a petitioning party under 11 U.S.C. § 303(b)(1). The putative debtor, American Resource & Energy, LLC, argued that none of the petitioners qualified as a petitioning party under the requirements of § 303(b)(1) because each of the claims was subject to a bona fide dispute as to liability and amount.

The court observed that under § 303(b)(1), "to qualify to file or to join an involuntary petition, a creditor must hold a claim against the putative debtor that is 'not contingent as to liability or the subject of a bona fide dispute as to liability or amount,'" and that to determine whether a bona fide dispute existed as to the petitioning creditors' claims, a court considers factors such as "the posture of the parties; the nature and gravity of their contentions with each other, factual and legal; and the backdrop non-bankruptcy law that governs their dispute." The court reasoned that it is tasked only to ascertain that a bona fide dispute exists, not to resolve the dispute. The court reasoned that the "petitioner had the initial burden to "establish a prima facie case that no bona fide dispute exists;'" that a bona fide dispute exists when "the debtor has an objective basis in *asserted* fact or law" to dispute the claim; that a putative debtor has an objective basis in fact to dispute a petitioner's claim "when facts are pled or framed plausibly to support a defense;" and that a putative debtor has an objective basis in law to dispute a petitioner's claim when the legal position is pled colorably against the petitioner. In summary, a bona fide dispute exists as to a petitioner's claim when there is an objectively plausible and legally-colorable basis on which the putative debtor contends that it is not liable to the petitioner on the basis and to the extent that the petitioner asserts.

The court then addressed the underlying factual and legal bases of each claim of the three petitioning creditors. It determined that a bona fide dispute existed as to all three petitioners' claims, and therefore, under § 303(b)(1), none of the entities qualified as a petitioner to commence the involuntary bankruptcy case against the putative debtor.

77. Lewis Bros. Bakeries, Inc. v. Interstate Brands Corp. (In re Interstate Bakeries Corp.), 751 F.3d 955 (8th Cir. 2014) (Colloton, J.) (*en banc*).

BECAUSE A LICENSE AGREEMENT WAS PART OF A LARGER, INTEGRATED AGREEMENT THAT WAS SUBSTANTIALLY PERFORMED, IT WAS NOT EXECUTORY FOR PURPOSES OF § 365(a)

The facts of this case are complex and a summary of the panel decision was included in the materials from last year's Institute. Pursuant to a federal district court judgment resolving an antitrust dispute, the debtor's subsidiary entered into an agreement to sell its Butternut bread operations and assets in the Chicago territory, and its Sunbeam bread operations and assets in the Central Illinois territory, to a buyer. To effect this transfer, the subsidiary and the buyer entered into two agreements: an asset purchase agreement and a license agreement. The purchase agreement provided for the transfer to the buyer of tangible assets and "the perpetual, royalty-free, assignable, transferable exclusive license to use the trademarks . . . pursuant to the terms of the License Agreement." The license agreement provided that for "a fee of ten dollars ($10.00), and other good and valuable consideration, set forth in the Allocation Agreement described in Section 2.3 of the Purchase Agreement," "[the subsidiary] grants to [buyer] . . . [a] license to use the Chicago Trademarks." Of the $20 million purchase price, the parties agreed to allocate $8.12 million to the intangible assets, including the trademark licenses, and the remaining $11.88 million to the various tangible assets. The license agreement defined the "Chicago Trademarks" as thirteen marks and provided mutual duties of notification regarding any infringement of the rights under the marks. It also required that the goods sold under the marks be of the same character and quality as those sold by the subsidiary at the time of the agreement, and provided that the buyer's failure to maintain such quality would constitute a material breach of the agreement. Years later, the debtor and eight subsidiaries, including the subsidiary discussed above, filed voluntary bankruptcy petitions under chapter 11. The debtor disclosed the existence of the license agreement and identified the agreement as an executory contract that it intended to assume as part of its plan of reorganization. The buyer commenced an adversary proceeding, seeking a declaratory judgment that the license agreement was not an executory contract under 11 U.S.C.A. § 365, and was therefore not subject to assumption or rejection by the debtor. The debtor countered by moving to reject the license agreement and seeking a declaration that it was an executory contract. Both parties moved for summary judgment, but before the bankruptcy court could rule, debtor withdrew its motion to reject the license agreement, reinstated its request to assume the license agreement, and reiterated its request for a declaration that the license agreement was an executory contract. The bankruptcy court, looking solely to the license agreement, found that both the subsidiary and the buyer had material, outstanding obligations. Relying on what it called the "seminal case" from a bankruptcy court in *In re Exide Techs*., the court concluded that the license agreement was executory and, therefore, subject to assumption under § 365. The buyer appealed to the district court, which affirmed. An appeal to the Eighth Circuit followed. While the appeal was pending, the debtor changed its name to Hostess Brands, Inc., which subsequently filed bankruptcy in another district, there, the bankruptcy court in granted Hostess Brands authority to wind down its business. In the meantime, a divided panel of the Eighth Circuit affirmed the district court. After having received briefing from the Antitrust Division of the Department of Justice and the Federal Trade Commission, the Eighth Circuit granted a petition for rehearing en banc. The full Eighth Circuit then reversed, and concluded that "the contract at issue here is not executory, because [the subsidiary] substantially performed its obligations under the Asset Purchase Agreement and License Agreement, and its failure to perform any of its remaining obligations would not be a material breach of the integrated agreement . . . The essence of the agreement here was the sale of [the subsidiary's] Butternut bread and Sunbeam bread business operations in specific territories, not merely the licensing of [the subsidiary's] trademark." Note: This material is excerpted from the July 2014 issue of the Bankruptcy Current Awareness Alert newsletter, with permission. Copyright (c) 2014 Thomson Reuters/West. For more information about this publication please visit www.legalsolutions.thomsonreuters.com.

78. U.S.A. v. Lange (In re Netal, Inc.), 498 B.R. 225 (B.A.P. 8th Cir. 2013) (Schermer, J.).

BANKRUPTCY COURT ABUSED ITS DISCRETION BY DENYING THE GOVERNMENT A CHANCE TO CONDUCT DISCOVERY AND PRESENT EVIDENCE ON ITS CLAIM

The BAP held that the bankruptcy court abused its discretion when it denied the IRS a chance to conduct discovery and to present evidence in support of its unsecured superpriority administrative expense claim under § 507(b), based on a lack of adequate protection. The bankruptcy court had based its ruling on the incorrect legal conclusion that 11 U.S.C. § 724(b) applied to the superpriority administrative expense claim of the IRS. The IRS's § 507(b) motion specified the amount of its claim, as well as its priority. Written objections by the chapter 7 trustee and several benefit plans to the § 507(b) motion contested that priority, but it wasn't until the hearing on the § 507(b) claim that the government was apprised of the fact that there was an issue regarding the amount of its claim. From that point on, the IRS made clear its desire to conduct discovery and to present evidence in support of its claim. The BAP remanded the case to the bankruptcy court for a determination of the amount, if any, of the IRS's § 507(b) claim.

79. Agri Star Meat & Poultry, LLC v. Nevel Properties Corp (In re Nevel Properties Corp.),--- F.3d ----, 2014 WL 4238212 (8th Cir. 2014) (Riley, J.).

FOR PURPOSES OF § 365, PURCHASER NEVER ACQUIRED ANY WATER RIGHTS UNDER A PURCHASE AGREEMENT

The Eighth Circuit stated that the bankruptcy court correctly found that the purchaser never acquired any rights to the well because the bankrupt meatpacking company's trustee was deemed to have rejected the contract as a matter of law. The court noted that before the purchaser had acquired the bankrupt meatpacking company's assets, the bankrupt meatpacking company was under the control of a trustee in chapter 11; because the trustee did not assume the well lease within the period required by § 365(d)(4), the lease was "deemed rejected"—well before the purchaser could have acquired any rights to the lease. Section 365(d)(4) provides that "an unexpired lease of nonresidential real property under which the debtor is the lessee shall be deemed rejected, and the trustee shall immediately surrender that nonresidential real property to the lessor, if the trustee does not assume or reject the unexpired lease by the earlier of—(i) the date that is 120 days after the date of the order for relief [unless extended by the bankruptcy court]; or (ii) the date of the entry of an order confirming a plan." In this case, the bankruptcy court ; found that "[the purchaser] does not argue that the [lease] was actually assumed in the 120-day period under the statute [or] that the Trustee attempted to preserve the Lease under the procedures required in § 365(d)." The court added that § 365(b)(1)(A) provides that "[i]f there has been a default in an . . . unexpired lease of the debtor, the trustee may not assume such . . . lease unless, at the time of assumption of such . . . lease, the trustee cures, or provides adequate assurance that the trustee will promptly cure, such default." Here, "[f]ar from assuming the lease in accordance with the provisions of § 365, the trustee could not have assumed the lease because [the meatpacking company's] rental payment default was never cured . . . As a matter of fact and law, [the purchaser] never acquired any rights to the well," the Eighth Circuit held. Note: This material is excerpted from the October 2014 issue of the Bankruptcy Current Awareness Alert newsletter, with permission. For more information about this publication please visit www.legalsolutions.thomsonreuters.com.

80. In re HovdeBray Enterprises, 499 B.R. 333 (Bankr. D. Minn. 2013) (Ridgway, J.).

A PETITIONING CREDITOR MAY NOT BE AWARDED AN ADMINISTRATIVE EXPENSE UNDER § 503(b)(3)(A) FOR LEGAL FEES INCURRED AFTER ENTRY OF THE ORDER FOR RELIEF

A petitioning creditor filed an application for allowance of an administrative expense claim, under 11 U.S.C. § 503(b)(3)(A), for fees and costs incurred in connection with bringing an involuntary chapter 7 petition. The court ruled that the petitioning creditor was entitled to recover, on a priority basis, the $299.00 fee that it incurred in filing the involuntary chapter 7 petition, as well as attorney's fees of $4.320.00 it incurred up until entry of the order for relief, since these amounts were reasonable and allowable as administrative expenses. However, after discussing the majority and minority views regarding allowance of administrative expenses claims for fees incurred after the order for relief, the court adopted the majority view and ruled that services provided and costs incurred by petitioning creditors after the entry of an order for relief in an involuntary case are not compensable as administrative expenses for "actual, necessary expenses" under § 503(b)(3)(A). The court also ruled that the petitioning creditor was not entitled to recover for the time spent by its salaried employees in connection with filing of the involuntary Chapter 7 petition.

81. In re Patriot Coal Corp., 497 B.R. 36 (B.A.P. 8th Cir. 2013) (Kressel, J.).

SECTION 1113 REJECTION SUBJECT TO § 1114 MODIFICATIONS OR LACK THEREOF

Coal companies in joint chapter 11 cases filed an adversary proceeding against former parent and affiliated companies to determine obligations under a prepetition assumption agreement relating to liabilities for retiree benefits, and whether obligations were changed as a result of the debtors' rejection of certain collective bargaining agreements. The bankruptcy court granted summary judgment for the defendants. On appeal, the BAP reversed and concluded that the benefits of the assumed retirees survived rejection, that the assumed retirees' benefits were not modified, and that the former affiliated entity's obligations under the prepetition liabilities assumption agreement were undisturbed. The BAP held that upon rejection of the agreement under § 1113, absent modification under § 1114, the terms of the individual employer plan remained controlling and binding, and providing defined plan benefits was a continuing obligation. The BAP found that the motion in this case not only didn't request approval to modify the assumed retirees' benefits, it specifically requested that the court not grant it such approval, and that therefore those benefits remained undisturbed by the court's order granting permission for other modifications. The BAP also noted that § 1114(g) prohibits the bankruptcy court from modifying benefits to a level below that proposed by the debtor in possession.

82. In re Driggs, BKY 13-42355 (Bankr. D. Minn. July 31, 2013) (Kishel, J.).

CHAPTER 11 PAYDOWN REQUIRES REVOCABILITY AND ATTORNEY OVERSIGHT

The *pro se* chapter 11 debtor sought approval for the employment of and "paydown before approval" for a professional. The court may grant approval of such early paydown according to the Chapter 11 Filing Instructions, Instruction 9(c). The court denied approval of the debtor's early paydown application but did approve the employment arrangement subject to the provisions of federal and local statutory requirements.

Instruction 9(c) conflicts with federal statutory requirements that disallow payments to a professional prior to approval under a process described in §§ 330–31. However, early paydown may be allowed in circumstances in which an attorney oversees the utilization of and payment for such professional services. In the instant case, the debtor did not retain counsel. Furthermore, the debtor did not include a provision in the application stating that payments made under early paydown were revocable pending a later formal approval of the arrangement. Thus, the court disallowed the debtor's application for early paydown.

83. In re Cook, 504 B.R. 496 (B.A.P. 8th Cir. 2014) (Saladino, J.).

DRAGNET CLAUSES REQUIRE UNAMBIGUOUS TERMS AND PROPER PERFECTION

In a determination of lien priority between judgment creditor banks, the bankruptcy court ruled for one bank (following a trial) and the other bank appealed. The BAP, applying Missouri law, found that the bankruptcy court erred in finding that the appellant bank's deed of trust was invalid for lack of consideration, and that the language of that deed of trust was not patently ambiguous (arising upon the face of the documents) or latently ambiguous (when a writing on its face is unambiguous but surrounding circumstances make it capable of multiple interpretations). Specifically, the BAP addressed the enforceability of "dragnet" clauses, or cross-collateralization provisions, and found that generally "dragnet clauses are not favored and are strictly construed," but that "[c]ourts in Missouri … will enforce a well drafted, properly perfected 'dragnet' clause." The BAP concluded, under the facts of the case, "that the language used in the deed of trust—'[a]ll obligations Grantor owes to Lender, which now exist or may later arise'—is not subject to multiple interpretations or uncertain meaning and is not latently ambiguous. The language used in the deed of trust is susceptible to only one interpretation—that the deed of trust is security for all obligations [owed to the bank]."

84. Transportation Alliance Bank, Inc. v. Western Star Transportation, LLC (In re Western Star Transportation, LLC), No: 13-6062 (B.A.P. 8th Cir. Jan, 28, 2014) (per curiam).

AN EXPRESS STATEMENT OF GOOD FAITH IN SUPERPRIORITY FINANCING MOTION FULFILLS THE GOOD FAITH REQUIREMENT, AND STAY PENDING APPEAL IS REQUIRED BY § 364(e)

The chapter 11 debtor sought postpetition secured superpriority financing. A creditor holding a first priority lien objected to that motion. The bankruptcy court approved the motion, and the creditor appealed. The creditor asserted that there was insufficient evidence of good faith under § 364(e); however, the financing order contained a clause explicitly stating that the lender in good faith agreed to extend credit to the debtor. The BAP dismissed the appeal.

In evaluating the protections conferred by § 364(e), the BAP considered two factors: (1) "whether the party challenging the order obtained a stay pending appeal" and (2) "whether the lender acted in good faith in extending the new credit." The creditor in this case did not obtain a stay pending appeal; in fact, it did not request one. Furthermore, the BAP determined that the statement of good faith in the financing motion fulfilled the good-faith requirement under § 364(e) and that the appellant failed to allege or proffer a basis for finding bad faith. The BAP's findings were not affected by the fact that "the maximum amount of the DIP loan financing ha[d] not been reached."

85. In re Francis, ---F.3d---, 2014 WL 1644171 (8th Cir. 2014) (Loken, J.).

KNOWLEDGE OF A MORTGAGE FILING DEFECT IS NOT NECESSARILY KNOWLEDGE OF THE EXISTENCE OF A CLAIM TO AN INTEREST IN THE PROPERTY

The appellant's predecessor in interest refinanced a first mortgage on land owned by the debtors. When the predecessor filed that mortgage with the recorder's office, though, it described the wrong piece of property. Even though the debtors made the predecessor aware of the defect, it did not modify the mortgage documents. The debtors then had the land split into two parcels. The debtors mortgaged the first parcel to a bank that ultimately decided that it held a first mortgage, even though the debtors made the bank aware of the predecessor's error. Additionally, the debtors gave a different bank a second mortgage on the first parcel and a first mortgage on the second parcel, also informing that bank of the flawed mortgage. In 2007, the debtors filed for bankruptcy. In an adversary proceeding, the predecessor sought the grant of a first-priority lien pursuant to the Arkansas doctrine of equitable subrogation, or, in the alternative, reformation of the mortgage due to mutual mistake. The district court ruled against the predecessor. The appellant challenged the ruling on equitable subrogation, and the Eighth Circuit affirmed.

Under Arkansas law, a court can grant equitable subrogation if a "person, not acting voluntarily, has paid a debt for which another was primarily liable and which that other party should have paid" and granting such relief would not cause "hardship or injustice to innocent parties." The court found that the predecessor had no interest in the property because it negligently filed a flawed mortgage. It also noted that allowing subrogation of the subsequent banks' mortgages would create injustice or hardship given that those banks held liens when no recorded lien on the debtors' property existed.

The appellant also argued that the banks' knowledge of the mistake should permit the court to grant equitable subrogation given that subsequent purchasers of land are not bound by prior unrecorded deeds unless that purchaser received actual notice of a preexisting interest in that land. The court rejected this argument. First, the court distinguished knowledge of a mistake from knowledge of a claim to an interest in property. In this case, the banks' knowledge of the mistake, coupled with the predecessor's failure to correct it, could not be construed as knowledge that the predecessor in fact claimed an interest in the property. Second, allowing a defective mortgage to have priority over other liens would undermine the purpose of fostering a stable mortgage lending market through the requirement of proper recordings. Finally, the predecessor bore responsibility for not correcting its error, and the court could not grant subrogation when the predecessor caused its present situation.

86. In re Petters Co., Inc., 506 B.R. 784 (Bankr. D. Minn. 2013) (Kishel, J.).

SUBSTANTIVE CONSOLIDATION IS APPROPRIATE

The Petters case has a long history, most of which is unnecessary for the purpose of this summary. This decision came from the trustee's motion to substantively consolidate the bankruptcy estates of the PCI-related entities, the special purpose entities used to operate the Ponzi scheme at the heart of the case.

While the court spends a large amount of time reviewing substantive consolidation in other circuits, the opinion primarily relies on binding precedent from In re Giller, 962 F.2d 796 (8th Cir. 1992). In *Giller*, the 8th Circuit set out a structure to analyze substantive consolidation, instructing courts to consider three factors:

1. The necessity of consolidation due to the interrelationship among the debtors;
2. Whether the benefits of consolidation outweigh the harm to creditors; and
3. Prejudice resulting from not consolidating the debtors.

In addressing the first factor, the court cited a number of facts to find that consolidation was necessary due to the interrelationship among the debtors. This analysis was split in two parts: first, analyzing the interrelatedness of the debtors and; second, examining the resulting necessity created by such interrelatedness.

As for the interrelatedness of the debtors, the court noted that there was a unity of equity interests and ownership among the various entities, and that there was a lack of formal observance of corporate formalities by the entities. Also, the entities commingled their assets and business functions in furtherance of the Ponzi scheme.

As a result, the court found that an accounting to reconcile all intercompany transfers among the entities would be costly (in the amount of $10 million) and once done would not be wholly reliable. Therefore, the first factor of the *Giller* test was satisfied.

However, within this factor, the court also analyzed the argument that creditors relied on the separateness of the entities involved in the case. Creditors argued that had these entities not been separate, they would not have loaned the money to the debtors.

The court began by establishing that the 8th Circuit's *Giller* test has no requirement that the expectations of creditors need to be examined. However, because other circuits have used this as a factor in determining the appropriateness of substantive consolidation, the issue was reviewed. Through examination of each creditor, the court found that all but one of them relied on the interrelatedness of the debtors to receive payment. Specifically, the creditors relied on the related entities to cure any default associated with a defaulting entity. Moreover, the creditors often integrated a secondary recourse option against many of the debtor entities. Therefore, in contrast to the defense that these creditors relied on the separateness of the debtor entities, the court determined that creditors actually relied on their interrelatedness in making the loans.

The court then addressed the second factor of the *Giller* test, finding that the benefits of substantive consolidation outweigh the harm to creditors. The court recognized that the most obvious benefit of consolidation is to the trustee in terms of administration and some issues regarding standing in the ongoing adversary proceedings. Furthermore, many of the creditors have filed the exact same claim in all the related entities' bankruptcy proceedings. Therefore, substantive consolidation may not alter the distribution rights of creditors in an inappropriately disproportionate way and the second factor fell in favor of consolidation.

Finally, addressing the third factor, the court found that prejudice would occur if the estates were not consolidated. The cost of repetitive adversaries and administration in general would diminish the overall return for creditors. For this reason and many of the reasons already mentioned in the opinion, the court found that the third factor favored consolidation.

In closing, the court made a point that, while not explicitly a factor to be considered in substantive consolidation, was important to its decision: "[this entire operation] came out of a massive fraud, directed and coordinated by one person in whom [the creditors] seem to have reposed large and inordinate trust, very much to their own peculiar benefit." While structured financing with bankruptcy-remote entities can be used in a bona fide, lending context, there was no real and non-collusive business activity to generate revenue to speak of in this case. Based on the facts, the fraud of a Ponzi scheme loomed over these cases and the lenders were participants. Therefore, the cases were consolidated.

87. <u>In re AFY</u>, 733 F.3d 791 (8th Cir. 2013) (Riley, J.).

SHAREHOLDERS DO NOT HAVE STANDING TO OBJECT TO CLAIMS MADE IN CASE OF CORPORATE DEBTOR

In April 2010, Rhett Sears, Rhett Sears Revocable Trust, Ronald Sears, the Ron Sears Trust, and Dane R. Sears made claims on the bankruptcy estate of AFY, Inc. (appellees). The only shareholders at the time appeared to be Roberts Sears and Korley Sears (appellants). The appellees, seeking payment for the purchase price of stock sold to AFY, Inc., filed proofs of claims. Robert and Korley Sears objected to these proofs of claim. The bankruptcy court rejected these objections, as did the Bankruptcy Appellate Panel in an appeal by Robert and Korley Sears. An appeal to the Eight Circuit followed.

In dismissing the appeal of Robert and Korley Sears, the appellate court found that they lack standing to appeal the bankruptcy court's order. The court stated that "AFY, which is the only party directly and adversely affected by the bankruptcy court's order allowing Claims 8, 9, and 10, is not a party to this appeal. Any effect on appellants is indirect, based on their status as shareholders of AFY." Corporations are separate from their shareholders; shareholders only have a derivative interest in the bankruptcy court's decisions regarding a corporation. Therefore, the court of appeals dismissed the appeal from the bankruptcy court's order.

88. In re Polaroid Corp., Court File No. 08-46617 (Bankr. D. Minn. Dec. 30, 2013) (Kishel, J.).

CLAIMS OBJECTIONS PARTIALLY ALLOWED AND 502(d) OBJECTIONS WERE PREMATURE

In 2009, PNY filed two proofs of claim in connection with the jointly administered Polaroid Corporation cases, one in February 2009 and one in October 2009. Both represented the same debt and had the same attachments due to the debtors' conversion from Chapter 11 to Chapter 7 in August 2009. The Chapter 7 trustee objected to both claims, arguing that the claims were duplicates, the claimant was not owed the amount set forth in the claims, the claimant's claim was a claim against another entity, not Polaroid Corporation, and the claim should be disallowed under 11 U.S.C. § 502(d) unless and until the claimant pays all amounts for which it was liable to the trustee.

As for the trustee's argument that the claims were duplicates, PNY acknowledged that the two were duplicative and it committed to withdrawing one of them. At the time of this opinion, the claim had not been withdrawn, therefore the court disallowed one of the duplicative claims.

As for the trustee's assertion that claimant was not owed the amount set forth in the claims, the court's decision turned on two agreements between PNY and Polaroid. In these agreements, PNY agreed to be "solely responsible for any situations, risks, liabilities, and claims related to charge backs." However, a large part of PNY's proof of claim was characterized as chargeback-related debt, and therefore that portion was disallowed. As for the remaining portion, the claim was allowed.

Next, the court addressed the trustee's argument that the claim should be filed against another entity. The court rejected the trustee's position, stating that the trustee's proposed treatment "would fly in the face of the [agreement], to which Polaroid Corporation was the sole signatory on the side of the Polaroid enterprise." Moreover, the court found that the trustee had presented no evidence to indicate that PNY ever consented to a substitution of Polaroid Corporation in the agreement. Therefore, the trustee's objection was overruled and the claim was allowed against the Polaroid Corporation.

Finally, addressing the trustee's objection under 11 U.S.C. § 502(d), the court overruled the objection, stating that the objection was premature. Cross-motions for partial summary judgment were pending in the adversary at the time and no judgment had been entered in favor of the trustee. An objection on these grounds would be premature until a judgment had been entered. The court stated that this objection could be renewed at that point if the judgment was not readily satisfied.