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Clear and Convincing Standard Must Be Met By Debtor to Continue Automatic Stay in Second Case Pending Within a Year

In *In re Kurtzahn*, Case No. 05-90815 (Bankr. D. Minn., January 31, 2006), the Bankruptcy Court denied a motion to continue the automatic stay past the initial 30 days after the petition date. Under the provisions of Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCA"), if a debtor has been a debtor in a previous case during the last year that was subsequently dismissed, a rebuttable presumption arises under 11 U.S.C. §362(c)(3)(c) that the current case was not filed in good faith under §362(c)(3)(B). The presumption may be rebutted by the debtor only by clear and convincing evidence to the contrary. Importantly, the debtor must file this motion and have a hearing on it within the first 30 days of the case.

The bankruptcy court used the previously developed good faith jurisprudence of the Eighth Circuit to frame the proper inquiry for analysis under BAPCA. Specifically, the court noted that the ultimate issue was whether a debtor's plan was feasible. In this case, the debtor's repeated delinquencies on her mobile home loan in the past, the debtor's age, and the debtor's husband's variable income, were all factors that led the Court to conclude that the debtor could not overcome the presumption.

Prior Liens on Real Property Factor In Whether Fair Value Paid At Auction

In the case of *Miller v. NLVK, LLC (In Re Miller)*, No. 05-3651, (8th Cir. July 21, 2006), the Eighth Circuit Court of Appeals held that prior liens on a debtor's real property should be considered in determining whether fair value had been paid for the property at a foreclosure sale.

In September 2001, the Debtor purchased real estate with a real estate loan secured by a mortgage for $495,150.00. The Debtor failed to pay his home owners association dues on the property, and in September 2003, filed for Chapter 11 protection but failed to list the home owners association as a creditor. Nor did the Debtor notify the county office of the Bankruptcy proceeding.

In October 2003, NLVK purchased the Debtor's property at a foreclosure auction for $3,847.00, the amount Miller owed the homeowners association in dues. At the time of the auction the balance on Miller's mortgage loan was approximately $463,000.00 and he maintained that the property was worth between $630,000.00 to $650,000.00. NLVK properly recorded its purchase of the property.

In March 2004, Miller amended his Bankruptcy schedule to include the homeowner's association debt. He contended the sale of the property violated the automatic stay and moved to set aside the transfer to NLVK under 11 U.S.C. § 549 (a).

The Bankruptcy Court did not find a violation of the automatic stay, but did set aside the transfer. The court found that the prior liens on the property, including the mortgage, should not be considered in determining the property's fair market value as the Court reasoned that NLVK had not assumed the mortgage or other liens on the property. The Court also concluded that NLVK's payment of $3,847.00 for the property did not constitute "present fair equivalent value." Therefore, the Court held that NLVK was not entitled to protection under Section 549 (c).

The District Court affirmed, and NLVK appealed. The Eighth Circuit Court of Appeals reversed, concluding that liens on a property are relevant for determining the value paid for that property whether or not those liens are legally assumed by the third party purchaser. Because neither the Bankruptcy Court nor the District Court considered the amount of any liens on the debtor's property in determining whether fair market value was paid, The Eighth Circuit Court of Appeals concluded that the lower courts failed to determine the amount of the liens or the property's value with specificity, and the case was remanded for that determination.

Trustee Should Recover Post Petition Transfers Resulting From Pre Petition Checks

In the case of Pyatt v. Brown In re Pyatt, NO. 06-6004EM, (B.A.P. 8th Cir., August 31, 2006), the Bankruptcy Appellate Panel held that a Chapter 7 Trustee, rather than the debtor, should be responsible for recovering funds that were transferred to creditors post-petition as the result of checks that were written and delivered to the creditors pre-petition.

In October 2004, the debtor filed a Chapter 7 petition. The debtor's schedule of personal property indicated that he had $300.00 in a bank account. However at the Meeting of Creditors in November 2004, the Trustee learned that the account actually had a balance of $1,938.00 on the petition date. The difference was attributable to checks written by the debtor pre-petition but honored by the bank post-petition. There was no suggestion or finding that the debtor intentionally misrepresented the balance in the account as of the petition date.

The Trustee filed a motion for turnover of the $1,938.00, which the Bankruptcy Court granted. The Court found that the $1,938.00 in the account was property of the estate and it was the debtor's obligation to restore those funds to the estate. The debtor argued that the Trustee bore the responsibility for recovering estate property under these circumstances.

The Bankruptcy Appellate Panel held that the Trustee, not the debtor, is in a better position to prevent the situation from happening and to remedy the consequences. In reversing the Bankruptcy Court's order granting the Trustee's motion to compel turnover, Judge Venters stated "it simply makes more sense to directly collect the post-petition transfers from the creditors who receive the transfers rather than from the debtors, who presumably, innocently made the payments pre-petition."

In a concurring opinion, Chief Judge Robert J. Kressel stated that, "[w]hile there may be remedies against the debtor for his failure to

comply with his statutory responsibilities, turnover is not among them", and a person cannot be ordered to turn over property that he does not have, citing Maggio v. Zeitz (In Re Luma Camera Service, Inc.), 333 U.S. 56 (1948).

Disability Income of Non-Borrower Spouse not Included in Undue Hardship Test

In *In re Cumberworth*, 347 B.R. 652, (B.A.P. 8th Cir. 2006), the BAP affirmed the Bankruptcy Court's decision that repayment of the debtor's student loans would be an undue hardship under Section 523(a)(8). Courts within the Eighth Circuit apply the "totality of circumstances" test to determine whether the debtor meets the undue hardship standard. The totality of circumstances test looks to: (1) the debtor's past, present, and reasonably reliable future financial resources; (2) a calculation of the debtor's and her dependents' reasonably necessary living expenses; and (3) any other relevant facts and circumstances surrounding each particular bankruptcy case.

In this case, both the debtor and her spouse had been previously determined to be 100% permanently disabled by the Social Security Administration. It was undisputed that neither the debtor nor her spouse would be able to obtain employment in the future because of their disabilities. Prior to trial, the debtor's spouse had been declared incompetent to manage his affairs and a fiduciary was appointed. The fiduciary testified that generally he may not pay the personal debt of a beneficiary's spouse, although under certain circumstances with express approval from the VA it would be allowed. The bankruptcy court concluded that it would be unlikely that the debtor would be able to utilize any portion of her spouse's VA disability income to meet her student loan obligations.

The Department of Education ("ED") argued that the bankruptcy court had erred by excluding the disability income of the debtor's spouse. The BAP recognized that generally, a bankruptcy court must include the non-borrower spouse's income in its undue hardship analysis. However, it concluded that they are not left with a definite and firm conviction that it is reasonably likely that the fiduciary will be able to use the spouses' disability income to pay the debtor's student loans anytime in the near future. Accordingly, they held that the bankruptcy court's factual determinations were not clearly erroneous.

Secondly, ED argued that the bankruptcy court erred in finding that the debtor's expenses were reasonable and necessary. Despite the debtor's expenses being atypically high for a debtor seeking to discharge her student loans, the BAP concluded that under a clearly erroneous standard given the debtor's unique circumstances the record is sufficient to sustain the bankruptcy court's factual findings regarding the debtor's expenses.

Lastly, ED argued the bankruptcy court erred in not considering several other factors in its analysis including the William D. Ford Program ("Ford Program"), good faith efforts to repay and the relevance of the debtor's disability given her retirement and disability income. The BAP concluded that the Ford Program is one of the factors that the bankruptcy court should consider but that it is not individually determinative. The BAP further concluded that it was satisfied that the debtor did attempt to lower her payments and that the debtor's disability was relevant because it eliminated her ability to increase her income through no fault of her own. Finally the BAP concluded that the debtor did establish by a preponderance of the evidence that forcing her to repay her student loans would

constitute an undue hardship under Section 523(a)(8).

Res Judicata and Judicial Estoppel do not Apply to Debtor's Prior Stipulation for Relief from Stay

In *Ginter v. Alliant Bank, Boonville (In re Ginter)*, No. 06-6026WM (B.A.P. 8th Cir. 2006), the BAP concluded that the Debtor's right to avoid a lien under Section 522(f) did not involve the same cause of action as the earlier relief from stay proceeding under Section 362(d). Furthermore, the Debtor did not take inconsistent positions by consenting to the Creditor's relief from stay motion and then filing the lien avoidance motion.

Prior to filing bankruptcy, the Debtor obtained a loan secured by tanning beds purchased with the loan funds as well as by tools the Debtor owned and used in the course of his employment as a mechanic. After filing the bankruptcy petition, the Debtor stipulated to the Creditor's motion for relief from the automatic stay with respect to the tanning beds and the tools. The Debtor subsequently filed a motion to avoid the Creditor's lien on the tools pursuant to Section 522(f)(1). The Creditor objected to the motion on waiver and estoppel grounds. The Bankruptcy Court denied the motion to avoid the lien on the alternate bases of judicial estoppel and res judicata. The Debtor appealed.

The doctrine of res judicata prohibits the relitigation by the same parties of the same cause of action. The BAP found that res judicata did not prevent the lien avoidance motion after the termination of the automatic stay because the two motions did not involve the same cause of action. The BAP reasoned that the motion for relief from the automatic stay was based on Section 362(d), whereas, the motion to avoid the lien was based on Section 522(f). While the two actions shared some of the same underlying facts, they were based on distinct sections of the Bankruptcy Code drafted to serve different purposes.

Judicial estoppel prevents a party from prevailing in one phase of litigation on one argument and then relying on a contradictory argument to prevail in another phase of the litigation. The BAP found a later lien avoidance action under Section 522(f) did not change the fact that the Creditor had a valid lien on an earlier date and was entitled to relief from the automatic stay under Section 362 at such time. The Debtor merely stipulated that grounds existed for relief from the automatic stay. The Debtor did not force the Creditor to incur any additional costs, prejudice the Creditor, nor gain an unfair advantage by consenting to the stay relief motion. Judicial estoppel is simply not appropriate in this situation because the Debtor had not taken clearly inconsistent positions.

Debtor's Attempt to Reject Collective Bargaining Agreement Denied and then Partially Reversed on Appeal

In *In re Mesaba Aviation, Inc., dba Mesaba Airlines*, No. 05-39258 (Bankr. D. Minn. 2006), the Bankruptcy Court denied without prejudice Debtor's motion for authority to reject its collective bargaining agreements. Under section 1113 of the Bankruptcy Code a debtor may move for rejection of a collective bargaining agreement. In order for such a motion to be granted, the debtor must meet the following nine requirements:

(1) The debtor in possession must make a proposal to the Union to modify the collective bargaining agreement;
(2) The proposal must be based on the most complete and reliable

information available at the time of the proposal;

(3) The proposed modifications must be necessary to permit the reorganization of the debtor;

(4) The proposed modifications must assure that all creditors, the debtor and all of the affected parties are treated fairly and equitably;

(5) The debtor must provide to the Union such relevant information as is necessary to evaluate the proposal;

(6) Between the time of the making of the proposal and the time of the hearing on approval of the rejection of the existing collective bargaining agreement, the debtor must meet at reasonable times with the Union;

(7) At the meetings the debtor must confer in good faith in attempting to reach mutually satisfactory modifications of the collective bargaining agreement;

(8) The Union must have refused to accept the proposal without good cause;

(9) The balance of the equities must clearly favor rejection of the collective bargaining agreement.

In re American Provision Co., 44 B.R. 907, 909 (Bankr. D. Minn. 1984).

The Bankruptcy Court divided these requirements into two types, procedural and substantive. The procedural factors (1, 2, 5, 6, and 7) were addressed first. Finding the first two of these factors met, the Bankruptcy Court then addressed whether all relevant information had been provided to the unions. At issue was the Mercer Model, software created by Mercer Management to enable Debtor to do a financial forecast of its post-bankruptcy operation under its revised fleet configuration. Despite numerous requests from the union representatives, Debtor refused to turn over a copy of the Mercer Model. Finding this refusal unreasonable, the Bankruptcy Court concluded that Debtor failed to meet the fifth element.

This conclusion resulted in the Bankruptcy Court finding in favor of the unions with respect to factors seven, eight, and nine set forth in *In re American Provision*. Debtor also had a minor failure with respect to the third element; whether Debtor's proposals are necessary to permit its reorganization. Debtor's motion was therefore denied. But the Bankruptcy Court did not find this denial a conclusive resolution of the issues between the parties. Indeed, the Bankruptcy Court stated that the parties could continue negotiations, or Debtor could simply cure the defects in its original proposal and renew its motion.

Ruling on Collective Bargaining Agreement Partially Reversed on Appeal.

On May 18, in *In re Mesaba Aviation, Inc., dba Mesaba Airlines*, No. 05-39258 (Bankr.D.Minn. 2006), the Bankruptcy Court denied without prejudice Debtor's motion for authority to reject its collective bargaining agreements. In its ruling, the Bankruptcy Court indicated that if the flaws in the Debtor's filing were fixed, it would likely approve a renewed motion to reject the collective bargaining agreements. According to the Bankruptcy Court, Debtor fixed the flaws of its prior motion, and the Bankruptcy Court authorized Debtor to reject its collective bargaining agreements with the unions.

On July 18, 2006, the unions appealed to the United States District Court for the District of Minnesota. In *Association of Flight Attendants-CWA, et al. v. Mesaba Aviation, Inc.*, No. 06-3041 (D.Minn. September 13, 2006), the District Court affirmed the Bankruptcy Court's orders in nearly all respects. But the District Court reversed and remanded two issues. First, the District

Court determined that Debtor failed to meet and confer in good faith because it refused to negotiate over the union's "snap-back" proposals. Second, the District Court found that Debtor failed to treat all affective parties fairly and equitably because it failed to show that its proposals treated the unions fairly and equitably in light of the potential sacrifices that Debtor's parent company may be asked to make during the reorganization.

Plaintiffs Are Entitled To A Presumption That The Res Of A Constructive Trust Exists.

In Kundrat v. BMC Industries, Inc. (In re BMC Industries, Inc.), 2006 WL 2502354 (D. Minn. August 29, 2006) the District Court reversed the Bankruptcy Court, holding when the Plaintiffs sought to impose an implied trust, the Debtors bore the burden of demonstrating that the res or traceable proceeds did not exist.

Prior to commencing their bankruptcy cases, the Debtors delivered to Plaintiffs a settlement payment under an agreement resolving Plaintiffs' employment discrimination action. Debtors filed their reorganization petitions before Plaintiffs negotiated the instrument. Subsequently, Plaintiffs commenced an adversary proceeding against Debtors seeking a declaration that the funds were not property of the estate and imposition of an implied trust upon funds in Debtors' account.

After trial, the Bankruptcy Court held that Minnesota law governs the imposition of a constructive trust. 328 B.R. 792 (Bankr. D. Minn. 2005). To impose a constructive trust, the plaintiff must demonstrate (1) there exists an appropriate reason to override the status of legal title and ownership such as unjust enrichment, (2) an identifiable res or traceable proceeds, and (3) the wrongdoer has possession of the res or traceable proceeds. The plaintiff must trace the proceeds from the time of unjust enrichment until the point which relief is sought – trial. The Bankruptcy Court held that Plaintiffs failed to show the existence of the funds, the account, or traceable proceeds for the fourteen months prior to trial. Accordingly, the Bankruptcy Court entered judgment for Debtors.

The Plaintiffs appealed. The District Court reversed the Bankruptcy Court and remanded the case for further proceedings. The District Court held that the Bankruptcy Court correctly ruled that Plaintiffs bore the burden of tracing the funds through trial. The District Court, however, held that Debtors had special access to such evidence, and accordingly, the Plaintiffs were entitled to the presumption that the res exists. Should the Debtors continue to maintain that no res exists, the District Court held that they bear the burden of producing evidence to support the assertion.

Defendant Was Not An Insider, Gave Reasonably Equivalent Value In One Of Two Exchanges, But Was Not Entitled To Transfer For Value and In Good Faith Protection Of Section 548(C).

In Stalnaker v. Gratton (In re Rosen Auto Leasing, Inc. and Rosen), No. 05-6047 (B.A.P. 8th Cir. August 2, 2006), the B.A.P. affirmed the Bankruptcy Court's holding that the Defendant was not an insider of either debtors Rosen Auto or Mr. Rosen and the Defendant gave reasonably equivalent value to Rosen Auto. But the B.A.P. reversed the Bankruptcy Court, ruling that the security interest given by Mr. Rosen to Defendant that constituted an avoidable fraudulent transfer was not a transfer for value and in good faith under section 548(c).

Defendant was, at one time, a personal acquaintance of Mr. Rosen. Defendant also

owned a non-voting ownership interest in Rosen Auto. Defendant later loaned Rosen Auto money as evidenced by a promissory note. The note was guaranteed by Mr. Rosen.

A couple of years later, Defendant demanded payment of the Note. Prior to 90-days before Rosen Auto's and Mr. Rosen's bankruptcy cases were commenced, Rosen Auto delivered a check to Defendant in the amount of the unpaid obligations under the note. Defendant endorsed the check to Mr. Rosen in exchange for a promissory note from Mr. Rosen for the same amount secured by a deed of trust on Mr. Rosen's condominium. Mr. Rosen then endorsed the same check to Rosen Auto, which was treated as an unsecured loan. All the transactions were undertaken in accordance with Mr. Rosen's advice.

After the commencement of the bankruptcy cases, the Trustee brought an action against Defendant to recover the payment from Rosen Auto to Defendant as either a preferential or fraudulent transfer. The Trustee also sought to avoid the lien granted by Mr. Rosen to Defendant as either a preferential or fraudulent transfer. After trial, the Bankruptcy Court held that Defendant was not an insider of either Rosen Auto or Mr. Rosen and, therefore, the transfers could not be avoided as preferential transfers because they were outside of the 90 day window. The Bankruptcy Court held that the transfer from Rosen Auto was not a fraudulent transfer because Defendant released an antecedent debt. The Bankruptcy Court held that the security interest granted by Mr. Rosen was a fraudulent transfer; however, it held that Defendant had taken the security interest for value and in good faith under section 548(c). Accordingly, Defendant was entitled to retain his lien.

The Trustee appealed three issues. First, the Trustee asserted that Defendant was an insider. The B.A.P. held that Defendant did not fall within the statutory definition, but that this list is not exclusive. The B.A.P. noted that an insider is one who has sufficiently close relationship with the debtor such that the party does not deal at arm's length. The B.A.P. affirmed holding that Defendant's past social relationship was not sufficient because he did not exert control over either of the debtors or otherwise have any relationship other than that of a creditor.

The second issue raised by the Trustee was whether Rosen Auto received less than reasonably equivalent value when Defendant released the debt in exchange for the payment. The B.A.P. affirmed the Bankruptcy Court. The satisfaction of the note by the payment constitutes value. The value was reasonably equivalent as the debt satisfied was equal to the amount of the payment.

Finally, the Trustee asserted that Defendant was not entitled to retain the avoided security interest in Mr. Rosen's condominium under section 548(c). The B.A.P. agreed. Prior to the transaction, Mr. Rosen owed an unsecured obligation to Defendant. Afterwards, Mr. Rosen's obligation was secured. Because Defendant went from an unsecured creditor to a secured creditor and gave nothing in return, he did not give value for purposes of section 548(c).

"Payments under the Plan" Does Not Mean "Payments to Unsecured Creditors under the Plan"

In *Banks, et. al. v. Griffin (In re Keith N. Griffin, Sr.*), No. 06-6025EM (B.A.P. 8th Cir. September 21, 2006) the B.A.P. reversed the bankruptcy court's decision that

the Debtor's failure to pay at least 70% of the allowed unsecured claims in a Chapter 13 case filed within six years of the Debtor's Chapter 7 petition date was grounds for denying the Debtor's discharge under 11 U.S.C. §727(a)(9).

The Debtor filed a voluntary petition for relief under Chapter 13 on July 8, 1999, obtained confirmation of a plan, completed payments under the plan and received a discharge in the Chapter 13 case. Allowed unsecured claims in the case totaled $20,101.10. A total of $28,784.34 was distributed to various parties under the Chapter 13 plan, of which amount $6,780.06 was paid to unsecured claimants -- approximately 34% of the allowed unsecured claims.

On June 4, 2005, the Debtor filed a Chapter 7 petition, less than six years after the Chapter 13 petition date. 11 U.S.C. § 727(a)(9) provides in relevant part:

> The court shall grant the debtor a discharge, unless…the debtor has been granted a discharge under section 1228 or 1328 of this title…in a case commenced within six years before the date of the filing of the petition, unless payments under the plan in such case totaled at least--
>
> (A) 100 percent of the allowed unsecured claims in such case; or
>
> (B) (i) 70 percent of such claims; and
>
> (ii) the plan was proposed by the debtor in good faith, and was the debtor's best effort;

The Debtor argued that for purposes of determining whether he satisfied either test in §727(a)(9), the phrase "payments under the plan" includes not only payments to unsecured creditors, but also payments for attorney's fees, trustee's fees and payments to secured creditors. The B.A.P. agreed that "the language of the statute does not include any reference to payments or distributions to unsecured creditors or on unsecured claims." The B.A.P. went on to point out that the phrase "payments under the plan" in 11 U.S.C. §1325(b)(1)(B) was amended by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 to read "payments to unsecured creditors under the plan", which led the B.A.P. to conclude that "Congress knows how to write clear language with regard to payments to unsecured creditors when it believes such language is appropriate."

Ultimately, the B.A.P. held that "The language of §727(a)(9) is clear and plain. If a debtor in a Chapter 13 case pays to the trustee for distribution under the plan an amount equal to 70% of the allowed unsecured claims, and the court finds that the plan was proposed by the debtor in good faith and was the debtor's best effort, or if such debtor pays to the trustee for distribution under the plan an amount which totals at least 100% of the allowed unsecured claims, the debtor, when filing a Chapter 7 case within six years of the petition date of the Chapter 13, will not be denied a discharge."

Failure to Disclose Material Facts May Constitute False Representation

In *Ward v. Rosedale Leasing, LLC* (*In re William F. Ward, II, a/s/f Ward Automotive, Inc.*), No. 06-2004 (D. Minn. September 7, 2006) the District Court affirmed the Bankruptcy Court's ruling that a debtor's silence regarding a material fact can constitute a false representation actionable under 11 U.S.C. §523(a)(2)(A).

Rosedale Leasing and the Debtor entered into an agreement whereby Rosedale agreed

to provide financing for Ward to acquire and resell luxury vehicles. The Debtor encountered financial difficulties and began using the proceeds from the sale of certain vehicles to pay creditors other than Rosedale Leasing. In 2003, after Rosedale Leasing discovered the Debtor was having financial difficulties, the Debtor was confronted by Dennis Hecker ("Hecker"), the owner of Rosedale Leasing. In 2004, the Debtor ceased buying and reselling vehicles and after being confronted by Hecker, the Debtor destroyed all of the documents relating to the vehicles sales.

In July 2005 the debtor filed a voluntary petition for relief under Chapter 7. In October 2005, Rosedale commenced an adversary proceeding by filing a complaint objecting to the Debtor's discharge, which complaint was amended in November 2005 to add a claim of fraud under §523(a)(2)(A).

Citing *In re Van Horne*, the District Court noted that "a borrower has the duty to divulge all material facts to the lender, and a debtor's silence regarding a material fact can constitute a false representation actionable under §523(a)(2)(A)." 823 F.2d 1285, 1288 (8th Cir. 1987) (abrogated on other grounds by *Grogan v. Garner*, 498 U.S. 279 (1991). In *Van Horne*, the debtor sought a loan from his mother-in-law, but failed to disclose that he was about to divorce his wife. The Eighth Circuit held that the debtor's failure to disclose his intention to his mother-in-la prior to her making the loan was a material omission actionable under §523(a)(2)(A). *Id.*

In this case, the Debtor argued that the Bankruptcy Court's factual findings were clearly erroneous because there was no evidence that the Debtor made misstatements to Rosedale Leasing or that Rosedale relied on any such misstatements to its detriment. The District Court noted that "it was undisputed that if Rosedale Leasing had known that Ward was using the proceeds to pay other creditors, Rosedale Leasing would not have continued to finance the purchase of additional cars."

Consistent with *Van Horne*, the District Court agreed with the Bankruptcy Court that "Ward's failure to disclose that he was using the proceeds to pay other creditors constituted a material omission, actionable under §523(a)(2)(A)." In affirming the Bankruptcy Court's determination excepting the Debtor's obligations to Rosedale Leasing from the Debtor's general discharge, the District Court found that the Bankruptcy Court's factual findings were supported by testimony and were not "clearly erroneous"